

**CHINA NEW ENERGY LIMITED**

**Company Registration No. 93306 (Jersey)**

**CHINA NEW ENERGY LIMITED**  
**DIRECTORS' REPORT AND FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

## CHINA NEW ENERGY LIMITED

### COMPANY INFORMATION

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<b>Directors</b>	Yu Weijun Tang Zhaoxing Chen Yong Foo Shiang Peow Richard Bennett	Executive Chairman Chief Executive Officer Non-Executive Director Non-Executive Director Non-Executive Director
<b>Company secretary</b>	Computershare Company Secretarial Services (Jersey) Limited	
<b>Registered office</b>	Queensway House Hilgrove Street St Helier JE1 1ES	
<b>Registered number</b>	93306 (Jersey)	
<b>Auditors</b>	Crowe Clark Whitehill LLP St Bride's House 10 Salisbury Square London EC4Y 8EH	
<b>Solicitors</b>	Stephenson Harwood One Raffles Place #12-00 Singapore 048616	
<b>Nominated adviser</b>	Cairn Financial Advisers LLP 61 Cheapside London EC2V 6AX	
<b>Broker</b>	SVS Securities plc 21 Wilson Street London EC2M 2SN	
<b>Registrars</b>	Computershare Investor Services (Jersey) Limited Queensway House, Hilgrove Street St. Helier Jersey JE1 1ES	
<b>Financial PR</b>	Threadneedle Communication 3 <sup>rd</sup> Floor 10-15 Queen Street London EC4N 1TX	
<b>Website</b>	<a href="http://www.chinanewenergy.co.uk/">http://www.chinanewenergy.co.uk/</a>	

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## **CHINA NEW ENERGY LIMITED**

### **Chairman's Statement**

I am pleased to report the Company's first full year results since joining the London AIM market in May 2011. In the year to 31 December 2011, China New Energy achieved a very satisfactory result with a strong 29.4% growth in revenue to RMB179 million (£17.6m) while the total value of contracts secured in the period was RMB 171 million (£16.8m), more than double the RMB79 million achieved in 2010.

Against this strong trading background during 2011, the management team also embarked on the next stage of the Company's growth strategy. Principally, CNE provides EPC (Equipment, Procurement and Construction) services and VAS (Value Added Services) mainly to ethanol, ethanol downstream product and biobutanol producers. The Board believes that prospects for the Company can be significantly advanced by identifying new streams of revenue that can complement and sustain the Company's turnover and growth, as well as lessen its dependence on the EPC business. In the Board's view, CNE is poised to capture the opportunities of growing demand for second generation biofuel.

Unlike most other forms of renewable energy, biofuels can be used as a direct substitute for petrol, as has been demonstrated by their extensive use in Brazil and the United States. The Board believes that in an environment where the price of oil is in excess of \$100 a barrel, biofuels will continue to play an increasingly important role in the energy market. Ambitious biofuel support policies have been adopted in both the United States (with 60 billion litres of second-generation biofuel by 2022) and the European Union (with 10% renewable energy in the transport sector by 2020).

Due to the size of the US and EU markets and their considerable biofuel imports, US and EU policies could become an important driver for the global development of second-generation biofuels. Current IEA analysis sees a shortfall in domestic production in both the US and EU that would need to be met with imports. This shortfall could be particularly favourable for Brazil and China, where pilot plants are already operating and infrastructure allows for biofuel exports.

In the future, the Company intends to expand on its core EPC business to develop complementary services, such as supply of active yeast and biogas recovery.

Furthermore CNE's own R&D programme together with collaborations with other world class third parties, should enable the Company to remain at the forefront of developments in second generation biofuel production and to scale-up of future biofuel and biochemical technology platforms quickly and cost efficiently.

### **Financial Review**

Pre-tax profits for the year increased by 9% to RMB25.8 million (£2.5m) (2010: RMB23.7 million (£2.3m)). During the year gross profit margins were lower at 22.8%, compared to 29.1% in 2010, mainly due to the distorting effect of unusually high margin contracts delivered during 2010 and the cost overruns of certain projects. Gross profit for the period was RMB41 million (£4.0m) (2010: RMB40 million (£3.9m)).

Other operating income grew from RMB0.46 million (£0.05m) in 2010 to RMB9.33 million (£0.9m) in 2011. This was mainly due to the recovery of bad debts previously written off. A 12% reduction in distribution expenses to RMB3.4 million (£0.3m) (2010: RMB3.9 (£0.4m)) reflected management's continued focus on controlling and minimising business overheads.

Administrative expenses were higher at RMB15.8 million (£1.6m) in 2011 (2010: RMB10.9 million (£1.1m)) largely due to charges for share based payments to employees and overheads comprising compliance and regulatory costs.

Operating expenses were up marginally to RMB2.3 million (£0.2m) in FY2011. Financial expenses were RMB 3.4 million (£0.3m) reflecting expenses arising from Citadel Bonds and bank loan of RMB 20 million (£2.0m) that were used to finance working capital for the Company's contract with Ubon.

Profit after tax was up by 10.0% to RMB22 million (£2.2m) in (2010: RMB20 million (£2.0m)).

As set out in the Admission Document in May 2011, the Company has agreed with Citadel Equity Fund Limited to repay its outstanding loan, via a series of repayments, US\$ 3 million plus interest by 8

## CHINA NEW ENERGY LIMITED

October 2012. To date the Company has paid US\$1.5 million, plus interest, and will pay the balance of \$1.5 million in three instalments ending on 8 October 2012.

### Operational Review

*Joint venture with Jilin Ethanol Industrial Co., Ltd ("JEIC") to exploit and commercialise technology and engineering solutions in the field of bioethanol production*

In 2011, Guangdong Zhongke Tianyuan New Energy Science and Technology Co., Ltd ("ZKTY"), the Company's wholly owned operating subsidiary, entered a strategic agreement with Jilin Ethanol Industrial Company Limited ("JEIC") and Jilin City Keda Applied Technology Development Limited ("JKDAT") to form a joint venture company ("JV"), Jilin Tianshun Biochemical Development Company Limited ("Tianshun") to exploit and commercialise technology and engineering solutions in the field of bio-ethanol production. ZKTY owns 34% of Tianyi while JEIC and JKDAT own 51% and 15% respectively.

Post financial year end, CNE entered an Agreement of Intent with JEIC subsidiary to provide technology solutions to modify and convert an existing ethanol production facility into a commercial-scale 50,000 tonne facility capable of converting non-edible "cellulosic" plant waste into acetone, butanol and ethanol (the "Jilin Biofuel Facility").

The Board believes the Jilin Biofuel Facility will play a critical role in the development and scale-up of CNE's future biofuel and biochemical technology platforms based on the biological conversion to biofuels using sustainable, low cost feedstocks. Approximately 80 per cent. of fuel-grade ethanol is produced from corn. The Board, therefore, believes that the successful completion of the Project, which is intended to process the waste material from corn crops, will be a significant milestone in meeting both China's energy objectives and its food security objectives.

### *Progress in Developing Cellulosic Biofuel*

During the period, CNE also achieved significant progress in developing process technologies for the production of biobutanol using cellulosic materials (agricultural waste). The process essentially involves a pre-treatment process to reduce the different chemical components of cellulosic biomass using unique combinations of acid, steam and other specific catalysts (such as ionic liquids) followed by enzymatic digestion of cellulose and/or hemicelluloses. As a direct result of this innovation, CNE is now able to offer its clients process technologies to ferment raw feed stock materials using corn starch, instead of dry milled corn, which enables clients to efficiently capture all co-products and by-products such as Acetone, Butanol and Ethanol (commonly known as "ABE") and biogases to generate additional revenue streams.

### *Entry into niche business of supplying liquid active yeast directly to ethanol producers*

The Company has signed a Letter of Intent dated 9 December 2011 with Guangzhou Zhongke Tianyuan Regeneration Resources Engineering Co. Ltd ("GZTY Regeneration Resources") to acquire 88.5% of the legal and beneficial interests of Bengbu Boltech Bio-technology Co., Ltd ("Boltech"). Boltech produces and sells active yeast, which is specifically formulated for use in the process of ethanol production, as well as yeast extracts.

Yeasts are essential to ethanol production and must be readily available to the fermentation process with consistent viability and vitality for optimal performance. Yeast used in commercial ethanol production can be in the form of dry active yeast or liquid active yeast. In China, commercial ethanol producers have generally used active dry yeast, purchased from yeast manufacturers, in the ethanol production process as it has the necessary stability properties for being stored and can therefore be used as and when needed. However, liquid active yeast has superior qualities for being used in the fermentation process itself. Boltech therefore intends to build specialised liquid active yeast production facilities adjacent to large scale commercial ethanol production facilities, in order to supply fresh liquid active yeast, with strong control on dosages, direct to the fermentation process. The result is that, when compared to the existing method of using dry active yeast, Boltech can help ethanol producers achieve superior performance, improve efficiency and reduce costs. Boltech believes that its business model of supplying active liquid yeast directly to ethanol producers is the first of its kind in China.

By leveraging the Company's customer base in China and around the world, the Board believes that the Boltech business model can radically change the way Chinese commercial ethanol producers use

## CHINA NEW ENERGY LIMITED

and source their yeast material. The Company's objective is to make Boltech the leading yeast supplier to ethanol producers in China. Subject to funding, the Company intends to complete the acquisition as soon as practicable, and intends to scale up this business and replicate its current success elsewhere in China and abroad.

### *Biogas recovery and purifying business progressing well*

CNE successfully completed and handover the Xin'ao biogas plant and, on 1st Nov 2011, this plant started commercial operation to recover and sell purified 7,000 cu. metre of biogas daily as fuel for civilian use. CNE specialises in the production of biogas through the treatment and anaerobic fermentation of waste-by-products from the bioethanol production process. Commercial production of biogas through CNE's process is relatively new. The successful completion of Xin'ao biogas plant is a testimony of the Company's technical and engineering capability to construct biogas recovery and purifying plant for bioethanol producers.

In addition to the Xin'ao biogas plant, CNE has an agreement to design and build a biogas recovery and purifying plant at a beer brewery owned by Kingway Beer Group, located in Shenzhen China, with the intention that the purified biogas be sold to Shenzhen City Gas Group. CNE expects to complete this project in the first half of 2012. Under this agreement, CNE shall bear the cost of constructing the biogas plant and co-share the revenue generated from the sale of biogas. This plant shall have a daily purified output of 7,000 cu. metre biogas and generate estimated total sales revenue of RMB8 million annually.

The successful completion of Xin'ao biogas plant enhances the Company's reputation for providing integrated solutions to the biofuel and biochemical industries both in China and internationally. The Board is confident that ZKTY's background and experience in designing and constructing ethanol production plants will help build a competitive strength for the Group in biogas production. Indeed, we intend to leverage our customer base to build aggressively the biogas recovery and purifying business, a business that can generate recurring cash flow with good margins to the Company.

## Outlook

In 2011, the Company has made progress in securing new contracts and generating revenue whilst continuing to enhance its reputation for providing integrated solutions to the biofuel and biochemical industries both in China and internationally.

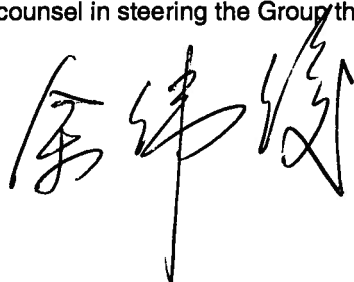
Looking forward we expect the market for ethanol and butanol, as replacements to fossil fuels, to continue to grow as such fuels provide form part of energy security policies and assist to mitigate the high price of oil. Our proven track record in first generation biofuel production and our competitive cost structure provides us with a real advantage in international markets. We also remain committed to improving the efficiency of existing generation one plants by optimising the fermentation process with our yeast management services, and to delivering energy management conservation ("EMC") solutions, as well as working with our partners to implement second generation biofuel technologies that utilise cellulosic materials or non-food feedstock such as corn stover to produce biofuels.

We remain confident that the Company will continue to deliver and achieve profitable growth in 2012 despite the softening economy and tight monetary conditions in China and elsewhere. Our strategic collaborations with Jilin Ethanol Industrial Company Limited lead us to believe that we will secure significant new contracts this year which will increase JEIC's production capacity and improve efficiency.

## Conclusion

On behalf of the Board, I would like to extend my appreciation to our valued shareholders, supportive business partners and associates, insightful management and dedicated staff for all their contribution and commitment towards the Company. Personally, I would also like to thank the Board of Directors for their invaluable counsel in steering the Group through this period.

Yu Weijun  
Chairman  
1 May 2012



## **CHINA NEW ENERGY LIMITED**

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011**

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The Directors present their report and financial statements for the year ended 31 December 2011.

