

CUMMINS INC
Form 10-K/A
March 10, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2005

Commission File Number 1-4949

CUMMINS INC.

Indiana
(State of Incorporation)

35-0257090
(IRS Employer Identification No.)

**500 Jackson Street
Box 3005
Columbus, Indiana 47202-3005**

(Address of principal executive offices)

Telephone (812) 377-5000

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Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|--------------------------------|---|
| Common Stock, \$2.50 par value | New York Stock Exchange Pacific Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: **None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting stock held by non-affiliates was approximately \$3.4 billion at June 26, 2005.

As of February 5, 2006, there were 46,455,939 shares outstanding of \$2.50 par value common stock.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement filed with the Securities and Exchange Commission pursuant to Regulation 14A are incorporated by reference in Part III of this Form 10-K.

Explanatory Note

We are filing this amendment to include the financial statements of Dongfeng Cummins Engine Company Limited, a 50% owned unconsolidated subsidiary, which are required to be filed under Regulation S-X by March 31, 2006. The financial statements were excluded from the annual report to shareholders by Rule 14a-3(b).

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as part of this report:

(1) Financial Statements

Management's Report to Shareholders*

Report of Independent Registered Public Accounting Firm*

*Consolidated Statements of Earnings**

*Consolidated Balance Sheets**

*Consolidated Statements of Cash Flows**

*Consolidated Statements of Shareholders' Equity**

*Notes to Consolidated Financial Statements**

*Selected Quarterly Financial Data**

(2) Financial Statement Schedules

Financial Statements of Dongfeng Cummins Engine Company Limited (financial statements required by Regulation S-X to be filed by March 31, 2006, which are excluded from the annual report to shareholders by Rule 14a-3(b))

Report of Independent Auditors

Statements of Operations

Balance Sheets

Statements of Cash Flows

Statements of Shareholders' Equity

Notes to the Financial Statements

* Previously filed

(b) Exhibits

Exhibit 23.1. Consent of Independent Auditor (filed herewith).

Exhibit 31(a). Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

Exhibit 31(b). Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

Exhibit 32. Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

(c) The financial statements required by Regulation S-X which are excluded from the annual report to shareholders by Rule 14a-3(b), including (1) separate financial statements of subsidiaries not consolidated and fifty percent or less owned persons, (2) separate financial statements of affiliates whose securities are pledged as collateral, and (3) schedules, are filed under Item 15(a) of this Report which are incorporated herein by reference.

FINANCIAL STATEMENT SCHEDULES

Financial Statements of Dongfeng Cummins Engine Company Limited

(Financial statements required by Regulation S-X which are excluded from the annual report to shareholders by Rule 14a-3(b))

DONGFENG CUMMINS ENGINE COMPANY LIMITED

FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005 AND 2004 AND FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

19th Floor, Metropolitan Tower
68 Zou Rong Lu, Yuzhong Qu
Chongqing 400010
People's Republic of China
Telephone +86 (23) 6374 0008
Facsimile +86 (23) 6374 0990

Report of Independent Auditors

To the Board of Directors and Shareholders of Dongfeng Cummins Engine Company Limited:

We have audited the accompanying balance sheets of Dongfeng Cummins Engine Company Limited (the Company) as of December 31, 2005 and 2004, and the related statements of operations, of cash flows and of shareholders' equity for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dongfeng Cummins Engine Company Limited at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers Zhong Tian Certified Public Accountants Ltd. Co.

Chongqing, People's Republic of China

February 27, 2006

DONGFENG CUMMINS ENGINE COMPANY LIMITED

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

IN RENMINBI

| | 2005 | 2004 | 2003 |
|---|-----------------|-----------------|-----------------|
| Net sales (includes related party sales of RMB2,384,594,571, RMB4,025,032,342 and RMB2,439,944,635, respectively) (note 3) | 3,595,464,317 | 4,779,263,602 | 2,616,270,513 |
| Cost of sales (includes related party purchases of RMB1,478,628,634, RMB1,806,481,983 and RMB899,050,757, respectively) (note 3) | (2,824,161,646) | (3,793,143,024) | (2,065,177,230) |
| Gross profit | 771,302,671 | 986,120,578 | 551,093,283 |
| Operating expenses: | | | |
| Selling expenses (note 3) | (93,640,218) | (87,299,525) | (48,861,867) |
| General and administrative expenses (note 3) | (134,395,882) | (82,966,313) | (63,586,931) |
| Operating profit: | 543,266,571 | 815,854,740 | 438,644,485 |
| Interest income | 3,200,750 | 3,140,044 | 1,109,217 |
| Interest expense | (12,511,383) | | (183,972) |
| Equity on loss from investees | (918,563) | | |
| Other income (expenses), net | 14,178,444 | (4,186,118) | 1,215,470 |
| Income before income tax | 547,215,819 | 814,808,666 | 440,785,200 |
| Income tax (expense) benefit (note 15) | (45,279,090) | (69,161,083) | 6,138,983 |
| Net income | 501,936,729 | 745,647,583 | 446,924,183 |

The accompanying notes are an integral part of these financial statements.

DONGFENG CUMMINS ENGINE COMPANY LIMITED**BALANCE SHEETS****AT DECEMBER 31, 2005 AND 2004****IN RENMINBI**

| | 2005 | 2004 |
|---|----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents (note 2) | 252,993,694 | 213,226,420 |
| Trade receivable, net (note 2) | 56,706,230 | 52,863,007 |
| Amounts due from related parties (note 3) | 214,743,064 | 792,865,311 |
| Notes receivable (note 4) | 85,473,026 | 369,157,994 |
| Inventories (note 5) | 731,323,941 | 635,474,360 |
| Prepayment | 4,329,132 | 8,286,854 |
| Restricted bank deposit (note 2) | 16,419,369 | 455,814 |
| Prepaid income tax | 26,736,437 | |
| Deferred income tax (note 15) | 9,457,922 | 16,605,385 |
| Other current assets (note 6) | 14,810,071 | 1,940,759 |
| Total current assets | 1,412,992,886 | 2,090,875,904 |
| Non-current assets: | | |
| Property, plant and equipment, net (note 7) | 976,711,873 | 662,965,154 |
| Intangible assets (note 8) | 16,980,927 | 24,409,929 |
| Investment in equity investees (Note 9) | 40,685,306 | |
| Deferred income tax (note 15) | 12,037,080 | 23,673,826 |
| Total non-current assets | 1,046,415,186 | 711,048,909 |
| Total assets | 2,459,408,072 | 2,801,924,813 |

The accompanying notes are an integral part of these financial statements.

| | 2005 | 2004 |
|--|----------------------|----------------------|
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Accounts payable | 344,128,226 | 699,414,414 |
| Notes payable (note 3,10) | 205,000,000 | |
| Accrued product coverage (note 2) | 61,927,871 | 74,734,593 |
| Amounts due to related parties (note 3) | 301,789,073 | 373,176,056 |
| Other accrued expenses | 38,388,895 | 38,910,003 |
| Reserve for staff retrenchment (note 16) | 685,477 | 935,693 |
| Short-term loans (note 11) | 483,861,000 | |
| Other current liabilities (note 12) | 71,161,154 | 64,506,794 |
| Total current liabilities | 1,506,941,696 | 1,251,677,553 |
| Long-term liabilities: | | |
| Reserve for staff retrenchment (note 16) | 720,884 | 3,575,227 |
| Deferred income (note 14) | 6,880,729 | |
| Other long-term liabilities (note 13) | 1,901,616 | 2,901,616 |
| Total long-term liabilities | 9,503,229 | 6,476,843 |
| Total liabilities | 1,516,444,925 | 1,258,154,396 |
| Equity: | | |
| Paid-in capital (note 18) | 751,483,660 | 751,483,660 |
| Capital surplus (note 19) | 3,294,019 | 3,132,199 |
| Surplus reserves (note 20) | 73,277,455 | 26,345,295 |
| Retained earnings | 114,908,013 | 762,809,263 |
| Total equity | 942,963,147 | 1,543,770,417 |
| Total liabilities and equity | 2,459,408,072 | 2,801,924,813 |

The accompanying notes are an integral part of these financial statements.

DONGFENG CUMMINS ENGINE COMPANY LIMITED

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

IN RENMINBI

| | 2005 | 2004 | 2003 |
|---|----------------------|----------------------|---------------------|
| Cash flows from operating activities: | | | |
| Net income | 501,936,729 | 745,647,583 | 446,924,183 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 75,722,250 | 72,836,833 | 68,901,168 |
| Provision for obsolete inventories and doubtful accounts | (7,789,221) | 30,552,290 | 4,372,829 |
| Loss on disposal of property, plant and equipment | 2,335,272 | 808,032 | 2,338,388 |
| Equity on loss of investees | 918,563 | | |
| Changes in operating assets and liabilities: | | | |
| Inventories | (88,101,737) | (311,577,351) | (231,985,821) |
| Receivables and other current assets | 626,750,295 | (535,981,761) | (593,459,496) |
| Accounts payable and other current liabilities | (519,101,178) | 533,682,298 | 404,868,479 |
| Others | 3,920,049 | 97,083,089 | 27,543,149 |
| Net cash provided by operating activities | 596,591,022 | 633,051,013 | 129,502,879 |
| Cash flows from investing activities: | | | |
| Proceeds from sale of property, plant and equipment | 1,054,307 | 2,077,908 | 1,060,805 |
| Capital expenditures | (292,148,715) | (104,925,724) | (59,418,105) |
| Investment in equity investees | (36,648,810) | | |
| Change in restricted bank deposit | (15,963,555) | 1,689,909 | (2,145,723) |
| Net cash used in investing activities | (343,706,773) | (101,157,907) | (60,503,023) |
| Cash flows from financing activities: | | | |
| Proceeds from short-term loans | 483,861,000 | | |
| Repayment of bank loans | | | (10,000,000) |
| Distribution of profits | (696,977,975) | (413,341,032) | (48,451,605) |
| Net cash used in financing activities | (213,116,975) | (413,341,032) | (58,451,605) |
| Net change in cash and cash equivalents | 39,767,274 | 118,552,074 | 10,548,251 |
| Cash and cash equivalents at beginning of year | 213,226,420 | 94,674,346 | 84,126,095 |
| Cash and cash equivalents at end of year | 252,993,694 | 213,226,420 | 94,674,346 |

The accompanying notes are an integral part of these financial statements.

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| | 2005 | 2004 | 2003 |
|--|-------------|------------|---------|
| Cash payment for interest during the year | 12,511,383 | | 183,972 |
| Cash payment for income tax during the year | 77,709,378 | 43,969,703 | |
| Significant non-cash transactions: | | | |
| Investment in an investee by injection of fixed assets | 4,963,356 | | |
| Dividends paid with notes receivable (Note 20) | 200,927,844 | | |
| Dividends paid with notes payable (Note 20) | 205,000,000 | | |

The accompanying notes are an integral part of these financial statements.