#### **Principal activities**

The principal activity of the Company is investment holding. The Group's principal activity is providing turnkey technology solutions to manufacturers of ethanol, edible alcohol and acetic acid from a range of bio-resources including corn, sugarcane, cassava and other bio-resources in China.

#### **Business review**

The Company recorded a strong 29.4% growth in revenue to RMB179 million for the financial year 2011 reflecting both the increased volume of contracts signed and executed. The total value of contracts secured in 2011 was RMB 171 million, up 116% from RMB79 million 2010.

Notwithstanding the growth in revenue, gross profit was only marginally higher at RMB41 million in FY2011, up 1.6% from RMB40 million in FY2010; gross profit margin was down from 29.1% in FY2010 to 22.8% in FY2011. The decline in gross margin was mainly attributed to unusually high margin contracts delivered during FY2010, and costs overrun of Thailand certain projects, mainly Ubon Ratchathani Project in Thailand ("Ubon").

Other operating income grew from RMB0.46 million in 2010 to RMB9.33 million in FY2011. This is mainly due to the recovery of bad debts previously written off.

The Company reduced distribution expenses by 12% from RMB3.9 million in FY2010 to RMB3.4 million in FY2011 demonstrating its continued focus on controlling and minimizing business overheads.

Administrative expenses were RMB15.8 million in FY2011, up 44.6% from RMB10.9 million in FY2010. The increase was mainly due to charges for share based payments to employees and overheads comprising compliance/ regulatory costs.

Operating expenses were up marginally 7.0% to RMB2.3 million in FY2011. Financial expenses were RMB 3.4 million mainly due to expenses arising from Citadel Bonds and bank loan of RMB 20 million that was used to finance working capital for the Company's contract with Ubon.

Profit after tax was RMB22 million in FY2011, up 10.0% to RMB20 million in FY2010.

#### **Risks and uncertainties**

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from expected and historic results. The Board monitors risks on an ongoing basis and implements appropriate procedures and processes to try and mitigate the adverse consequences of such risks.

The business faces three principal risks. Firstly, the Group needs to expand and retain its current position in this industry. Future growth will be both organic and through potential acquisitions. There are a number of uncertainties relating to future acquisitions and there can be no guarantee that the Group will be able to expand as envisaged. The Board of Directors meets regularly to review the future of the group and potential areas for growth.

Secondly, the Group may need to raise additional capital to fund its future expansion. There can be no assurance that the Group will be able to obtain such funding.

The Board of Directors actively monitors its capital to ensure that the Group operates as a going concern and maintains sufficient flexibility to process planned wishes. This process considers the variety of capital and the sources from which it would be found.

Thirdly, the Group's operating subsidiaries' functional currency is Chinese Yuan ("RMB"), the fluctuations in RMB could have an adverse effect on the Group's business and operating results.

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### DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011

In addition, the financial instruments and risk profile of the Group are set out in note 28.

#### Results and dividends

The consolidated revenue and profit after taxation for the year amounted to RMB 178,998,000 (2010: RMB 138,359,000) and RMB 22,044,000 (2010: RMB 20,039,000) respectively, as set out in the Consolidated Statement of Comprehensive Income.

The Directors do not recommend a dividend payment for the year.

#### Post balance sheet events

Events after the balance sheet date have been disclosed in note 32.

#### Directors' interests

The following Directors have held office during the period and their interests as at 31 December 2011, all of which are beneficial unless otherwise stated, whether direct or indirect, of the Directors and their families in the issued share capital of the Company and options over Ordinary Shares which had been granted, are as follows:

		<i>Number of Ordinary Shares</i>	<i>Percentage of Ordinary Shares</i>
<i>Director</i>			
Yu Weijun		64,000,000	20.60%
Tang Zhaoxing		48,000,000	15.45%
Chen Yong (Appointed 25 March 2011)		-	-
Foo Shiang Peow (Appointed 25 March 2011)		8,079,728	2.60%
Richard Bennett (Appointed 25 March 2011)		-	-

In accordance with Article 22.2 of the Articles of Association of the company, all directors shall not remain in office for longer than 2 years since their last election or re-election without submitting themselves for re-election. The directors will retire by rotation, for which one third of Directors who have been in the office longest shall retire by rotation.

#### Employment policies

The Group pursues a policy of equal opportunities to all employees and potential employees. The Group has continued its policy of giving fair consideration to applications for employment made by disabled persons bearing in mind the requirements for skills and aptitude for the job. In the areas of planned employee training and career development, the Group strives to ensure that disabled employees receive equal treatment, including opportunities for promotion. Every effort is made to ensure that continuing employment and opportunities are also provided for employees who become disabled. It is the Company's policy to take the views of employees into account in making decisions, and wherever possible to encourage the involvement of employees in the Group's performance.

#### Payments to suppliers

The Company's policy for the year ended 31 December 2011 is to settle the terms of payment with suppliers when agreeing the terms of the business transactions:

- ensure that suppliers are aware of the terms of payments by the inclusion of the relevant terms in contracts; and
- pay in accordance with the company's contractual and other legal obligations.

The number of days of trade purchases outstanding for the group as at 31 December 2011 was 93 days (2010: 120 days).



## CHINA NEW ENERGY LIMITED

### DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011

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#### Going concern

The Directors are required to report that the business is a going concern, with supporting assumptions or qualifications as necessary.

After making enquiries, the Directors consider that the Company and the Group has adequate resources and committed borrowing facilities to continue in operational existence for the foreseeable future. Consequently, they have adopted the going concern basis in preparing the Financial Statements.

#### Financial Risk Management

Details of the Group's financial risk management objectives, policies and strategies are set out in note 28.

#### Statement of Directors' responsibilities

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group to enable them to ensure that the financial statements comply with the Companies (Jersey) Law, 1991. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

#### Statement of disclosure to auditor

The Directors have confirmed that:

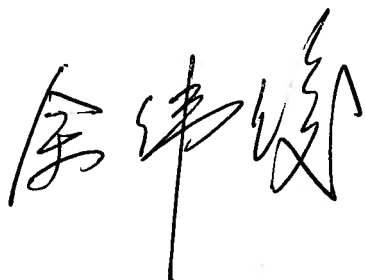
- so far as each Director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- each director has taken all the necessary steps he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

#### Auditor

In accordance with Article 109 of the Companies (Jersey) Law 1991, a resolution proposing that Crowe Clark Whitehill LLP be re-appointed for the forthcoming year will be put to the Annual General Meeting.

By order of the Board

Yu Weijun  
Director  
1 May 2012



## **CHINA NEW ENERGY LIMITED**

### **CORPORATE GOVERNANCE STATEMENT**

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#### **Principles of Corporate Governance**

As a Company listed on AIM, the Company is not governed by the UK Code of Corporate Governance adopted by the London Stock Exchange ('the Code') but is required to operate principles of good governance and best practice. Accordingly, the Directors are committed to the Code and believe that an effective system of corporate governance supports the enhancement of shareholder value. These principles have been in place since the Company's listing on 23rd May 2011.

The Directors acknowledge the importance of the Code and intend to apply its principles so far as is practicable taking into account the Company's size and stage of development. The Company has three non-executive Directors.

The Directors have established an Audit Committee (the "Audit Committee"), a Remuneration Committee (the "Remuneration Committee") and an AIM Rules Compliance Committee (the "AIM Rules Compliance Committee") with formally delegated duties and responsibilities to operate.

#### **Audit Committee**

The Audit Committee, which comprises of Richard Bennett as Chairman, as well as Yu Weijun and FOO Shiang-Peow, determines and examines any matters relating to the financial affairs of the Company including the terms of engagement of the Group's auditor and, in consultation with the auditor, the scope of the audit. The Audit Committee receives and reviews reports from the management and the external auditor of the Group relating to the annual and interim amounts and the accounting and internal control systems of the Group. In addition, it considers the financial performance, position and prospects of the Company and ensures they are properly monitored and reported on.

#### **Remuneration Committee**

The Remuneration Committee is responsible for making recommendations to the Board on the Company's framework of Executive remuneration and its cost. The Committee determines the contract terms, remuneration and other benefits for each of the Executive Directors and senior employees, including performance related bonus schemes, pension rights and compensation payments.

The Remuneration Committee, which comprise Chen Yong, Tang Zhaoxing and FOO Shiang-Peow with Chen Yong acting as Chairman, reviews the performance of the executive Directors and senior management and sets and reviews their remuneration and the terms of their service contracts, determine the payment of bonuses to the Executive Directors and considers the Group's bonus and option schemes.

#### **AIM Compliance Committee**

In addition, the Board has established an AIM Rules Compliance Committee which has responsibility for ensuring that the Company complies fully with the AIM Rules.

The Directors comply with Rule 21 of the AIM Rules relating to Directors' dealings and take all reasonable steps to ensure compliance by the Company's applicable employees. The Company has adopted and operates a share dealing code for Directors, and employees in accordance with the AIM Rules.

#### **The Board**

The Board is responsible to shareholders for the proper management of the Company. The Non-Executive Directors have a particular responsibility to ensure that the strategies proposed by the Executive Directors are fully considered. The Board has a formal schedule of matters reserved to it and has discussions on a monthly basis since its listing on the AIM Market. The Board is responsible for overall strategy, reviewing management accounts, approval of major capital expenditure projects and consideration of significant financing matters.

## CHINA NEW ENERGY LIMITED

### CORPORATE GOVERNANCE STATEMENT

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#### Directors

During the year, the Board comprised the Chairman Yu Weijun, the Chief Executive Officer Tang Zhaoxing, a London based Non-Executive Director Richard Bennett and two further Non-Executive Directors, FOO Shiang-Peow and Chen Yong.

#### Internal controls

The Directors are responsible for the Company's system of internal controls and reviewing its effectiveness. The Board has designed the Company's system of internal controls in order to provide the Directors with reasonable assurance that its assets are safeguarded, that transactions are authorised and properly recorded and that material errors and irregularities are either prevented or would be detected within a timely period. However, no system of internal controls can eliminate the risk of failure to achieve business objectives or provide absolute assurance against material misstatement or loss.

The key elements of the control systems in operation are:

- The Board meets regularly with a formal schedule of matters reserved to it for decision.
- It has put in place an organisational structure with clear lines of responsibility defined and with appropriate delegation of authority.
- Established procedures for the planning, approval and monitoring of capital expenditure and information systems for monitoring the Company's financial performance against approved budgets and forecasts.
- Departmental heads are required annually to undertake a full assessment process to identify and quantify the risks that face their businesses and functions and assess the adequacy of the prevention, monitoring and modification practices in place for those risks.
- Significant risks and associated controls and monitoring procedures are reported regularly to the Board to enable the Directors to review the effectiveness of the system of internal controls.

#### Relations with shareholders

The Board attaches great importance to maintain a good relationship with shareholders. The Board regards the annual general meeting as a good opportunity to communicate directly with investors who are encouraged to make inquiries to officers of the company.

#### Substantial shareholders

As at 31 December 2011, the Company had been notified of the following beneficial interest of 3% or more in its shares:

Name of holder	Number of Ordinary Shares	Percentage of Ordinary Shares
Leader Vision Investment Limited (Yu Weijun)	64,000,000	21%
Asia Tianxing Investment Limited (Tang Zhaoxing)	48,000,000	15%
Best Full Investments Limited (Liang Hongtao)	48,000,000	15%
Cobalt Ventures Ltd	40,398,640	13%
Tewin Capital Holding Limited (Yu Weijun)	26,932,440	9%
Employee Share trust	8,079,728	3%
Mr Weiming Qiu	20,000,000	6%
NovusAsia Capital	8,079,728	3%
Mr Xinchun Jiang	10,000,000	3%
Ms ShuiXia Jiang	10,000,000	3%

## **CHINA NEW ENERGY LIMITED**

### **Independent Auditor's Report to the Members of China New Energy Limited**

We have audited the Financial Statements of China New Energy Limited for the year ended 31 December 2011, which comprise the Group and Company Statement of Comprehensive Income, Group and Company Statement of Financial Position, Group and Company Statement of Cashflows, Group and Company Statement of Change in Equity and the related notes.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union. This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law, 1991. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

#### **Respective responsibilities of directors and auditors**

As explained more fully in the statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

#### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

We read all the financial and non-financial information in the Chairman's Statement, the Directors Report and the Corporate Governance Statement to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

#### **Opinion**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2011 and of the group's and parent company's profit for the year then ended;
- the financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991.

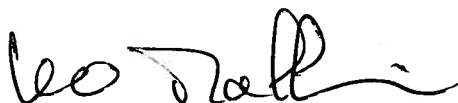
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### **Independent Auditor's Report to the Members of China New Energy Limited (continued)**

#### **Matter on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the parent company, or
- proper returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.