DONGFENG CUMMINS ENGINE COMPANY LIMITED

STATEMENTS OF SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

IN RENMINBI

| | Pain-in Capital RMB | Capital Surplus RMB | Surplus Reserves RMB | Retained Earnings RMB | Total RMB |
|---|---------------------------|---------------------------|----------------------------|-----------------------------|-----------------|
| Balance at January 1, 2003 | 414,198,250 | 3,040,934 | | 58,375,429 | 475,614,613 |
| Capital injection during the year | 337,285,410 | | | | 337,285,410 |
| Non-cash assets donation received from owner | | 91,265 | | | 91,265 |
| Net profit for the year | | | | 446,924,183 | 446,924,183 |
| Appropriation to surplus reserves | | | 8,756,315 | (8,756,315) | |
| Profit distribution to owners | | | | (48,451,605) | (48,451,605) |
| Balance at December 31, 2003 | 751,483,660 | 3,132,199 | 8,756,315 | 448,091,692 | 1,211,463,866 |
| Net profit for the year | | | | 745,647,583 | 745,647,583 |
| Appropriation to surplus reserves | | | 17,588,980 | (17,588,980) | |
| Profit distribution to owners | | | | (413,341,032) | (413,341,032) |
| Balance at December 31, 2004 | 751,483,660 | 3,132,199 | 26,345,295 | 762,809,263 | 1,543,770,417 |
| Non-cash assets donation received from owner | | 161,820 | | | 161,820 |
| Net profit for the year | | | | 501,936,729 | 501,936,729 |
| Appropriation to surplus reserves | | | 46,932,160 | (46,932,160) | |
| Profit distribution to owners | | | | (1,102,905,819) | (1,102,905,819) |
| Balance at December 31, 2005 | 751,483,660 | 3,294,019 | 73,277,455 | 114,908,013 | 942,963,147 |

The accompanying notes are an integral part of these financial statements.

DONGFENG CUMMINS ENGINE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1. Organization and principal activities

Dongfeng Cummins Engine Company Limited (the Company) is a sino-foreign equity joint venture amongst Cummins Engine Company, Inc. (Cummins USA), Cummins (China) Investment Co., Ltd. (CCI) and Dongfeng Automobile Co., Ltd. (Dongfeng Auto) established under the relevant laws and regulations of the People's Republic of China (the PRC).

The Company, established on May 14, 1996, is engaged in the manufacture and sale of diesel engines, related parts and the provision of after-sale services.

On February 22, 2003, Cummins USA, CCI and Dongfeng Auto reached an agreement (the Agreement) to increase the Company's paid-in capital. According to the Agreement, Dongfeng Auto increased its interest in the Company by contributing certain fixed assets and construction in progress of its Diesel Engine Branch, while Cummins USA increased its interest in the Company by contributing cash and certain fixed assets and construction in progress of its subsidiary, Cummins (Xiangfan) Machining Co., Ltd. Subsequent to the capital increase, Cummins USA, CCI and Dongfeng Auto each holds 40%, 10% and 50%, respectively, of the paid-in capital of the Company.

The Company has a term of 35 years from the date of establishment and may be extended subject to the unanimous approval of the Board of Directors and the approval of the relevant PRC authorities.

2. Summary of significant accounting policies

Basis of presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

Use of estimates

The accompanying notes are an integral part of these financial statements.

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The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition

The Company recognizes revenues on the sale of products, net of estimated costs of returns, allowances and sales incentives, when it is realized or realizable, which generally occurs when persuasive evidence of an arrangement exists, the product has been shipped and legal title and all risks of ownership have been transferred, customer acceptance has occurred and payment is reasonably assured.

Foreign currency translation

The Company's financial records are maintained in Renminbi (RMB), the functional currency. Transactions in foreign currencies are translated into Renminbi at the exchange rates prevailing at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into Renminbi at the exchange rates at the balance sheet date. Exchange differences arising in these cases are recorded in the Statement of Operations.

Income tax accounting

The Company determines the deferred tax provision using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax effects of temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The Company also recognizes future tax benefits associated with tax loss and credit carry forwards as deferred tax assets. Deferred tax assets are reduced by a valuation allowance to the extent there is uncertainty as to their ultimate realization. The Company measures deferred tax assets and liabilities using enacted tax rates in effect for the year in which the temporary differences are expected to be settled or recovered.

Cash and cash equivalents

Cash equivalents are defined as short-term, highly liquid investments with an original maturity of 90 days or less at the time of purchase. The carrying amounts reflected in the balance sheet for cash and cash equivalents approximate fair value due to the short-term maturity of these investments.

Inventories

Inventories are stated at the lower of cost or market value. Inventory cost calculated on the weighted average basis comprises materials, direct labor and the manufacturing overhead expenditures. Inventory reserves include provisions for obsolete and excess inventory based on management's forecasts of demand over specific future time horizons and reserves to value our inventory at the lower of cost or market which rely on forecasts of average selling prices (ASPs) in future periods.

Restricted bank deposit

The restricted bank deposit represents the pledge for letter of credit. Reclassification has been made to prior year balance of Rmb 455,814 from cash and cash equivalents to restricted bank deposit in order to conform to the current year presentation.

Investments in joint ventures

The equity method is used to account for the Company's investments in joint ventures in which the Company has the ability to exercise significant influence, generally represented by common stock ownership or partnership equity of at least 20 percent but not more than 50 percent. Generally, under the equity method, original investments in these entities are recorded at cost and subsequently adjusted by the Company's share of equity in earnings or losses after the date of acquisition.

Investment amounts in excess of the Company's share of an investee's assets are amortized over the life of the related asset creating the excess. If the excess is goodwill, then it is not amortized. Equity in earnings or losses of each investee is recorded according to the Company's level of ownership; if losses accumulate, the Company records its share of losses until the investment has been fully depleted. When the investment has been fully depleted, the Company recognizes additional losses only when the Company is the primary funding source.

The Company eliminates (to the extent of its ownership percentage) the profit in inventory held by its equity method investees that has not yet been sold to a third party. The Company's investments are classified as Investments in and advances to equity investees in the Balance Sheets. The Company's shares of the result from joint ventures are reported in the Statements of Operations as Equity on income (loss) from investees.

Property, plant and equipment, net

Property, plant and equipment are recorded at costs. Property, plant and equipment are depreciated over their estimated useful lives on a straight-line basis, taking into account their residual value which is estimated at 10% of cost. The applicable useful lives of property, plant and equipment are as follows:

| | Years |
|----------------------|-------|
| Buildings | 20 |
| Production machinery | 10 |
| Vehicles | 5 |
| Office equipment | 5 |

Major additions and betterments are capitalized and depreciated over their estimated useful lives and repairs and maintenance expenses are charged to the Statement of Operations in the period incurred.