Roland Malkin (Senior Statutory Auditor)  
For and on behalf of Crowe Clark Whitehill LLP  
(Statutory Auditor)

St Bride's House  
10 Salisbury Square  
London  
EC4Y 8EH

1 May 2012

Note: The maintenance and integrity of the China New Energy Limited website is the responsibility of the directors. The work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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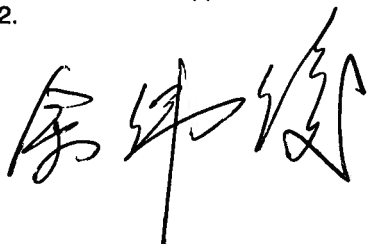
## Statement of Financial Position

	Note	Group As at 31 December		Company As at 31 December	
		2011 RMB'000	2010 RMB'000	2011 RMB'000	2010 RMB'000
<b>Non-current assets</b>					
Property, plant and equipment	4	9,888	11,118	-	-
Intangible assets	5	4,177	3,370	-	-
Trade receivables	10	4,402	6,601	-	-
Investment in subsidiary	6	-	-	89,922	84,069
Investment in associated companies	7	1,700	-	-	-
		<u>20,167</u>	<u>21,089</u>	<u>89,922</u>	<u>84,069</u>
<b>Current assets</b>					
Inventories	8	23,354	35,026	-	-
Due from customers for construction contracts	9	93,241	56,735	-	-
Financial asset at fair value through profit and loss	29	7,181	-	7,181	-
Trade and other receivables	10	53,896	45,675	9,283	4,054
Notes receivable	28	3,150	6,893	-	-
Cash and cash equivalents	11	6,682	10,631	118	772
		<u>187,504</u>	<u>154,960</u>	<u>16,582</u>	<u>4,826</u>
<b>Current liabilities</b>					
Trade and other payables	12	92,352	72,959	11,926	4,665
Due to customers for construction contracts	9	10,054	18,725	-	-
Notes payable		4,725	8,166	-	-
Interest payable		1,781	-	1,781	-
Income tax payable		4,640	1,118	17	19
Short-term borrowing		6,500	5,000	-	-
Convertible bonds	13	37,758	49,790	37,758	49,790
		<u>157,810</u>	<u>155,758</u>	<u>51,482</u>	<u>54,474</u>
<b>Net current (liabilities)/assets</b>		<u>29,694</u>	<u>(798)</u>	<u>(34,900)</u>	<u>(49,648)</u>
<b>Non-current liabilities</b>					
Deferred tax liabilities	24	913	1,018	-	-
		<u>913</u>	<u>1,018</u>	<u>-</u>	<u>-</u>
<b>Net assets</b>		<u>48,948</u>	<u>19,273</u>	<u>55,022</u>	<u>34,421</u>
<b>Equity</b>					
Share capital	14	1,118	1,013	1,118	1,013
Share premium	14	38,601	29,354	38,601	29,354
Combination reserve	16	(33,156)	(33,156)	-	-
Statutory reserve	15	9,856	7,247	-	-
Convertible bonds reserve	13	6,549	9,722	6,549	9,722
Warrant reserve	18	1,673	-	1,673	-
Own shares	19	(5,853)	-	-	-
Accumulated earnings/(losses)		6,467	(16,442)	(16,612)	(27,374)
Foreign currency translation reserve	17	23,693	21,535	23,693	21,706
		<u>48,948</u>	<u>19,273</u>	<u>55,022</u>	<u>34,421</u>

The notes on pages 21 to 63 form part of these financial statements.

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 1 May 2012.

Yu Weijun  
Director



# CHINA NEW ENERGY LIMITED

## Statement of Comprehensive Income

		Group	Company		
		Year Ended 31 December			
	Note	2011 RMB'000	2010 RMB'000	2011 RMB'000	2010 RMB'000
Revenue	20	178,998	138,359	-	-
Cost of sales		(138,125)	(98,131)	-	-
Gross profit		40,873	40,228	-	-
Other operating income	21	9,331	464	14,511	7,883
Selling and distribution expenses		(3,430)	(3,909)	-	-
Administrative expenses		(15,811)	(10,934)	(2,530)	(3,007)
Other operating expenses	22	(2,341)	(2,187)	31	(1,404)
Interest expense		(3,376)	-	(1,781)	-
Change in fair value of Held for sale investments	29	531	-	531	-
Profit before income tax	23	25,777	23,662	10,762	3,472
Income tax expense	24	(3,733)	(3,623)	-	-
Profit for the financial year attributable to owners of the company		22,044	20,039	10,762	3,472
Other comprehensive income:					
Exchange difference arising on translating foreign operations		2,158	3,496	1,987	3,670
Total comprehensive income for the financial year		24,202	23,535	12,749	7,142
Total comprehensive income attributable to owners of the company		24,202	23,535	12,749	7,142
Earnings per share (RMB)					
Basic	25	RMB 0.077	RMB 0.074		
Diluted	25	RMB 0.075	RMB 0.074		

The notes on pages 21 to 63 form part of these financial statements.

All amounts are derived from continuing operations.

**CHINA NEW ENERGY LIMITED**

**Consolidated Statement of Changes in Equity**

	Note	Share capital RMB'000	Share premium RMB'000	Combina tion reserve RMB'000	Statutory reserve RMB'000	Convertible bonds reserve RMB'000	Own shares RMB'000	Accumulated earnings/ (losses) RMB'000	Foreign currency translation reserve RMB'000	Total RMB'000
<b>Balance at 31 December 2009</b>										
Profit for the year		1,013	29,354	(33,156)	4,788	9,722	-	(34,022)	18,039	(4,262)
Exchange difference arising on the translation of overseas subsidiaries		-	-	-	-	-	-	20,039	-	20,039
Total comprehensive income for the year		-	-	-	-	-	-	-	3,496	3,496
		-	-	-	-	-	-	20,039	3,496	23,535
<b>Transfer to statutory reserve</b>										
		-	-	-	2,459	-	-	(2,459)	-	-
<b>Balance at 31 December 2010</b>										
Profit for the year		1,013	29,354	(33,156)	7,247	9,722	-	(16,442)	21,535	19,273
Exchange difference arising on the translation of overseas subsidiaries		-	-	-	-	-	-	22,044	-	22,044
Total comprehensive income for the year	17	-	-	-	-	-	-	-	2,158	2,158
Issue of shares, net of share issue cost		-	-	-	-	-	-	22,044	2,158	24,202
Shares granted to Employee Benefit Trust	14	84	3,415	-	-	(3,173)	-	1,673	-	1,999
Transfer to statutory reserve	19	21	5,832	-	-	-	(5,853)	3,474	-	3,474
		-	-	-	2,609	-	-	(2,609)	-	-
<b>Balance at 31 December 2011</b>		<b>1,118</b>	<b>38,601</b>	<b>(33,156)</b>	<b>9,856</b>	<b>6,549</b>	<b>(5,853)</b>	<b>8,140</b>	<b>23,693</b>	<b>48,948</b>



## CHINA NEW ENERGY LIMITED

Share premium: The share premium reserve represents the consideration that has been received in excess of the nominal value of shares on issue of new ordinary share capital, net of share issue costs.

Combination reserve: The merger reserve represents shares that have been issued at a premium to their nominal value on acquisition of another company.

Statutory reserve: The statutory reserve represents the amount set aside in accordance with the legislation in the People's Republic of China.

Convertible bond reserve: The equity component of the convertible loan notes represents the remaining equity component of convertible notes which have

Own shares reserve: Company shares held by the Employee Benefit Trust are deducted from the shareholders' funds and classified as Own Shares until such time as they vest unconditionally to participating employees and their families.

Accumulated earnings/(losses): The accumulated earnings/(losses) represent the profits and losses retained in the current and previous period.

Foreign currency translation reserve: The foreign currency translation reserve represents the exchange gains and losses resulting from translating foreign currency amounts to the reporting currency.

The notes on page 22 to 64 form part of these financial statements.

All amounts are derived from continuing operations.

Own shares relate to the holding of 8,079,728 (2010: 0) unallocated and unvested ordinary shares in the Company by the Employee Benefit Trust, representing 3% per cent (2010: 0) of the ordinary shares in issue at 23 May 2011.

**CHINA NEW ENERGY LIMITED**  
**Company Statement of Changes in Equity**

	Note	Share capital RMB'000	Share premium RMB'000	Combina tion reserve RMB'000	Statutory reserve RMB'000	Convertible bonds reserve RMB'000	Own shares RMB'000	Accumulated earnings/ (losses) RMB'000	Foreign currency translation reserve RMB'000	Total RMB'000
<b>Balance at 31 December 2009</b>										
Profit for the Year		1,013	29,354	-	-	9,722	-	(30,846)	18,037	27,280
Exchange differences		-	-	-	-	-	-	3,472	-	3,472
Total comprehensive income for the year		-	-	-	-	-	-	-	3,669	3,669
								3,472	3,669	7,141
<b>Balance at 31 December 2010</b>										
Profit for the year		1,013	29,354	-	-	9,722	-	(27,374)	21,706	34,421
Exchange difference	17	-	-	-	-	-	-	10,762	-	10,762
Total comprehensive income for the year		-	-	-	-	-	-	-	1,987	1,987
Issue of shares, net of shares issue cost	14	84	3,415	-	-	(3,173)	-	10,762	1,987	12,749
Shares granted to Employee Benefit Trust	19	21	5,832	-	-	-	-	1,673	-	1,999
								-	-	5,853
<b>Balance at 31 December 2011</b>										
		1,118	38,601	-	-	6,549	-	(14,939)	23,693	55,022

The notes on page 22 to 64 form part of these financial statements.

All amounts are derived from continuing operations.

# CHINA NEW ENERGY LIMITED

## Statement of Cash Flows

Statement of Cash Flows	Group		Company	
	Year ended			
	31-Dec			
	2011	2010	2011	2010
	RMB'000	RMB'000	RMB'000	RMB'000
<b>Operating activities</b>				
Profit/ before income tax	25,777	23,662	10,762	3,472
Adjustments for:				
Depreciation and amortisation	2,060	1,761	-	-
Administrative expenses-issue of shares to employees	3,473	-	-	-
Allowance for doubtful trade receivable	-	502	-	-
Loss/(gain) on disposal of property, plant and equipment	(419)	446	-	-
Fair value gain	(531)	-	(531)	-
Dividend income	-	-	(14,068)	-
Interest income	(357)	-	-	-
Interest expenses	3,376	-	1,781	-
<b>Operating cash flows before movements in working capital</b>	33,379	26,371	(2,056)	3,472
Inventories	11,672	(11,456)	-	-
Construction work-in-progress	(45,177)	(20,438)	-	-
Trade and other receivables	(12,672)	(11,511)	(1,114)	(348)
Notes receivables	3,743	(1,594)	-	-
Trade and other payables	19,393	10,349	451	2,559
Notes payables	(3,441)	2,675	-	-
Deferred tax	-	2,370	-	-
Cash generated from/(used in) operations	6,897	(3,234)	(2,719)	5,683
Income taxes paid	(314)	(170)	(2)	-
Dividend received	-	-	9,953	-
<b>Net cash from/(used in) operating activities</b>	6,583	(3,404)	7,232	5,683
<b>Investing activities</b>				
Proceeds from disposal of property, plant and equipment	917	563	-	-
Acquisition of property, plant and equipment	(1,233)	(290)	-	-
Acquisition of intangible assets	(902)	-	-	-
Net cash outflow from acquisition of subsidiary	-	(6,067)	-	-
Payment for associated company in the course of acquisition	(1,700)	-	-	-
<b>Net cash from/(used in) investing activities</b>	(2,918)	(5,794)	-	-

# CHINA NEW ENERGY LIMITED

## ***Financing activities***

Short-term borrowing	1,500	5,000	-	-
Proceeds from issuance of shares	2,001	-	2,001	-
Proceeds from issuance/ (redemption) of convertible bonds	(9,845)	(4,914)	(9,845)	(4,914)
Interest received	357	-	-	-
Interest paid	(1,595)	-	-	-
<b><i>Net cash from/(used in) financing activities</i></b>				
	(7,582)	86	(7,844)	(4,914)
<b><i>Net increase/(decrease) in cash and cash equivalents</i></b>	(3,917)	(9,112)	(612)	769
Cash and bank balances at beginning of year	10,631	19,743	772	3
Effect of foreign exchange rate changes in cash and bank balances	(32)	-	(42)	-
<b><i>Cash and cash equivalents at end of year</i></b>	<b>6,682</b>	<b>10,631</b>	<b>118</b>	<b>772</b>

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements**

#### **1. General**

The Company ("CNE") (Registration Number 93306) was incorporated in Jersey on 2 May 2006 as an investment holding Company with its registered office at Ordnance House, 31 Pier Road, St Helier, Jersey JE4 8PW.

The principal activities of the main subsidiary, Guangdong Zhongke Tianyuan New Energy Science and Technology Co Ltd., ("ZKTY") are engaged in turnkey technology solutions to manufacturers of ethanol, edible alcohol and acetic acid from a range of bio-resources including corn, sugarcane, cassava and other bio-resources. On 28 September 2010, the Group acquired Guangdong Boluo Jiumeng High Technology Engineering Co. Ltd, ("Boluo"), a company engaged in the fabrication and manufacture of equipment.

The principal place of business is located at Wushan, Tianhe District, Guangzhou, People's Republic of China ("PRC").

#### **2. Summary of significant accounting policies**

##### **2.1. Basis of preparation**

The consolidated financial information have been prepared in accordance with International Financial Reporting Standards as adopted by the EU ("IFRS") issued by the International Accounting Standards Board ("IASB"), including related Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

The individual financial information of each group entity are measured and presented in the currency of the primary economic environment in which the entity operates (its functional currency). The consolidated financial information of the CNE Group are presented in Chinese Renminbi ("RMB"), which is the presentation currency for the consolidated and Company financial statements. The functional currency of the Company is British pound sterling ("GBP"). As the CNE Group mainly operates in the PRC, RMB is used as the presentation currency of the CNE Group. All financial information presented in RMB has been recorded to the nearest thousand.

The consolidated financial information incorporates the financial information of the Company and its subsidiaries. The Subsidiaries are entities (including special purposes entities) over which the Company has the power to govern the financial operating policies, generally accompanied by a shareholding giving rise to the majority of the voting rights, as to obtain benefits from their activities.

##### **Amendments and interpretations to published standards not yet effective**

China New Energy prepares its financial statements in accordance with applicable International Financial Reporting Standards (IFRS) and interpretations issued by the International Accounting Standards Board as adopted by the European Union.

As at the date of approval of these financial statements, the following standards and interpretations were in issue but not yet effective:

Issued but not yet EU adopted

*IFRS 1- Amendments severe hype inflation and removal of fixed dates for first time adoption.*

*IFRS 9- Financial instruments*

*IFRS 10- Consolidated Financial Statements*

*IFRS 11- Joint Arrangements*

*IFRS 12- Disclosure of Interests in other entities*

*IFRS 13- Fair value measurement*

*IAS 1- (amended) – Presentation of items of other comprehensive income*

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.1. Basis of preparation (continued)**

*IAS 12– (amended) – Deferred tax: Recovery of underlying Assets*  
*IAS 19– (amended) – Employee Benefits*  
*IAS 27– Separate Financial Statements*  
*IAS 28– Investments in Associates and Joint Ventures*  
*IFRIC 20– Stripping costs in the production Phase of a surface mine*

Issued and EU adopted

*IFRS 7 (amended) - Financial instruments disclosures*

The Directors do not anticipate that the adoption of these standards and interpretations in future reporting periods will have a material impact on the Group's results.

The Directors consider that adopting these standards and interpretations in the future will not have a material impact to the financial information.

**Going concern**

The Financial Statements have been prepared assuming the Group will continue as a going concern. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the necessity of liquidity, nor ceasing trading or seeking protection from creditors pursuant to laws or regulations. In assessing whether the going concern assumption is appropriate, management takes into account all available information for the foreseeable future, in particular for the twelve months from the date of approval of the Financial Statements. Based on the budgets prepared, management have a reasonable expectation that the group has adequate resources to continue its operational exercises for the foreseeable future and the group has adopted the going concern basis of accounting in preparing the financial statements. In making this assessment, the Group has specifically taken into consideration the settlement of the convertible bonds after the year end as referred to in notes 13.

**2.2. Basis of consolidation**

The subsidiaries are consolidated from the date on which control is transferred to the Group up to the effective date on which control ceases, as appropriate.

Intra-Group balances and transactions and any unrealised income and expenses arising from intra-Group transactions are eliminated on consolidation. Unrealised gains arising from transactions with associates and joint ventures are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no impairment.

The financial information of the subsidiary companies is prepared for the same reporting period as that of the Company, using consistent accounting policies. Where necessary, accounting policies of a subsidiary are changed to ensure consistency with the policies adopted by other members of the Group.

**2.3. Business combinations within the scope of IFRS 3 (revised)**

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the CNE Group in exchange for control of the acquiree, plus any costs directly attributable to the

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.3. Business combinations within the scope of IFRS 3 (revised) (continued)**

business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 (revised) are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held-for-sale in accordance with IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations, which are recognised and measured at the lower of cost and fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the CNE Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised.

When the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired exceeds the cost of the business combination, and if, after reassessment, the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired remains higher than the cost of the business combination, the excess is recognised immediately in the statement of comprehensive income.

The interest of minority shareholders in the acquiree is measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised. The acquisition of Boluo, has been accounted for using the purchase method.

**2.4. Common control business combination outside the scope of IFRS 3 (revised)**

A business combination involving entities under common control is a business combination in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. For such common control business combinations, the merger accounting principles are used to include the assets, liabilities, results, equity changes and cash flows of the combining entities in the combined financial statements.

In applying merger accounting principles, financial statement items of the combining entities or businesses for the reporting period in which the common control combination occurs, and for any comparative periods disclosed, are included in the combined financial statements of the combined entity as if the combination had occurred from the date when the coming entities or businesses first came under the control of the controlling party or parties.

A single uniform set of accounting policies is adopted by the combined entity. Therefore, the combined entity recognises the assets, liabilities and equity of the combining entities or businesses at the carrying amounts in the combined financial statements of the controlling party or parties prior to the common control combination. The carrying amounts are included as if such combined entity's accounting policies and applying those policies to all periods presented. There is no recognition of any goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of the common control combination. The effects of all transactions between the combining entities or businesses, whether occurring before or after the combination, are eliminated in preparing the combined financial statements of the combined entity.

The combination reserve represents the differences between the nominal amount of the share capital of the combining entities at the date on which it was acquired by the Group and the nominal amount of the share capital issued as consideration for the acquisition.

In this respect, the company has recognised in this manner its acquisition of Guongdong

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **2. Summary of significant accounting policies (continued)**

##### **2.4. Common control business combination outside the scope of IFRS 3 (revised)**

Zhongke Tianyuan New Energy Science and Technology Co. Ltd ("ZKTY"). In determining the appropriate accounting treatment for this transaction, the Directors considered IFRS 3 "Business Combinations" (Revised 2008). However, the transaction described above represents a combination of entities under common control.

In accordance with IAS 8 "Accounting Policies, changes in accounting estimates and errors", in developing an appropriate accounting policy, the Directors have considered the pronouncements of other standard setting bodies, specifically looking to accounting principles generally accepted in the United Kingdom ("UK GAAP") for guidance (FRS 6 – Acquisitions and mergers) which do not conflict with IFRS and reflect the economic substance of the transaction as a group reconstruction.

Under UK GAAP the assets and liabilities of both entities are recorded at book value, not fair value (although adjustments are made to achieve uniform accounting policies); intangible assets and contingent liabilities are recognised only to the extent that they were recognised by the legal acquiree in accordance with applicable IFRS, no goodwill is recognised, and any comparative amounts, if applicable, are restated as if the combination had taken place at the beginning of the earliest accounting period present.

Both entities had the same management as well as majority shareholders, illustrating common control.

On this basis the Directors decided that it was appropriate to reflect the combination using merger accounting principles as a group reconstruction under FRS 6 – acquisitions and mergers in order to give a true and fair view.

##### **2.5. Investments in associates**

The Group's investment in associates are accounted for using the equity method. An associate is an entity in which the Group has significant influence. Under the equity method, the investment in the associate is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of consolidated comprehensive income reflects the share of the results of operations of the associate unless immaterial to the group. Where there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate. The share of profit of associates is shown on the face of the consolidated statement of comprehensive income. This is the profit attributable to equity holders of the associate and therefore is profit after tax and non-controlling interests in the subsidiaries of the associates.

The financial statements of the associate are prepared for the same reporting period as the parent company. Where necessary, adjustments are made to bring the accounting policies in line with those of the Group. After application of the equity method, the Group determines whether it is necessary to recognise an additional impairment loss on the Group's investment in its associates. The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If



**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.5. Investments in associates (continued)**

this is the case the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated statement of comprehensive income.

Upon loss of significant influence over the associate, the Group measures and recognises any retaining investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retaining investment and proceeds from disposal is recognised in the consolidated statement of comprehensive income.

**2.6. Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. The cost of property, plant and equipment includes its purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Dismantlement, removal or restoration costs are included as part of the cost of property, plant and equipment if the obligation for dismantlement, removal or restoration is incurred as a consequence of acquiring or using the property, plant and equipment.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate their depreciable amounts over their estimated useful lives as follows:

	Years
Plant and machinery	5
Motor vehicles	10
Office equipment	5
Leasehold improvement	3

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

The estimated useful lives, residual values and depreciation methods are reviewed, and adjusted as appropriate, at the end of each financial year.

The gain or loss arising on disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the Statement of Comprehensive Income.

Fully depreciated plant and equipment are retained in the financial statements until they are no longer in use.

**2.7. Intangible assets**

**Computer software**

Acquired computer software licenses are initially capitalised at cost which includes the purchase price (net of any discounts and rebates) and other directly attributable costs of preparing the software for its intended use. Direct expenditure which enhances or extends the performance of computer software beyond its specifications and which can be reliably measured is added to the original cost of the software. Costs associated with maintaining computer software are recognised as an expense as incurred.

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.7. Intangible assets (continued)**

Computer software licenses are subsequently carried at cost less accumulated amortisation and accumulated impairment losses. These costs are amortised to the Statement of Comprehensive Income using the straight-line method over their estimated useful lives of 3 years.

Land use rights

Land use rights are capitalised and stated at cost less accumulated amortisation and impairment losses. Amortisation is provided on a straight line basis over the term of the rights.

Patent rights

Patent rights acquired are initially recognised at cost less accumulated amortisation and accumulated impairment losses. These costs are amortised to the income statement using the straight-line method over 10 years.

The amortisation period and amortisation method of intangible assets other than goodwill are reviewed at the end of each financial year. The effects of any revision are recognised in the Statement of Comprehensive Income when the changes arise.

**2.8. Impairment of tangible and intangible assets excluding goodwill**

At the end of each financial year, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

The recoverable amount of an asset or cash-generating unit is the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in the Statement of Comprehensive Income, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash-generating unit 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 or the cash-generating unit in prior years. A reversal of an impairment loss is recognised immediately in the Statement of Comprehensive Income, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.9. Income tax**

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 Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are not taxable or tax deductible in the current period. The Group's liability for current tax is calculated using tax rates (and tax laws) that have been enacted or substantively enacted in countries where the Company and its subsidiaries operate by the end of the financial year.

Deferred tax is recognised on the differences between the carrying amounts of assets and liabilities in the financial information and the corresponding tax bases 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 on taxable temporary differences arising on investment in subsidiary, 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 the end of each financial year 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 realised based on the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the financial year. Deferred tax is charged or credited to the Statement of Comprehensive Income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax are recognised as an expense or income in the Statement of Comprehensive Income, except when they relate to items credited or debited directly to equity, (in which case the tax is also recognised directly in equity) or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **2. Summary of significant accounting policies (continued)**

##### **2.10. Financial instruments**

Financial assets and financial liabilities are recognised on the Group's consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

##### **Effective interest method**

The effective interest method is a method of calculating the amortised cost of a financial instrument and allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) throughout the expected life of the financial instrument, (or where appropriate, a shorter period), to the net carrying amount of the financial instrument. Income and expenditure are recognised on an effective interest basis for debt instruments other than those financial instruments recognised at fair value through the Statement of Comprehensive Income.

##### **Financial assets**

Financial assets within the scope of IAS 39 are classified as either:

- (i) financial assets at fair value through profit or loss
- (ii) loans and receivables
- (iii) held-to-maturity investments
- (iv) available-for-sale financial assets

The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of financial assets at initial recognition and re-evaluates this classification at every reporting date.

All standard purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase the asset. Regular way purchases and sales are purchases or sales of financial assets that require delivery of the financial assets within the period generally established by regulation or convention of the market place concerned.

Financial assets are derecognised when the rights to receive cash flow from the financial assets have expired or have been transferred and the Group have transferred substantially all risks and rewards of ownership.

##### **Financial assets at fair value through profit and loss**

Financial assets are classified in this category if they are acquired for the purpose of selling in the short term. Gains or losses on investments held for trading are recognised in the Statement of Comprehensive Income.

##### **Loans and receivables**

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in active market are classified as loans and receivables. Loans and receivables are measured at amortised cost, using the effective interest method less impairment. Interest is recognised by applying the effective interest method, except for short-term receivables when the recognition of interest would be immaterial.

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

**2.10. Financial instruments (continued)**

Available for Sale Investments

Available for sale investments are those non-derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss. After initial recognition, available for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the statement of comprehensive income.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the closure of business on the statement of financial position date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value, discounted cash flow analysis and option pricing models.