Upon retirement or other disposal of fixed assets, the costs and related amounts of accumulated depreciation are reversed from the asset and accumulated depreciation accounts, respectively. The difference, if any, between the net asset value and the proceeds is adjusted to earnings.

Construction in progress represents capital assets under construction or being installed and is stated at cost. Cost comprises original cost of plant and equipment, installation, construction and other direct costs which include interest costs on specific borrowings used to finance the capital assets, prior to the date of reaching the expected usable condition. Construction in progress is transferred to the property, plant and equipment account and depreciation commences when the asset has been substantially completed and reaches the expected usable condition.

No interest cost was capitalized in 2005 (2004: nil).

Impairment of long-lived assets

The Company reviews long-lived assets for possible impairment whenever events or changes in circumstances indicate, in management's judgment, that the carrying value of such assets may not be recoverable. The Company assesses the recoverability of the carrying value of the long-lived assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. An impairment of a long-lived asset or asset group exists when the expected future pre-tax cash flows (undiscounted and without interest charges) estimated to be generated by the asset or asset group is less than its carrying value. If these cash flows are less than the carrying value of such asset or asset group, an impairment loss is measured based on the difference between the estimated fair value and carrying value of the asset or asset group. Assumptions and estimates used to estimate cash flows in the evaluation of impairment and the fair values used to determine the impairment are subject to a degree of judgment and complexity. Any changes to the assumptions and estimates resulting from changes in actual results or market conditions from those anticipated may affect the carrying value of long-lived assets and could result in an impairment charge.

Intangible assets

Intangible assets with finite useful lives are subject to amortization. Intangible assets are presented at cost and are amortized on the straight-line basis over their estimated useful lives. The applicable useful lives are as follows:

| | Years |
|------------------------|-------|
| Land occupancy rights | 35 |
| Proprietary technology | 7 |
| Software | 5 |

Operating leases

Payments made under operating leases are expensed on a straight-line basis over the lease periods of the leases.

Product coverage

The Company charges the estimated costs of product coverage programs, other than product recalls, to earnings at the time products are shipped to customers. The Company uses historical experience of product coverage programs to estimate the remaining liability for various product coverage programs. As a result of the uncertainty surrounding the nature of product recall programs, the liability for such programs is recorded when the recall action is announced. The liability for these programs is reviewed and assessed on a quarterly basis.

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Below is the summary of the activities of the product coverage liability account for the years ended December 31, 2005, 2004 and 2003:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|---------------------------------|--------------|--------------|--------------|
| Beginning balance | 74,734,593 | 20,812,031 | 1,332,790 |
| Provision for warranties issued | 56,037,554 | 104,788,040 | 38,443,586 |
| Payments | (68,844,276) | (50,865,478) | (18,964,345) |
| Ending balance | 61,927,871 | 74,734,593 | 20,812,031 |

Allowance for doubtful accounts

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the existing accounts receivable. The Company determines the allowance based on historical collection experience and by performing an analysis of the accounts receivable in light of the current economic environment. The Company reviews allowance for doubtful accounts on a regular basis. In addition, when necessary, the Company provides an allowance for the full amount of specific accounts deemed to be uncollectible. Account balances are charged off against the allowance in the period in which the Company determines that it is probable the receivable will not be recovered. The activities in the allowance for doubtful accounts for the years ended December 31, 2005, 2004 and 2003 were as follows:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|-------------------|-------------|-------------|-------------|
| Beginning balance | 283,330 | 569,283 | 77,166 |
| Provision | | 73,447 | 943,302 |
| Write-offs | (84,175) | | (451,185) |
| Recovery | (41,377) | (359,400) | |
| Ending balance | 157,778 | 283,330 | 569,283 |

Research and development

Research and development costs are charged to operations as incurred. For the year ended December 31, 2005, the Company incurred research and development costs amounting to RMB34,963,569 (2004: RMB7,770,672; 2003:RMB4,274,654).

Shipping and handling

The accompanying notes are an integral part of these financial statements.

Shipping and handling costs are included in selling expenses. For the year ended December 31, 2005, the Company incurred shipping and handling costs amounting to RMB18,266,443 (2004: RMB13,873,150; 2003: RMB7,537,492).

3. Related party transactions

The Company purchases products and components from related parties, and sells products and components to related parties. Related party transfer prices may differ from normal selling prices. In accordance with the provision of various agreements, certain products transferred are priced at cost, some are priced on a cost-plus basis, and others are priced at market value.

The following table lists the major related parties and their relationship with the Company:

| Name of related parties | Relationship with the Company |
|--|--|
| Cummins USA | Owner |
| CCI | Owner |
| Dongfeng Auto | Owner |
| Dongfeng Motor Co., Ltd. (Dongfeng Motor) | Parent company of Dongfeng Auto |
| Dongfeng Motor Corporation (Dongfeng Corporation) | A company has indirect beneficial interest in Dongfeng Motor |
| Darlington Engine Co., Ltd. (Darlington UK) | Subsidiary of Cummins USA |
| Cummins Engine (Shanghai) Trade & Service Co., Ltd. (Cummins Shanghai) | Subsidiary of CCI |
| Cummins (Xiangfan) Machining Co., Ltd. (CXMC) | Subsidiary of Cummins USA |
| Cummins India Co., Ltd (Cummins India) | Subsidiary of Cummins USA |
| Cummins Brazil Co., Ltd (Cummins Brazil) | Subsidiary of Cummins USA |
| Marketing Department of Dongfeng Motor Inc. Commercial Vehicle Branch (Marketing Department of DFCV) | Subsidiary of by Dongfeng Motor |
| Wuxi Holset Engine Co., Ltd. (Wuxi Holset) | Subsidiary of Cummins USA |

The following table summarizes related party sales for the years ended December 31, 2005, 2004 and 2003:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|-------------------------------------|---------------|---------------|---------------|
| Dongfeng Motor and its subsidiaries | 2,374,998,258 | 3,945,142,313 | 2,326,766,421 |
| Cummins Shanghai | 3,580,514 | 36,060,515 | 11,278,938 |
| CCI | | 10,221,875 | 98,482,778 |
| Cummins USA | | 26,110,359 | |
| Others | 6,015,799 | 7,497,280 | 3,416,498 |
| | 2,384,594,571 | 4,025,032,342 | 2,439,944,635 |

Dongfeng Auto, a subsidiary of Dongfeng Motor, is a major customer of the Company for 6B engines. The selling price to Dongfeng Auto is determined and adjusted on a quarterly basis. The adjustment to the selling price is not applied retrospectively to previous quarter's sales. Selling price to Dongfeng Auto may differ from that to other customers.