Impairment of financial assets

Financial assets, other than Fair Value Through Profit or Loss, are assessed for indicators of impairment at the end of each financial year. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For financial assets carried, at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amounts of all financial assets are reduced by the impairment loss directly with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in the Statement of Comprehensive Income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised, the previously recognised impairment loss is reversed through the Statement of Comprehensive Income to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of available-for-sale equity instruments, any subsequent increase in fair value after an impairment loss is recognised directly in equity.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the

Notes to the financial statements (continued)

2. Summary of significant accounting policies (continued)

2.10. Financial instruments (continued)

Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds receivables.

**Financial liabilities and equity instruments**

**Classification as debt or equity**

Financial liabilities and equity instruments issued by Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

**Equity instruments**

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments are recorded at the proceeds received, net of direct issue costs.

**Financial liabilities**

Financial liabilities are classified as either financial liabilities at fair value through the Statement of Comprehensive Income or other financial liabilities.

Financial liabilities are classified as at fair value through the comprehensive income statement if the financial liability is either held for trading or it is designated as such upon initial recognition.

**Other financial liabilities**

**Trade and other payables**

Trade and other payables are initially measured at fair value, net of transaction costs, and are subsequently measured at amortised cost, where applicable, using the effective interest method, with interest expense recognised on an effective yield basis.

**Derecognition of financial liabilities**

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

2.11. Inventories

Inventories are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Notes to the financial statements (continued)

2. Summary of significant accounting policies (continued)

2.12. Contract to construct specialised equipment ("Construction contracts")

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs are recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date ("percentage-of-completion method"). When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that are likely to be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Contract revenue comprises the initial amount of revenue agreed in the contract and variations in the contract work and claims that can be measured reliably. A variation or a claim is recognised as contract revenue when it is probable that the customer will approve the variation, or negotiations have reached an advanced stage such that it is probable that the customer will accept the claim.

The stage of completion is measured by reference to the contract costs incurred to date compared to the estimated total costs for the contract. Costs incurred during the financial year in connection with future activity on a contract are excluded from costs incurred to date when determining the stage of completion of a contract. Such costs are shown as construction contract work-in-progress on the balance sheet unless it is not probable that such contract costs are recoverable from the customers, in which case, such costs are recognised as an expense immediately.

At the balance sheet date, the aggregated costs incurred plus recognised profit (less recognised loss) on each contract is compared against the progress billings. Where costs incurred plus the recognised profits (less recognised losses) exceed progress billings, the balance is presented as due from customers on construction contracts. Where progress billings exceed costs incurred plus recognised profits (less recognised losses), the balance is presented as due to customers on construction contracts.

2.13. Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments which are readily convertible to known amounts of cash and are subject to insignificant risk of changes in value.

2.14. Incentive scheme charge

The fair value of employee service received in exchange for the grant of shares is recognised as an expense. The total amount to be expensed over the performance period, from grant date to vesting date, is determined by reference to the fair value of the shares determined at the date the employee is deemed to be fully aware of their potential entitlement and all conditions of vesting.

2.15. Leases

Operating Leases

Rentals payable under operating leases are charged to comprehensive income statement on a straight-line basis over the term of the relevant lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **2. Summary of significant accounting policies (continued)**

##### **2.15. Leases (continued)**

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability and released to the income statement as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

##### **2.16. Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the financial year, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Changes in the estimated timing or amount of the expenditure or discount rate are recognised in comprehensive income statement when the changes arise.

##### **2.17. Share capital**

Ordinary share capital is recognised at the fair value of the consideration received by the Company.

Incremental costs directly attributable to the issuance of new equity instruments are taken to equity as a deduction, net of tax, from the proceeds.

##### **2.18. Own shares**

Company shares held by the Employee Benefit Trust ("EBT") are deducted from the shareholders' funds and classified as Own Shares until such time as they vest unconditionally to participating employees and their families.

##### **2.19. Retirement benefit costs**

Defined contribution plans are post-employment benefit plans under which the Group pays fixed contributions into separate entities such as the social security plan in the People's Republic of China ("PRC") on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid.

Contributions to defined contribution plans are recognised as an expense in the statement of comprehensive income in the same financial year as the employment that gives rise to the contributions.



## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **2. Summary of significant accounting policies (continued)**

##### **2.20. Compound financial instruments**

Compound financial instruments issued by the Group comprise convertible bonds that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair values.

The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortised cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

##### **2.21. Revenue recognition**

###### Revenue from construction contracts

Please refer to Note 2.12 "Contract to construct specialised equipment" for the accounting policy for revenue recognition from construction contracts.

###### Interest income

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

###### Income from sale of scrap materials

Income from sale of scrap materials is recognised upon the transfer of significant risks and rewards of ownership of the goods to customers, which generally coincides with delivery and acceptance of the goods sold.

##### **2.22. Foreign currency transactions and translation**

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency are recorded at the rate of exchange prevailing on the date of the transaction. At the end of each financial year, monetary items denominated in foreign currencies are retranslated at the rates prevailing as of the end of the financial year. 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 retranslation of monetary items are included in comprehensive income statement for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair

**Notes to the financial statements (continued)**

**2. Summary of significant accounting policies (continued)**

value are included in comprehensive income statement 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. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations (including comparatives) are expressed in Renminbi using exchange rates prevailing at the end of the financial year. Income and expense items (including comparatives) are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised in comprehensive income statement in the period in which the foreign operation is disposed of.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities (including monetary items that, in substance, form part of the net investment in foreign entities), are taken to the foreign currency translation reserve.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

**2.23. Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the executive directors and the chief executive officer who make strategic decisions.

**2.24. Research and development expenditure**

Research and development expenditure is written off to the Statement of Comprehensive Income in the year in which it is incurred, unless the directors are satisfied as to the commercial and financial viability of individual projects. This being the case, the expenditure would be deferred and amortised over the period during which the Group is expected to obtain benefits from the expenditure.

**3. Critical accounting judgements and key sources of estimation uncertainty**

In the application of the Group's accounting policies, which are described in Note 2, management made judgements, estimates and assumptions about the carrying amounts of assets and liabilities that were not readily apparent from other sources. The estimates and associated assumptions were based on historical experience and other factors that were considered to be reasonable under the circumstances. Actual results may differ from these estimates.

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

**3. Critical accounting judgements and key sources of estimation uncertainty (continued)**

**3.1 Critical judgements in applying the entity's accounting policies**

The following are the critical judgements, apart from those involving estimations (see below) that management has made in the process of applying the CNE Group's accounting policies and which have the significant effect on the amounts recognised in the financial information.

Impairment of financial assets

The Group follows the guidance of IAS 39 – Financial Instruments: Recognition and Measurement, in determining whether a financial asset is impaired. This determination requires significant judgement, the Group evaluates, among other factors, the duration and extent to which the fair value of a financial asset is less than its cost and the financial health of and near-term business outlook for the financial asset, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

Deferred tax assets

Deferred tax assets are recognised to the extent that it is probable that the taxable profit will be available against which the deferred tax asset recognised can be utilised. Management's judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future tax planning strategies.

Impairment of construction in progress

Provision for impairment on construction in progress is made when the construction project is suspended for a long period; the construction project is technically and physically obsolete and its economic benefits to the Group is uncertain; or other evidences can prove the existence of the decline in value of construction project. An impairment loss is recognised individually for the shortfall of the recoverable amount of construction in progress below its carrying amount. The carrying amounts of the CNE Group's, construction in progress as at 31 December 2010 and 2011 are disclosed in Note 9.

**3.2 Key sources of estimation uncertainty**

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

Allowance for trade and other receivables

Management reviews its loans and receivables for objective evidence of impairment at least quarterly. Significant financial difficulties of the debtor, the probability that the debtor will enter bankruptcy, and default or significant delay in payments are considered objective evidence that a receivable is impaired. In determining this, management makes judgement as to whether there is observable data indicating that there has been a significant change in the payment ability of the debtor, or whether there have been significant changes with adverse effect in the technological, market, economic or legal environment in which the debtor operates in.

Where there is objective evidence of impairment, management makes judgement as to whether an impairment in value should be recorded in the income statement. In determining this, management uses estimates based on historical loss experience for assets with similar credit risk characteristics. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between the estimated loss and actual loss experience.

**Notes to the financial statements (continued)**

**3. Critical accounting judgements and key sources of estimation uncertainty (continued)**

**3.2 Key sources of estimation uncertainty (continued)**

The allowance policy for doubtful debts of the Group is based on the ageing analysis and management's ongoing evaluation of the recoverability of the outstanding receivables. A considerable amount of judgement is required in assessing the ultimate realisation of these receivables, including the assessment of the creditworthiness and the past collection history of each customer. If the financial conditions of these customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The carrying amounts of the Group's trade and other receivables as at 31 December 2010 and 2011 were RMB 45.7 million and RMB 53.9 million, respectively.

Construction contracts

Where the outcome of a construction contract can be estimated reliably, the Group recognises revenue and costs by reference to the stage of completion of the contract activity at the statement of financial position, measured based on the proportion of contract costs incurred for work performed to date relative to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent it is probable that contract costs incurred will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

The Group's accounting approach reflects a sound judgement as potential losses on contract are being considered and reflected with its probability immediately upon occurrence while contract revenue which cannot be estimated reliably is realised only after confirmed by written agreement.

Impairment of intangible assets

Determining whether intangible assets are impaired requires an estimation of the value in use of the cash-generating units ("CGU") to which intangible assets have been allocated. The value-in-use calculation requires the entity to estimate the future cash flows expected to arise from the CGU and a suitable discount rate in order to calculate present value. No impairment loss was recognised during the financial year. The carrying amounts of the intangible assets as at 31 December 2010 and 2011 were RMB 3.4 million and RMB 4.2million respectively.

Depreciation of property, plant and equipment

The Group depreciates the property, plant and equipment, using the straight-line method, over their estimated useful lives after taking into account of their estimated residual values. The estimated useful life reflects management's estimate of the period that the Group intends to derive future economic benefits from the use of the Group's property, plant and equipment. The residual value reflects management's estimated amount that the Group would currently obtain from the disposal of the asset, after deducting the estimated costs of disposal, as if the asset were already of the age and in the condition expected at the end of its useful life. Changes in the expected level of usage and technological developments could affect the economics, useful lives and the residual

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **3. Critical accounting judgements and key sources of estimation uncertainty (continued)**

##### **3.2 Key sources of estimation uncertainty (continued)**

values of these assets which could then consequentially impact future depreciation charges. The carrying amounts of the Group's property, plant and equipment as at 31 December 2010 and 2011 were RMB11.1 million and RMB9.9million, respectively.

##### Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on the current market condition and the historical experience of manufacturing and selling products of similar nature. It could change significantly as a result of changes in customer demand and competitor actions in response to severe industry cycle. Management reassesses these estimates at each balance sheet date. The carrying amount of the Group's inventories as at 31 December 2010 and 2011 were RMB 35.0 million and RMB 23.4million, respectively.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 4. Property, plant and equipment

	Plant and machinery RMB'000	Motor vehicles RMB'000	Office equipment RMB'000	Leasehold improvements RMB'000	Total RMB'000
<b>As at 31 December 2010</b>					
<b>Cost</b>					
At 1 January 2010	5,334	3,041	1,274	291	9,940
Additions	685	140	189	411	1,425
On acquisition of subsidiary	4,839	1,030	7	-	5,876
On disposal	(446)	-	-	-	(446)
At 31 December 2010	10,412	4,211	1,470	702	16,795
<b>Accumulated depreciation</b>					
At 1 January 2010	1,547	522	815	247	3,131
Charge for the year	931	192	149	19	1,291
On acquisition of subsidiary	1,190	299	2	-	1,491
On disposal	(236)	-	-	-	(236)
At 31 December 2010	3,432	1,013	966	266	5,677
<b>Net book value</b>					
At 31 December 2010	6,980	3,198	504	436	11,118
<b>As at 31 December 2011</b>					
<b>Cost</b>					
At 1 January 2011	10,412	4,211	1,470	702	16,795
Additions	533	563	85	52	1,233
Disposals	(1,282)	(342)	(812)	(291)	(2,727)
At 31 December 2011	9,663	4,432	743	463	15,301
<b>Accumulated depreciation</b>					
At 1 January 2011	3,432	1,013	966	266	5,677
Charge for the year	999	618	153	195	1,965
Disposals	(1,153)	(83)	(731)	(262)	(2,229)
At 31 December 2011	3,278	1,548	388	199	5,413
<b>Net book value</b>					
At 31 December 2011	6,385	2,884	355	264	9,888

The company holds no fixed assets.