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The following table summarizes related party purchases included in Cost of sales in the Statement of Operations for the years ended December 31, 2005, 2004 and 2003:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|-------------------------------------|---------------|---------------|-------------|
| Cummins USA | 653,613,217 | 642,015,692 | |
| Dongfeng Motor and its subsidiaries | 606,482,317 | 890,635,572 | 399,358,149 |
| Wuxi Holset | 111,228,474 | 180,254,869 | |
| Darlington UK | 100,050,014 | 84,193,653 | 494,166,790 |
| Others | 7,254,612 | 9,382,197 | 5,525,818 |
| | 1,478,628,634 | 1,806,481,983 | 899,050,757 |

The following table summarizes other related party transactions for the years ended December 31, 2005, 2004 and 2003:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|---------------------------------|-------------|-------------|-------------|
| Royalty fee | | | |
| - Cummins USA | 33,415,791 | 42,323,581 | 18,429,866 |
| Sales commission fee | | | |
| - CCI | 5,171,892 | 2,656,028 | 2,199,674 |
| Management fee | | | |
| - CCI | 12,285,484 | 9,933,775 | 8,071,192 |
| Warranty service charge | | | |
| - Marketing Department of DFCV | 61,453,586 | 66,689,182 | 117,560,056 |
| Research and development fee | | | |
| - Cummins USA | 8,475,547 | | |
| Land rental expense | | | |
| - Dongfeng Corporation | 3,405,916 | 3,405,916 | 3,405,916 |
| Rental income | | | |
| - CXMC | | | 237,000 |
| After-sales service network fee | | | |
| - CCI | | | 10,000,000 |
| - Dongfeng Auto | | | 10,000,000 |
| | | | 20,000,000 |

The following tables summarizes significant balances with related party:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|---------------------------------------|--------------------------|--------------------------|
| Amounts due from related parties | | |
| - Dongfeng Motor and its subsidiaries | 210,924,848 | 760,103,109 |
| - Cummins Brazil | 2,027,338 | |
| - Cummins India | 1,334,995 | |
| - Cummins USA | | 30,549,407 |
| - CCI | | 1,261,560 |
| - Others | 455,883 | 951,235 |
| | 214,743,064 | 792,865,311 |

| | December 31, 2005 RMB | December 31, 2004 RMB |
|---------------------------------------|--------------------------|--------------------------|
| Amounts due to related parties | | |
| - Cummins USA | 168,437,374 | 36,620,259 |
| - Dongfeng Motor and its subsidiaries | 80,978,863 | 163,881,211 |
| - Darlington UK | 13,458,931 | 165,942,288 |
| - Wuxi Holset | 15,782,013 | |
| - CCI | 16,019,266 | 6,732,298 |
| - Others | 7,112,626 | |
| | 301,789,073 | 373,176,056 |

| | December 31, 2005 RMB | December 31, 2004 RMB |
|-------------------------|--------------------------|--------------------------|
| Notes payable (Note 10) | | |
| - Dongfeng Auto | 205,000,000 | |

4. Notes receivable

All notes receivable are issued by banks and due within 1 - 6 months.

5. Inventories

Inventories are composed of the following:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|-----------------|--------------------------|--------------------------|
| Raw materials | 667,529,449 | 514,479,380 |
| Work in process | 31,652,898 | 52,512,518 |
| Finished goods | 48,595,685 | 103,231,417 |
| | 747,778,032 | 670,223,315 |
| Less: provision | (16,454,091) | (34,748,955) |
| | 731,323,941 | 635,474,360 |

6. Other current assets

| | December 31, 2005 RMB | December 31, 2004 RMB |
|-------------------|--------------------------|--------------------------|
| Other receivables | 9,497,571 | 1,940,759 |
| Deferred expense | 5,312,500 | |
| | 14,810,071 | 1,940,759 |

7. Property, plant and equipment, net

Property, plant and equipment comprised the following:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|--------------------------------|--------------------------|--------------------------|
| Buildings | 176,731,323 | 170,274,553 |
| Production machinery | 861,294,049 | 834,153,046 |
| Vehicles | 6,547,952 | 6,337,526 |
| Office equipment | 23,753,861 | 18,780,452 |
| Construction in progress | 361,094,775 | 69,586,910 |
| | 1,429,421,960 | 1,099,132,487 |
| Less: accumulated depreciation | (452,710,087) | (436,167,333) |

The accompanying notes are an integral part of these financial statements.

976,711,873

662,965,154

Depreciation expense for the year ended December 31, 2005 was RMB67,431,447 (2004: RMB65,787,651; 2003: RMB61,927,941).

8. Intangible assets

The gross and net balances of intangible assets were:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|--------------------------------|--------------------------|--------------------------|
| Land occupancy rights - gross | 9,774,040 | 9,774,040 |
| Less: accumulated amortization | (1,665,050) | (1,375,325) |
| Net | 8,108,990 | 8,398,715 |
| Proprietary technology - gross | 41,488,327 | 41,488,327 |
| Less: accumulated amortization | (38,989,068) | (32,990,749) |
| Net | 2,499,259 | 8,497,578 |
| Software - gross | 10,600,472 | 9,738,672 |
| Less: accumulated amortization | (4,227,794) | (2,225,036) |
| Net | 6,372,678 | 7,513,636 |
| Total | 16,980,927 | 24,409,929 |

For the year ended December 31, 2005, amortization expense for intangibles amounted to RMB8,290,803 (2004: RMB7,049,182; 2003: RMB6,973,227). The estimated amortization expense for the five succeeding years, assuming no further acquisitions or disposals, is approximately RMB4,835,683 in 2006, RMB1,641,215 in 2007, RMB1,546,256 in 2008, RMB1,492,590 in 2009, and RMB290,010 in 2009.