As at 31 December 2011, Plant and machinery of the Group amounting to RMB 6.3million (2010: RMB 6.9million) were pledged as security for the short term borrowing amounting to RMB 6.5million.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 5. Intangible assets

	As at 31 December		Computer software	Patent	Technology Knowhow	Land use management	Total
	2011	2010					
	RMB'000	RMB'000					
<b>Cost</b>							
Balance at beginning of year	4,003	380	70	70	250	3,613	4,003
Additions	902	-	-	902	-	-	902
Acquisition of subsidiary	-	3,623	-	-	-	-	-
Balance at end of year	4,905	4,003	70	972	250	3,613	4,905
<b>Accumulated amortisation</b>							
Balance at beginning of year	633	272	28	11	250	344	633
Amortisation for the year	95	361	9	3	-	83	95
Balance at end of year	728	633	37	14	250	427	728
<b>Net book value</b>	<b>4,177</b>	<b>3,370</b>	<b>33</b>	<b>958</b>	<b>-</b>	<b>3,186</b>	<b>4,177</b>

Intangible assets include patents, computer software license and technology knowhow acquired. Amortisation of intangible assets is included in amortisation expense under administrative expenses.

The land use management was valued by a third party at RMB 3.6million on acquisition in 2010.

The intangible assets are tested for impairment as part of the cash generating unit to which it belongs. The carrying amount of the cash generating units are tested for impairment based on 30 years discounted cash flow method at the discount rate of 8%.

A movement of 8% of cashflow in the period and 10% in the discount factor would result in the request for an impairment of the intangible asset.

As at 31 December 2011, land use management of the Group amounting to RMB 3,186,000 (2010: RMB 3,269,000) were pledged as security for the short term borrowing amounting to RMB 6,500,000 (2010: RMB 5,000,000).

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 6. Investment in subsidiary

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
As at 1 January	84,069	84,069
Additions during the period	5,853	-
As at 31 December	89,922	84,069

The details of the subsidiary are as follows:

Name of subsidiary/ place of incorporation	Principal activity	Effective equity interest held by the Group	
		As at 31 December 2011	2010
Guangdong Zhongke Tianyuan New Energy Science and Technology Co Ltd / The PRC	Provision of engineering, procurement and construction services to ethanol producers.	100%	100%
Guongdong Boluo Jiuneng High Technology Engineering Co Ltd / The PRC	Fabrication and manufacture of equipment in accordance with project requirements and designs of ZKTY and provision of services to ZKTY	100%	100%
China New Energy Limited Employee Benefit Trust	The Trust is established with a view to providing benefits for the employees and officers of the Company, its holding company and its subsidiaries.	-	-

### 7. Investment in associated companies

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
As at 1 January 2011	-	-
Acquired during the period	1,700	-
Share of post-acquisition profits	-	-
As at 31 December 2011	1,700	-



# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 7. Investment in associated companies (continued)

The associate company, which is a private entity and not listed on any public exchange is as follows:

Name of subsidiary/ place of incorporation	Principal activity	Effective equity interest held by the Group	
		As at 31 December	
		2011	2010
Jilin Tianshun Bio-chemical Technology Co Ltd / The PRC	Provision of R&D achievements of grain deep and technical service	34%	

The group consider this company as an associate because it has no control over the board and voting rights.

### 8. Inventories

	Group As at 31 December	
	2011	2010
	RMB'000	RMB'000
Raw materials	13,526	21,467
Work-in-progress	9,828	13,559
	<u>23,354</u>	<u>35,026</u>

The cost of inventories recognised as expense and included in "cost of sales" in 2010 and 2011 amounted to RMB 64.3 million and RMB 108.8 million, respectively.

### 9. Due from/to customers for construction contracts

	Group As at 31 December	
	2011	2010
	RMB'000	RMB'000
Aggregate costs incurred and profits recognised to - date	741,693	631,899
Less: Progress billings on outstanding contracts as at the year end	(652,849)	(552,885)
	<u>88,844</u>	<u>79,014</u>
Allowance for impairment	(5,657)	(41,004)
	<u>83,187</u>	<u>38,010</u>
<u>Presented as:</u>		
Due from customers for construction contracts	93,241	56,735
Due to customers for construction contracts	(10,054)	(18,725)
	<u>83,187</u>	<u>38,010</u>

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 9. Due from/to customers for construction contracts (continued)

Movements in allowance for impairment on amount due from customers for construction contracts are as follows:

	Group As at 31 December		Company As at 31 December	
	2011	2010	2011	2010
	RMB'000	RMB'000	RMB'000	RMB'000
At beginning of the year	41,004	44,061	-	-
Allowance for impairment/ (write back)	(35,347)	(3,057)	-	-
At end of the year	5,657	41,004	-	-

### 10. Trade and other receivables

	Group As at 31 December		Company As at 31 December	
	2011	2010	2011	2010
	RMB'000	RMB'000	RMB'000	RMB'000
<b><u>Current</u></b>				
Trade receivables				
- Related party	-	-	-	1,404
- Third parties	97,034	72,875	-	-
- Group companies	-	-	6,765	2,650
	97,034	72,875	6,765	4,054
Allowance for impairment of receivables	(60,828)	(41,547)	-	-
	36,206	31,328	6,765	4,054
Other receivables				
Deposits	9,550	5,353	-	-
VAT recoverable	-	7,010	-	-
Due from related parties	-	-	-	-
Due from shareholders	-	-	-	-
Others	-	-	2,518	-
Allowance for impairment	8,140	1,984	-	-
	53,896	45,675	9,283	4,054
<b><u>Non-current</u></b>				
Trade receivables	4,402	6,601	-	-
	4,402	6,601	-	-

Deposits comprise office rental deposits and deposits to suppliers for the purchase of raw materials.

Other receivables comprise loans to employees.

As at 31 December 2010 and 2011 retention monies held by customers for contract work amounted to RMB 3.8 million and RMB 2.5million, respectively.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 10. Trade and other receivables (continued)

The amounts due from related parties are non-trade, unsecured, non-interest bearing and repayable on demand.

The carrying amounts of other receivables approximate their fair values.

There is one trade receivables represents a project from a customer repayable in 5 years. The fair value of trade receivables current and non-current are as follows:

	<b>Group</b>		<b>Company</b>	
	<b>As at 31 December</b>		<b>As at 31 December</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
<b><u>Current</u></b>				
Face value	97,224	73,362	-	4,054
Discount on trade receivables	(190)	(487)	-	-
Fair value	<u>97,034</u>	<u>72,875</u>	<u>-</u>	<u>4,054</u>
<b><u>Non-current</u></b>				
Face value	5,351	7,550	-	-
Discount on trade receivables	(949)	(949)	-	-
Fair value	<u>4,402</u>	<u>6,601</u>	<u>-</u>	<u>-</u>

Movements in allowance for doubtful debts in receivables are as follows:

	<b>Group</b>		<b>Company</b>	
	<b>As at 31 December</b>		<b>As at 31 August</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
At beginning of the year	41,558	41,266	-	-
Allowance during the year	35,389	502	-	-
Write off	(16,119)	(210)	-	-
At end of the year	<u>60,828</u>	<u>41,558</u>	<u>-</u>	<u>-</u>

The Group's historical experience in the collection of third parties trade receivable falls within the recorded allowances. Due to these factors, management believes that no additional credit risk beyond amounts provided for collection losses is inherent in the Group's receivables.

**CHINA NEW ENERGY LIMITED**

**Notes to the financial statements (continued)**

**11. Cash and cash equivalents**

	<b>Group</b>		<b>Company</b>	
	<b>As at 31 December</b>		<b>As at 31 December</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
Cash at bank and on hand	6,682	10,631	118	772

The currency profiles of the CNE Group's cash and cash equivalents as at 31 December 2010 and 2011 are disclosed in Note 28.

**12. Trade and other payables**

	<b>Group</b>		<b>Company</b>	
	<b>As at 31 December</b>		<b>As at 31 December</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
Trade payables				
- Third parties	37,900	32,486	-	-
Other payables				
- Advance deposits from customers	17,782	15,229	-	-
- Other payables and accruals	12,161	8,452	18	19
- VAT payables	24,135	16,215	-	19
- Due to related parties	-	-	11,534	4,050
- Due to directors	374	577	374	577
	92,352	72,959	11,926	4,665

Other payables and accruals comprise expenses incurred for rental of office premises, entertainment expenses and audit fees.

The carrying amounts of trade and other payables approximate their fair values.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 13. Convertible bonds

On 30 July 2007, the Company entered into a subscription agreement with Citadel. Under the subscription agreement, Citadel subscribed for an aggregate principal amount of US\$12.0 million of convertible bonds (the "Convertible Bonds") issued by the Company and were originally matured on 30 July 2010. In October 2008, the Company entered into a redemption agreement (the "Redemption Agreement") with Citadel, whereby, the Company will pay the full amount of US\$8.0 million to Citadel as full redemption of the principal amount of US\$12.0 million.

On 17 October 2008, the Company redeemed US\$4 million of the Convertible Bonds and met its first committed instalment payment of US\$4 million, but failed to pay the second and third instalments of US\$1.5 million in November 2008 and US\$2.5 million in October 2009, respectively.

On 28 August 2009, the Company, Citadel and certain other parties entered into an agreement relating to a proposed reverse acquisition transaction with an investment company, which would purchase 100% of the issued ordinary shares of the Company in exchange for a cash payment and the issuance of new shares of this investment company to the shareholders of the Company (the "Reverse Acquisition"). It was agreed that upon completion of the Reverse Acquisition, US\$4 million would be paid to Citadel and that the Convertible Bonds would be cancelled. However, as the Reverse Acquisition did not occur, Citadel continues to hold an aggregate principal amount of US\$8 million of Convertible Bonds (the "Debt Principal"). Therefore, the parties wished to restructure the Debt Principal and entered into a term sheet relating to the settlement of the outstanding convertible bonds dated 10 September 2010 (the "Term Sheet").

On 21 December 2010, the Company and Citadel recorded the terms agreed for the full and final settlement of the Debt Principal on a binding basis (the "Settlement Agreement"). The settlement agreement cancels the convertible bond once a number of conditions are fulfilled, a number of which were outstanding at 31 December 2010.

On 28 February 2011, the company redeemed US\$0.5million based on the "Settlement Agreement". On 31 October 2011, the company redeemed US\$1million according to the "Settlement Agreement".

The fair value of the liability component and the equity conversion component were determined at the date of the Convertible Loan Agreement. The fair value of the liability component, included in current liabilities, was estimated using prevailing market interest rate for a similar debt instruments without a conversion option. The residual amount, representing the value of the equity conversion component, is included in shareholders' equity in convertible bonds reserve.

The Convertible Bonds recognised in the consolidated balance sheets is calculated as follows:

	<b>Group</b>		<b>Company</b>	
	<b>As at 31 December</b>		<b>As at 31 December</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
Face value of convertible	44,307	59,512	44,307	59,512
Equity conversion component	(6,549)	(9,722)	(6,549)	(9,722)
Fair value of debt	<u>37,758</u>	<u>49,790</u>	<u>37,758</u>	<u>49,790</u>
Represented by:				
Current	37,758	9,941	37,758	9,941
Non-current	<u>          </u>	<u>39,849</u>	<u>          </u>	<u>39,849</u>
Fair value of debt	<u>37,758</u>	<u>49,790</u>	<u>37,758</u>	<u>49,790</u>

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 14. Share capital

	Number of Shares	Share Capital		Share premium	
		£ '000	RMB '000	£ '000	RMB '000
As at 31st December 2010	6,733,107	67	1,013	1,952	29,354
As at 21st March 2011	67,331,070	67	1,013	1,952	29,354
As at 6 May 2011	269,324,280	67	1,013	1,952	29,354
Shares issued in connection with the Placing	9,360,147	2	24	653	6,756
Share issued in settlement of fees to professional	9,920,295	2	26	692	7,160
Share issued to EES Trustees International Limited	8,079,728	2	21	564	5,832
Shares issued to Citadel pursuant to warrant agreement	7,932,412	2	20	305	3,152
Placing on 14 Dec 2011	6,000,000	2	14	258	2,650
Less share issue costs	-	-	-	-	(16,303)
As at 31 December 2011	310,616,862		1,118		38,601
Total shares in issue	310,616,862				

On 21 March 2011, pursuant to written resolutions passed by the shareholders of the Company, the Company approved (i) the subdivision of the authorised share capital of the Company into 10,000,000,000 ordinary shares of par value £0.001 each and (ii) that each existing issued ordinary share of par value £0.01 at such date be subdivided into 10 ordinary shares of par value £0.001 each, and (iii) that the Company's memorandum of association be amended to reflect the same.

On 15 April 2011 by resolutions of the Board, the Board approved the allotment of an aggregate of 2,019,932 ordinary shares of par value £0.001 each to EES Trustees International Limited at Admission, to be held on trust in accordance with the terms of the China New Energy Limited Employee Benefit Trust and to be allocated to certain named employees of the Group provided such persons remain employees of the Group on the anniversary of Admission.

On 6 May 2011, pursuant to written resolutions passed by the shareholders of the Company, the Company approved (i) the subdivision of the authorised share capital of the Company into 40,000,000,000 ordinary shares of par value £0.00025 each and (ii) that each existing issued ordinary share of par value £0.001 at such date be subdivided into 4 ordinary shares of par value £0.00025 each, and (iii) that the Company's memorandum of association be amended to reflect the same.

On 16 May 2011 by resolutions of the Board, the Board approved, conditional on Admission, (i) the allotment of up to 9,360,147 Ordinary Shares free of pre-exemption in connection with the Placing; (ii) that a further 2,966,845 Ordinary Shares be at the disposal of the Board pursuant to the warrant agreement to be executed in favour of Cairn in part settlement of fees; (iii) that a further 357,142 Ordinary Shares be allotted to Cairn on Admission in part settlement of fees; (iv) that a further 1,483,425 Ordinary Shares be allotted to SVS on Admission in part settlement of fees; and (v) that a further 8,079,728 Ordinary Shares be allotted to NovusAsia Capital Limited on Admission in part settlement of fees.

On 9 June 2011 Citadel elected to exercise the cashless exercise mechanism in respect of its aggregate rights under the warrant. The effect of the cashless exercise mechanism results in Citadel being issued and allotted 7,932,412 new ordinary shares. The fair value of the warrants was RMB 3,172,856. Following this issue of equity, the company transferred to the warrants reserve from convertible reserve RMB 3,172,856.

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **14. Share capital (continued)**

On 14 December 2011, the company placed 6,000,000 new ordinary shares of 0.025p each ("Ordinary Shares") at a price of 5 pence per share, raising gross proceeds of £300,000 for the Company (the "Placing")

The substantial shareholders have not changed from 31 December 2011.

The Company has one class of ordinary shares which carry no right to fixed income.

#### **15. Statutory reserve**

##### **(a) Statutory surplus reserve**

According to the relevant PRC regulations and the Articles of Association of the subsidiary, it is required to transfer 10% of its profit after income tax to the statutory surplus reserve until the reserve balance reaches 50% of their registered capital. The transfer to this reserve must be made before the distribution of dividends to equity owners. Statutory surplus reserve can be used to make good previous years' losses, if any, and may be converted into paid-in capital in proportion to the existing interests of equity owners, provided that the balance after such conversion is not less than 25% of the registered capital.

##### **(b) Statutory public welfare fund**

According to the relevant PRC regulations and the Articles of Association of the subsidiary, it is required to transfer 5% of its profit after income tax to the statutory public welfare fund. The statutory public welfare fund is established for the purpose of providing employee facilities and other collective benefits to its employees.

Movements in these accounts are set out in the consolidated statement of changes in equity.

#### **16. Combination reserve**

Combination reserve represents the differences between the nominal amount of the share capital of the combining entities at the date on which it was acquired by the Group and the nominal amount of the share capital issued as consideration for the acquisition of ZKTY as described further in note 2.4.

#### **17. Foreign currency translation reserve**

The foreign currency translation reserve represents exchange differences arising from the translation of the financial statements of foreign operations where functional currencies are different from that of the Group's presentation currency.

Movements in these accounts are set out in the consolidated statement of changes in equity.

#### **18. Warrants reserve**

On 23 May 2011, the Company issued 2,966,845 warrants for services provided to the Company. The fair value of the warrants was RMB 1,673,000, which was calculated using the Black Scholes method.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 19. Employee Benefit Trust

In accordance with the requirements of SIC 12 "Consolidation-special purpose entities" and IAS 32 "Financial Instruments: Presentation", certain of the assets and liabilities of the EBT have been included in the Group's accounts resulting in the inclusion of RMB 21,000 own shares and RMB 5,832,000 share premium. This represents shares held by the Employee Benefit Trust that had not vested to employees.

On 24 March 2011, shareholders approved the establishment of the China New Energy Limited Employee Benefit Trust (the "EBT") and associated share scheme as part of the Company's employee incentive arrangements. The scheme provided for the issue of up to 8,079,728 shares to employees in respect of the one year ended 23 May 2012 for nil consideration.

#### Income statement change

	Group		Company	
	As at 31 December		As at 31 December	
	2011	2010	2011	2010
	RMB'000	RMB'000	RMB'000	RMB'000
Original scheme	3,474	-	-	-
	3,474	-	-	-

As required by SIC 12-"Consolidation – Special Purpose Entities" and IAS 32 the EBT is included in the Group's accounts, accordingly this shareholding of 8,079,728 ordinary shares is represented in the Statement of Changes In Equity as Own Shares (RMB 5,853,000).

### 20. Revenue

	Year ended 31 December	
	2011	2010
	RMB" 000	RMB" 000
Contract revenue	178,998	138,359

### 21. Other operating income

	Group	
	2011	2010
	RMB'000	RMB'000
Interest income	358	-
Sale of scrap materials	205	464
Bad debt written back	8,535	-
Gain on disposal of property, plant and equipment	191	-
Subsidy income	42	-
	9,331	464



**CHINA NEW ENERGY LIMITED****Notes to the financial statements (continued)****22. Other operating expenses**

	<b>Year ended 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
Research and development expense	2,253	1,128
Bank charges	114	101
Foreign currency exchange loss	(26)	1,425
Allowance for doubtful trade receivables	-	(434)
Technical service fee	-	10
Others	-	(43)
	<b>2,341</b>	<b>2,187</b>

**23. Profit/(loss) before income tax**

	<b>Year ended 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
Staff costs including directors remuneration	8,308	7,376
Depreciation of property, plant and equipment	1,965	1,284
Gain/(loss) on disposal of property, plant and equipment	419	(446)
Amortisation of intangible assets	95	361
Operating lease	562	509
Fair value gain	531	-
Auditors Remuneration:		
• Audit Services	560	575

**CHINA NEW ENERGY LIMITED****Notes to the financial statements (continued)****24. Income tax expense**

	<b>Year ended 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
Current income tax	(3,733)	(3,623)
Deferred tax asset	-	-
Current income tax	(3,733)	(3,623)

The Company has been granted exempt Company status under Article 123A of the Income Tax (Jersey) Law 1961 for the years ended 31 December 2007 and 2008. With effect from 1 January 2009, exempt Company status was abolished and a general zero rate of Jersey corporate income tax was introduced.

Movements in deferred tax asset are as follows:

	<b>Year ended 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
At beginning of the year	-	2,370
Tax paid	-	-
Utilised in the year	-	(2,370)
At end of the year	-	-

Movements in deferred tax liabilities are as follows:

	<b>Year ended 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
At beginning of the year	1,018	1,055
Charged/reversal for the year	(105)	(37)
At end of the year	913	1,018

On 1 September 2006, the Subsidiary was established in the PRC as a wholly foreign owned enterprise ("WFOE") under the laws of the PRC. In accordance with the "Income Tax Law of the PRC for Enterprise with Foreign Investment and Foreign Enterprise", where the Subsidiary is entitled to full exemption from Enterprise Income Tax ("EIT") for the first two years commencing from its first profitable year and, thereafter is entitled to a 50% relief of EIT for the next three years which results in an effective tax rate of 12.5%

## Notes to the financial statements (continued)

## 24. Income tax expense (continued)

*Relationship between tax expense and accounting profit*

A reconciliation between tax expense and the product of accounting profit multiplied by the applicable tax rate for the years ended 31 December 2010 and 2011 are as follows:

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
Profit before income tax	25,777	23,662
Income tax using PRC tax rate of 12.5%	3,222	2,958
Disallowed expenses	511	665
	<u>3,733</u>	<u>3,623</u>

## 25. Earnings per share

The calculation for earnings per share (basic and diluted) for the relevant period is based on the profit after income tax attributable to equity holder for the years ended 31 December 2010 and 2011 are as follows:

	Earnings RMB'000	Weighted average number of shares '000	Earnings per share RMB
<b>2011</b>			
Basic	22,044	285,860	0.077
Diluted	22,044	292,125	0.075
<b>2010</b>			
Basic	20,039	269,324	0.074
Diluted	20,039	269,324	0.074

The weighted average of ordinary shares for diluted earnings per share reconciles to the weighted average number of ordinary shares for basic earnings per share as follows:

	2011 '000	2010 '000
Weighted average number of ordinary shares used in the calculation of basic earnings per share	285,860	269,324
Dilutive effect of EBT	6,265	-
Weighted average number of ordinary shares used in the calculation of diluted earnings per share	<u>292,125</u>	<u>269,324</u>

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 25. Earnings per share (continued)

In order to show results from operating activities on a comparable basis, an adjusted profit after tax per share has been calculated which excludes the EBT charge where the relevant shares are satisfied by issues of new shares:

	2011 RMB'000	2010 RMB'000
Profit for the year	22,044	20,039
Add back: share based payments	3,474	-
	25,518	20,039

	Adjusted Earnings RMB'000	Weighted average number of shares '000	Earnings per share
<b>2011</b>			
Basic adjusted	25,518	285,860	0.089
Diluted adjusted	25,518	292,125	0.087
<b>2010</b>			
Basic adjusted	20,039	269,324	0.074
Diluted adjusted	20,039	269,324	0.074

### 26. Operating lease commitments

As at each of the balance sheet date, the future aggregate minimum lease payments under non-cancellable operating leases contracted for but not recognised as liabilities, are as follows:

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
Within one year	21	598
After one year but before five years	-	619
	21	1,217

Operating lease payments represent rents payable by the Group for office premises and other operating facilities. Leases are negotiated for an average term of 1 to 3 years and rentals are fixed for an average 3 years.

## CHINA NEW ENERGY LIMITED

### Notes to the financial statements (continued)

#### 27. Significant related party transactions

a) Related parties are entities with common direct or indirect shareholders and/or directors. Parties are considered to be related if one party has the ability to control the other party in making financial and operating decisions.

Certain of the Group's transactions and arrangements are with related parties and the effect of these on the basis determined between the parties is reflected in these financial statements. The balances are unsecured, interest-free and repayable on demand unless otherwise stated.

During the financial year, in addition to those disclosed elsewhere in these financial statements, the following significant transactions took place at terms agreed between the parties:

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
Related parties		
- acquisition of Boluo Jiuneng company	-	6,099
- Deposit for investment	2,800	-
- Subcontracting fees	-	1,064
- Disposal of a motor vehicle	678	-
- Payment on behalf of a related party	-	(7,134)

During the financial year, the Group disposed of a motor vehicle for RMB 678,000 to Bengbu Boltech Bio-technology Co., Ltd.

During the financial year, the Group paid a deposit of RMB 2,800,000 to Guangdong Zhongke Tianyuan Regeneration Energy Co., Ltd for the acquisition of Bengbu Boltech Bio-technology Co., Ltd post year end, as disclosed in note 32.

Both Bengbu Boltech Bio-technology Co., Ltd and Guangdong Zhongke Tianyuan Regeneration Energy Co., Ltd are controlled by Mr Yu Weijun, Mr Tang Zhaoxing, Mr Weiming Qiu and Mr Xinchun Jiang, who also shareholders of CNE.

b) Key management personnel compensation is analysed as follows:

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
Remuneration	1,519	1,460
Other short term benefits	18	33
	1,537	1,493

**CHINA NEW ENERGY LIMITED****Notes to the financial statements (continued)****27. Significant related party transactions (continued)****c) Directors' emoluments**

Directors' remuneration for the year was:

	<b>Short term employment benefits RMB'000</b>	<b>Post employment benefits RMB'000</b>	<b>Total RMB'000</b>
<b>2011</b>			
Yu Weijun	630	-	630
Tang Zhaoxing	639	18	657
Chen Yong	62	-	62
Shiang Foo	62	-	62
Richard Bennett	125	-	125
Aggregate emoluments	1,518	18	1,536
<b>2010</b>			
Yu Weijun	600	-	600
Tang Zhaoxing	600	17	617
Jiang Xinchun	260	17	277
Aggregate emoluments	1,460	34	1,494

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **28. Financial risk management**

The Group's activities expose it to credit risk, liquidity risk and market risk (including interest rate risk, currency risk and commodity price risk). The Group's overall risk management strategy seeks to minimise adverse effects from the volatility of financial markets on the Group's financial performance.

The Board of Directors is responsible for setting the objectives and underlying principles of financial risk management for the Group. The Company management then establishes the detailed policies such as risk identification and measurement, exposure limits and hedging strategies, in accordance with the objectives and underlying principles approved by the Board of Directors.

There has been no change to the Group's exposure to these financial risks or the manner in which it manages and measures the risk. Market risk exposures are measured using sensitivity analysis indicated below.