9. Investment in equity investees

| | December 31, 2004 RMB | Change in investment cost RMB | Equity on loss of investees RMB | December 31, 2005 RMB |
|--|-----------------------------|-------------------------------------|---------------------------------------|-----------------------------|
| Associates | | | | |
| - Fuda Dongkang Crank Co. Ltd. | | 4,955,059 | | 4,955,059 |
| - Cummins East Asia Research and Development Co. Ltd. | | 36,648,810 | (918,563) | 35,730,247 |
| | | 41,603,869 | (918,563) | 40,685,306 |

Details of the investees are as the following:

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| Name of investees | Location | Registered capital | Business scope | The Company's investment | Direct interest |
|---|-------------------|--------------------|--|--------------------------|-----------------|
| Fuda Dongkang Crank Co. Ltd. | Xiangfan, the PRC | RMB 20,000,000 | Develop, produce and sell crank and spare parts of automobiles (except engine) | RMB 5,000,000 | 25% |
| Cummins East Asia Research and Development Co. Ltd. | Wuhan, the PRC | US\$ 10,000,000 | Research and develop diesel and compressed natural gas engine | US\$ 4,500,000 | 45% |

10. Notes payable

All notes payable are issued by banks to Dongfeng Auto, owner of the Company, and due within 1-6 months.

11. Short-term loans

As of December 31, 2005, all short-term loans are unsecured and bear interest at the following rates:

| | Original currency | | RMB equivalent RMB | Annual interest rate |
|---|-------------------|------------|-----------------------|----------------------|
| China Construction Bank | RMB | 40,000,000 | 40,000,000 | 4.698% |
| Industrial and Commercial Bank of China | US\$ | 20,000,000 | 161,404,000 | LIBOR 3 month + 0.8% |
| Bank of China | US\$ | 35,000,000 | 282,457,000 | LIBOR 1 month + 1.1% |
| | | | 483,861,000 | |

Interest expense incurred in relation to short-term bank loans in 2005 are RMB7,415,593 (2004 and 2003:nil).

12. Other current liabilities

Other current liabilities are composed of the following:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|---------------------------------------|--------------------------|--------------------------|
| Welfare payable | 22,853,455 | 5,346,173 |
| Value added tax & other taxes payable | 19,860,170 | 28,768,404 |
| Advance from customers | 8,196,372 | 19,561,421 |
| Other payable | 20,251,157 | 10,830,796 |
| | 71,161,154 | 64,506,794 |

13. Other long-term liabilities

The accompanying notes are an integral part of these financial statements.

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Pursuant to the land use right transfer agreement dated December 24, 1996 (the Contract Date) reached by the Company and the Land Bureau of Xiangfan, Hubei Province, the Company is entitled to use a parcel of land of 65,800 square meters in the Xiangfan Automobile Industry Development Zone for a period of thirty-five years starting from the Contract Date.

As consideration, a land use fee amounting to RMB8,504,040 should be paid in three installments. The first 30% installment has been paid within ten days of the Contract Date and the second 30% installment has been paid before December 30, 2001. The third 40% installment should be paid before December 30, 2011. Up to December 31, 2005, the Company has paid RMB1,500,000 of the third installment. The remaining third installment balance is recorded as other long-term liabilities.

14. Deferred income

| | December 31, 2005 RMB | December 31, 2004 RMB |
|-----------------|--------------------------|--------------------------|
| Deferred income | 6,880,729 | |

In 2005, according to Xiang Guo Shui Han [2005] No. 23, the Company is entitled to a government grant of RMB7,266,564 arising from the purchase of equipment manufactured domestically. The government grant is accounted for as deferred income and amortized over the estimated useful life of the related equipment acquired. In 2005, RMB385,835 of the deferred income (2004: nil) was amortized and credited to cost of sales.

15. Taxation**(a) Income taxes**

The statutory income tax rate in the People's Republic of China (the PRC) is 33%. However, since the Company is located in a national high-tech development zone and is qualified as a high-tech enterprise, the applicable enterprise income tax rate is 15% and the local tax rate is 3%, resulting in an aggregate tax rate of 18%, and as approved by the PRC tax authorities, the Company is not subject to local income tax. In addition, in accordance with the PRC Law of Enterprise Income Tax for Enterprises with Foreign Investment and Foreign Enterprises, the Company is subject to a two-year exemption from enterprise income taxes followed by a three-year of a 50% tax reduction, commencing from the first cumulative profit-making year net of losses carried forward from the previous 5 years. Further, in accordance with relevant tax regulations, any new capital injection into the Company is subject to separate preferential income tax policy.

The Company increased its capital in 2003 (Note 1) and the newly injected capital in 2003 represented 50% of the total paid-in capital of the Company, (capital injected prior to 2003 is referred to as the First Injection, and capital injected post 2002 is referred to as the Second Injection). Pursuant to Xiang Guo Shui Zi Fa [2004] No.14 issued by the local tax authority, profit generated from the Second Injection is subject to a two-year exemption from enterprise income taxes followed by a three-year of a 50% enterprise income tax reduction commencing from the first cumulative profit-making year. Further, according to the relevant approval, the taxable profit of the Company arising from the First Injection and the Second Injection can be estimated based on the ratio of the capital injected during these two periods.

The first profit-making year of the First Injection and Second Injection was 2002 and 2003, respectively. In this connection, the Company is entitled to 50% reduction of enterprise income tax in 2005. As approved by the tax authorities, the

enterprise income tax rate for the Company in 2005 is 10%.

Tax adjustment items are applied to revenue less cost and expenses, as well as gains and losses to arrive at taxable income. For the year ended December 31, 2005, significant components of adjustments from total accounting profit to taxable income included provision for bad debt, inventory provision and provision for product warranty, which are not tax deductible in the current year.