##### **Credit risk**

Credit risk refers to the risk that counterparty will default on its contractual obligations resulting in a loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults. The Group performs on going credit evaluation of its counterparties' financial condition. The Group does not hold any collateral as security over its customers. The Group's major classes of financial assets are cash and bank balances, trade and other receivables and notes receivable.

As at the end of the financial year/period, the Group's maximum exposure to credit risk is represented by the carrying amount of each class of financial assets recognised in the statements of financial position.

As at 31 December 2010, and 2011, substantially all the cash and bank balances as detailed in Notes 11 to the financial statements, are held in major financial institutions which are regulated and located in the PRC, which management believes are of high credit quality. The management does not expect any losses arising from non-performance by these counterparties.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 28. Financial risk management (continued)

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date of the CNE Group is as follows:

	As at 31 December	
	2011 RMB'000	2010 RMB'000
Cash and cash equivalents	6,682	10,631
Trade and other receivables	53,896	45,675
Notes receivables	3,150	6,893
	<u>63,728</u>	<u>63,199</u>

At the balance sheet date, the Group's trade receivable was due from the related parties and third parties. There was significant concentration of credit risk in the Group's trade receivables as the Group's five biggest customers accounted for 60% and 60% the total receivables as at 31 December 2010 and 2011 respectively. Two customers' trade receivables are more than 10%.

Customer	as at 31 December 2011	
	Balance of Trade Receivable RMB'000	Percentage to Total
Songyuan Laihe Co.,Ltd	22,000	61%
Guangxi Mingyang Bio-chemical TechnologyCo., Ltd	<u>4,854</u>	13%
Total	26,854	74%

#### Credit risk

##### Trade receivables that are past due but not impaired

The Group's trade receivables that are past due but not impaired are as follows:

	As at 31 December	
	2011 RMB'000	2010 RMB'000
Less than 30 days	9,727	4,617
31-60 days	22	3,980
Over 60 days	<u>26,646</u>	<u>23,207</u>
	<u>36,395</u>	<u>31,804</u>



# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 28. Financial risk management (continued)

#### Currency risk

##### Trade receivables that are impaired

The Group's trade receivables that are impaired are as follows:

	<b>As at 31 December</b>	
	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
Less than 30 days	35,389	502
31-60 days	-	-
Over 60 days	25,438	41,056
	<b>60,827</b>	<b>41,558</b>

Currency risk arises from a change in foreign currency exchange rate, which is expected to have adverse effect on the Group in the current reporting year and in future years.

The Company and its subsidiary maintain their respective books and accounts in their functional currencies. As a result, the Group is subject to transaction and translation exposures resulting from currency exchange rate fluctuations. However, to minimise such foreign currency exposures, the Group uses natural hedges between sales receipts and purchases, and operating expenses disbursement. It is, and has been throughout the current and previous financial year the Group's policy that no derivatives shall be undertaken except for the use as hedging instruments where appropriate and cost-efficient. The Group does not apply hedge accounting.

The Group incurs foreign currency risk on sales, purchases and operating expenses that are denominated in currencies other than the respective functional currencies of Group entities, primarily the United States dollar ("US\$").

The Group's currency exposure based on the information provided by key management is as follows:

	<b>RMB '000</b>	<b>£ '000</b>	<b>US\$ '000</b>	<b>EUR'000</b>	<b>HK\$ '000</b>	<b>Total</b>
<b>At 31 December 2011</b>						
<b>Financial assets</b>						
Financial asset at fair value through profit and loss	-	-	-	-	7,181	7,181
Trade and other receivables	51,378	2,518	-	-	-	53,896
Notes receivables	3,150	-	-	-	-	3,150
Cash and bank balances	6,517	110	40	15	-	6,682
<b>Financial liabilities</b>						
Trade and other payables	91,960	392	-	-	-	92,352
Notes payables	4,725	-	-	-	-	4,725
<b>Net financial assets</b>	<b>(35,640)</b>	<b>2,236</b>	<b>40</b>	<b>15</b>	<b>7,181</b>	<b>(26,168)</b>
Less: Net financial assets denominated in the functional currency	<b>(35,640)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(35,640)</b>
<b>Net currency exposure</b>	<b>-</b>	<b>2,236</b>	<b>40</b>	<b>15</b>	<b>7,181</b>	<b>9,472</b>

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 28. Financial risk management (continued)

#### Currency risk

	RMB '000	£ '000	US\$ '000	EUR'000	HK\$ '000	Total
<u>At 31 December 2010</u>						
<b>Financial assets</b>						
Trade and other receivables	44,271	1,404	-	-	-	45,675
Notes receivables	6,893		-	-	-	6,893
Cash and bank balances	9,798	762	28	19	-	10,607
<b>Financial liabilities</b>						
Trade and other payables	68,294	4,665	-	-	-	72,959
Notes payables	8,166		-	-	-	8,166
<b>Net financial assets</b>	(15,498)	(2,499)	28	19	-	(17,950)
Less: Net financial assets denominated in the functional currency	(15,498)	-	-	-	-	(15,498)
<b>Net currency exposure</b>	-	(2,499)	28	19	-	(2,452)

#### Sensitivity analysis

If the £ sterling and US\$ vary against the RMB by 10% with all other variables including tax rate being held constant, the effect on the net profit will be as follows:

	<u>Years ended 31 December</u>	
	2011	2010
	RMB'000	RMB'000
<b>£ against RMB</b>		
- strengthen	11	76
- weaken	(11)	(76)
<b>US\$ against RMB</b>		
- strengthen	4	3
- weaken	(4)	(3)
<b>EUR against RMB</b>		
- strengthen	1	2
- weaken	(1)	(2)
<b>HK\$ against RMB</b>		
- strengthen	-	-
- weaken	-	-

## CHINA NEW ENERGY LIMITED

### Notes to the financial statements (continued)

#### 28. Financial risk management (continued)

##### Currency risk (continued)

##### Interest rate risk

The Group has no significant interest-bearing liabilities and assets.

The Group monitors the interest rates on its interest bearing assets closely to ensure favourable rates are secured.

##### Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting financial obligations due to shortage of funds. The Company's exposure to liquidity risk arises primarily from mismatches of the maturities of financial assets and liabilities. The Company's objective is to maintain a balance between continuity of funding and flexibility through financial support of related companies and secures committed funding facilities from financial institution.

The table below summarises the maturity profile of the Company's financial liabilities at the reporting date based on contractual undiscounted payments:

	Less than one year RMB'000	Later than one year RMB'000	Total RMB'000
<u>31 December 2011</u>			
Trade and other payables	92,352	-	92,352
Notes payables	4,725	-	4,725
Convertible bonds	37,758	-	37,758
	<u>134,835</u>	<u>-</u>	<u>134,835</u>
<u>31 December 2010</u>			
Trade and other payables	72,959	39,849	112,808
Notes payables	8,166	-	8,166
Convertible bonds	9,941	-	9,941
	<u>91,066</u>	<u>39,849</u>	<u>130,915</u>

##### Commodity price risk

The Group has commodity price risk as steel are one of the main components of raw materials. Metals are traded commodities and their prices are subject to the fluctuations of the world commodity markets. Any significant increases in the prices for metals will have a material adverse impact on the financial position and results of operation. The Group's profitability will be adversely affected if the Group is unable to pass on any increase in raw material prices to its customers on a timely basis or find cheaper alternative sources of supply.

The Group monitors the material price fluctuation closely and constantly studies other ways to reduce material wastage in order to reduce the impact of material price risk.

##### Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

## CHINA NEW ENERGY LIMITED

### Notes to the financial statements (continued)

#### 28. Financial risk management (continued)

##### Capital risk management(continued)

The capital structure of the Group consists of equity attributable to equity holders of the parent, comprising share capital, share premium, statutory reserve, foreign currency translation reserve, and accumulated profits/(losses) as disclosed in the statements of financial position.

The Group manages its capital structure by making necessary adjustments to it in response to the changes in economic conditions.

The Group's strategy was to maintain gearing ratio between 85% to 100%. Gearing ratio is calculated as net debt divided by total of capital. Net debt is calculated as total debt (as shown in the statements of financial position) less cash and bank balances. Total capital is calculated as total equity plus net debt.

The gearing ratios as at 31 December 2010 and 2011 were as follows:

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
Total debt	157,810	156,776
Less: Cash and bank balances	(6,682)	(10,631)
Net debt	151,128	146,145
Total equity	48,948	19,273
Total capital	200,076	165,418
Gearing ratio	76%	100%

A subsidiary of the Group is required by the relevant PRC regulations to contribute to and maintain a non-distributable statutory reserve fund whose utilisation is subject to approval by the relevant PRC authorities.

The Group manages capital by regularly monitoring its current and expected liquidity requirements. The Group is not subject to either internally or externally imposed capital requirements except for conversion of RMB into foreign currencies is subject to the rules and regulations of the foreign exchange control promulgated by the PRC government.

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 29. Fair value of financial instruments

The carrying amount of the financial assets and financial liabilities in the consolidated financial statements approximate their fair values due to the relative short term maturity of these financial instruments. The fair values of other classes of financial assets and liabilities are disclosed in the respective notes to the consolidated financial statements.

The fair values of financial assets and financial liabilities are determined as follows:

- (i) the fair value of financial assets and financial liabilities with standard terms and conditions and trade on active liquid markets are determined with reference to quoted market prices;
- (ii) the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow; and
- (iii) the fair value of derivative instruments are calculated using quoted prices. Where such prices are not available, discounted cash flow analysis is used, based on the applicable yield curve of the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

The Group have received equity instruments as consideration in return for the provision of services. These investments are classified as held for trading and measured at fair value through profit or loss as the directors consider that these investments have been incurred principally for the purpose of selling in the near term.

The fair value of the listed equity securities are based upon their current bid prices in active markets. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. These instruments are included at level 1 in the fair value hierarchy and comprise of listed equity instruments classified as held for trading. The fair value of the other and non current investments are included at level 2 in the fair value hierarchy and represent the latest active market transaction in the shares of these entities.

<b>GROUP</b>	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
<b>Trading Investments carried at fair value through profit or loss</b>		
As at 1 January	-	-
Additions in the year	6,650	-
Disposals in the year	-	-
Fair value movement during the year	531	-
<b>As at 31 December</b>	<b>7,181</b>	<b>-</b>

	<b>2011</b>	<b>2010</b>
	<b>RMB'000</b>	<b>RMB'000</b>
<b>Listed equity securities</b>		
Bio-Dynamic Group Limited	7,181	-
	<b>7,181</b>	<b>-</b>

# CHINA NEW ENERGY LIMITED

## Notes to the financial statements (continued)

### 30. Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments. The CNE Group's revenue breakdown by geographical location is determined based on our customers' country of incorporation.

The CNE Group's revenue breakdown by geographical location is determined based on its customers' country of incorporation. The CNE Group's cost of sales and operating expenses are aggregated on a cumulative basis and are not attributable to specific geographical regions. Therefore, a breakdown of gross profit for the financial years by geographical regions is not shown.

	Year ended 31 December	
	2011 RMB'000	2010 RMB'000
PRC	104,027	103,081
Taiwan	-	32,996
Romania	318	2,282
America	648	-
Thailand	74,005	-
	<u>178,998</u>	<u>138,359</u>

#### Business segment

The CNE Group's assets, liabilities and capital expenditure are almost entirely attributable to a single business segment of provision of technology and engineering services to ethanol, ethanol downstream product and biobutanol producers. Therefore, the CNE Group does not have separately reportable business segments under IFRS 8 *Segmental Reporting*. Nonetheless the CNE Group's revenue and results can be classified into the following streams:

- EPC of plants producing ethanol and ethanol downstream products ("EPC activities"); and
- Value-added and other value added services ("VAS") services.

	EPC activities RMB'000	VAS RMB'000	Total RMB'000
<b>Revenue</b>			
Year ended 31 December 2011	143,306	35,692	178,998
Year ended 31 December 2010	110,435	27,923	138,358
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Results</b>			
Year ended 31 December 2011	32,882	7,846	40,728
Year ended 31 December 2010	35,429	4,856	40,285
	<u>          </u>	<u>          </u>	<u>          </u>

## **CHINA NEW ENERGY LIMITED**

### **Notes to the financial statements (continued)**

#### **31. Events after the balance sheet date**

On 1 January 2012, the group signed a Letter of Intent with Guangzhou Zhongke Tianyuan Regeneration Resources Engineering Co. Ltd ("GZTY Regeneration Resources") to acquire 96.5% of the legal and beneficial interests of Bengbu Boltech Bio-technology Co., Ltd ("Boltech"). Boltech produces and sells active yeast, which is specifically formulated for use in the process of ethanol production, as well as yeast extracts. The aggregate purchase consideration for the Proposed Transaction shall be on an arm's length basis and on normal commercial terms.