Income tax expense (benefit) comprised:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|---|--------------|-------------|-------------|
| Income tax - current year | 51,732,990 | 75,714,327 | |
| Income tax - 2004 tax rate adjustment (note a) | (25,238,109) | | |
| Deferred taxation relating to the origination and reversal of temporary differences | 18,784,209 | (6,553,244) | (6,138,983) |
| | 45,279,090 | 69,161,083 | (6,138,983) |

Note:

(a) In 2004, the Company had reported and paid enterprise income tax for profit generated from the First Injection at an income tax rate of 15%. Since 2004 was the third cumulative profit-making year for the First Injection, as approved by the local tax authorities in September 2005, the enterprise income tax rate for this portion of profit in 2004 should be 10%. As such, the Company credited the over-paid enterprise income tax of RMB25,238,109 from the income tax expense in 2005.

(b) **Value added tax**

The Company's sales of self-manufactured products are subject to value added tax (VAT). The applicable tax rate for domestic sales is 17%.

Input VAT on purchases of raw materials, fuel, utilities, merchandise and transportation can be deducted from output VAT. VAT payable is the net difference between output and deductible input VAT.

(c) **Deferred tax**

Tax effect of temporary differences between the tax bases of assets or liabilities and their reported amounts in financial statements that give rise to net deferred tax assets were:

| December 31, 2005 RMB | December 31, 2004 RMB |
|--------------------------|--------------------------|
|--------------------------|--------------------------|

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| | | |
|---|------------|------------|
| Asset appreciation on contributed assets | 11,191,213 | 22,760,629 |
| Product coverage | 6,556,139 | 11,210,189 |
| Provision on receivables and inventories | 1,661,187 | 5,254,842 |
| Accrued research and development expenses | 847,555 | |
| Accrued bonus | 614,729 | |
| Accrued custom duty & freight fee | 458,972 | |
| Reserve on staff retrenchment | 165,207 | 1,039,861 |
| Assets received through donation | | 13,690 |
| Deferred tax assets | 21,495,002 | 40,279,211 |

The deferred income tax balances are classified in the balance sheets as follows:

| | December 31, 2005 RMB | December 31, 2004 RMB |
|-------------|--------------------------|--------------------------|
| Current | 9,457,922 | 16,605,385 |
| Non-current | 12,037,080 | 23,673,826 |
| | 21,495,002 | 40,279,211 |

No valuation allowance is recorded to reduce the gross deferred tax assets.

The income tax expense for the years ended December 31, 2005, 2004 and 2003 can be reconciled to the profit per the Statement of Operations as follows:

| | 2005 RMB | 2004 RMB | 2003 RMB |
|---|---------------|---------------|---------------|
| Income before income tax | 547,215,819 | 814,808,666 | 440,785,200 |
| Tax calculated at statutory rate of 33% | 180,581,220 | 268,886,860 | 145,459,116 |
| Tax effect of tax holiday and tax concession | (126,714,049) | (199,876,893) | (154,400,740) |
| Tax effect of change of 2004 applicable tax rate | (8,621,415) | | |
| Tax effect of (non-taxable income) / non-deductible expense net | (269,792) | 151,116 | 2,802,641 |
| Others | 303,126 | | |
| Total income tax expense | 45,279,090 | 69,161,083 | (6,138,983) |

16. Reserve for staff retrenchment

During 2003, the Company initiated and completed a plan to reduce the Company's work force. As a result, 46 employees were retired prior to their statutory retirement age in 2004. The Company recorded a reserve of RMB6,483,141 in 2003 of estimated employee related termination cost, which will be paid over the next 12 years. For the year ended December 31, 2005, the Company paid RMB1,310,798 (2004: RMB1,267,524; 2003: RMB704,697) to the early retired employees as retirement compensation.

| | 2005 RMB | 2004 RMB | 2003 RMB |
|-------------------|-------------|-------------|-------------|
| Beginning balance | 4,510,920 | 5,778,444 | |

The accompanying notes are an integral part of these financial statements.

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| | | | |
|-----------------------|-------------|-------------|-----------|
| Provision | | | 6,483,141 |
| Reversal | (1,793,761) | | |
| Payments | (1,310,798) | (1,267,524) | (704,697) |
| Ending balance | 1,406,361 | 4,510,920 | 5,778,444 |
| Less: Current portion | 685,477 | 935,693 | 1,064,119 |
| Non-current portion | 720,884 | 3,575,227 | 4,714,325 |

17. Fair value of financial instruments

The Company's financial instruments comprised of cash, trade receivables and payables, notes receivable and payable, and short-term bank loans. Due to the short-term nature of these instruments and the related interest rates, the carrying amounts approximate fair values.

18. Paid-in capital

| | December 31, 2005 RMB | December 31, 2004 RMB |
|---------------|--------------------------|--------------------------|
| Cummins USA | 252,063,985 | 252,063,985 |
| CCI | 82,819,550 | 82,819,550 |
| Dongfeng Auto | 416,600,125 | 416,600,125 |
| | 751,483,660 | 751,483,660 |

As of December 31, 2005, the Company has fully paid its registered capital in conformity with PRC law and regulations.

19. Capital surplus

Capital surplus mainly represents exchange difference relating to foreign currency capital contribution in accordance with the joint venture contract.

20. Surplus reserves and profit appropriations

In accordance with the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment and the Company's Articles of Association, appropriations from net profit should be made to the Reserve Fund, the Staff and Workers' Bonus and Welfare Fund and the Enterprise Expansion Fund, after offsetting accumulated losses from prior years, and before profit distributions to the investors. The percentages to be appropriated to these funds are determined by the Board of Directors of the Company.

The Staff and Workers' Bonus and Welfare Fund is available to fund payments of special bonuses to staff and for collective welfare benefits. Upon approval from the Board of Directors, the Reserve Fund can be used to offset accumulated losses or to increase capital. The Enterprise Expansion Fund can be used to expand production or to increase capital.

The accompanying notes are an integral part of these financial statements.

According to resolutions at the Board of Directors meetings dated April 18, 2005 and November 9, 2005, the Company appropriated 2% of its net income of RMB735,945,770 for the year ended December 31, 2004 and RMB437,358,294 from January 1 to September 30, 2005 (as reported under the accounts prepared in accordance with accounting standards generally accepted in the PRC) to the Reserve Fund, 2% to the Staff and Workers Bonus and Welfare Fund, and 2% to the Enterprise Expansion Fund.

In addition, dividends of RMB1,102,905,819 (2004: RMB413,341,032; 2003: RMB48,451,605) were declared to the investors in 2005 of which RMB 696,977,975 was settled by cash, RMB200,927,844 was settled by transferring certain of the Company's notes receivables to the investors, and RMB205,000,000 was settled by issuing notes payable to the investors.

The reserve fund and Enterprise Expansion Fund are recorded in the surplus reserves account. The activities in the surplus reserves account for the years ended December 31, 2005, 2004 and 2003 was as follows:

| | Reserve Fund RMB | Surplus reserves Enterprise Expansion Fund RMB | Total RMB |
|------------------------------|---------------------|---|--------------|
| Balances at January 1, 2003 | | | |
| Current year additions | 7,005,051 | 1,751,264 | 8,756,315 |
| Balance at December 31, 2003 | 7,005,051 | 1,751,264 | 8,756,315 |
| Current year additions | 8,794,490 | 8,794,490 | 17,588,980 |
| Balance at December 31, 2004 | 15,799,541 | 10,545,754 | 26,345,295 |
| Current year additions | 23,466,080 | 23,466,080 | 46,932,160 |
| Balance at December 31, 2005 | 39,265,621 | 34,011,834 | 73,277,455 |

According to generally accepted accounting principles in the United States of America, appropriation to Staff and Workers Bonus and Welfare Fund of RMB23,466,080 during the year ended December 31, 2005 (2004: RMB8,794,490; 2003: RMB1,167,509) were accounted for as expenses and the balance of the fund is recorded as welfare payable in other current liabilities.

21. Segment information

The Company is principally engaged in the sales of engine products under one reportable segment. During the year ended December 31, 2005, all of the sales of engine products were conducted in the PRC, except for sales of engine products of RMB29,337,570 (2004: RMB64,694,874; 2003: nil) that were made to overseas customers.

The Company's largest customers are Dongfeng Motor and its subsidiaries. For the year ended December 31, 2005, sales to Dongfeng Motor and its subsidiaries amounted to RMB2,374,998,258 (2004: RMB3,945,142,313; 2003: RMB 2,326,766,421), representing 66% (2004: 83%; 2003: 89%) of the Company's net sales. No other customer accounted for more than 10% of the Company's net sales in 2005, 2004 and 2003.

22. Retirement benefit arrangements

In accordance with statutory regulations in the PRC, the Company participates in a government sponsored pension plan which provides retirement benefits to the Company's employees through a defined contribution plan. Regulations issued by the local labor bureau require the Company to pay a monthly premium to the local labor bureau based on 36% (2004: 34%; 2003: 32%) of its current employees' total salaries, of which 30% (2004: 28%; 2003: 26%) are borne by the Company and the remaining 6% (2004 and 2003: 6%) are borne by the employees. The local labor bureau is responsible for meeting all retirement benefit obligations and the Company has no further commitments beyond the monthly premium.

For the year ended December 31, 2005, the Company incurred retirement expenses amounting to RMB14,913,260 (2004: RMB13,003,479; 2003: RMB13,726,177).

23. Leases

The Company leases land, office equipment and automobiles for varying periods under lease agreements. Most of the leases are non-cancellable and all leases are operating leases with fixed monthly rental payments, expiring over the next 3 to 35 years. For the year ended December 31, 2005, rental expenses under these leases amounted to RMB6,440,302 (2004: RMB5,612,302; 2003: RMB3,711,937).

Following is a summary of the future minimum lease payments at December 31, 2005 and 2004:

| | 2005 RMB | 2004 RMB |
|-------------------------------------|-------------|-------------|
| Within 1 year | 5,838,226 | 5,987,476 |
| Between 1-2 years | 4,674,626 | 5,764,456 |
| Between 2-3 years | 4,409,996 | 4,511,566 |
| Between 3-4 years | 4,392,916 | 4,392,916 |
| Between 4-5 years | 4,392,916 | 4,392,916 |
| More than 5 years | 92,251,236 | 96,644,152 |
| Total future minimum lease payments | 115,959,916 | 121,693,482 |

24. Capital Commitment

As of December 31, 2005, the Company has various equipment renovation projects in progress. Committed capital expenditure in connection with these projects approximates

RMB184,868,513 (2004: RMB175,726,239).

25. Investment commitment

According to an agreement signed between the Company and Guilin Fuda Group Co., Ltd. on July 18, 2005, the Company is committed to invest production machinery of RMB20,000,000 to establish Fuda Dongkang Crank Co., Ltd. At December 31, 2005, the Company had invested production machinery of RMB5,000,000, and the remaining machinery of RMB15,000,000 will be invested to Fuda Dongkang Crank Co., Ltd. before June 1, 2006.

26. Concentration of credit risk

Sales to the Company's largest customers, Dongfeng Motor and its subsidiaries, represented 66% of total revenue for the year ended December 31, 2005 (2004: 83%; 2003: 89%). Amounts due from Dongfeng Motor and its subsidiaries represented 78% of the total trade receivables (including third party receivable and amounts due from related parties) as of December 31, 2005 (2004: 90%).

27. Risk and uncertainties

The Chinese market in which the Company operates poses certain macro-economic and regulatory risks and uncertainties. Though the PRC has implemented a wide range of market-oriented economic reforms since 1978, continued reforms and progress towards a full market-oriented economy are uncertain and are likely to be readjusted and refined on an ongoing basis. This refinement and readjustment process, along with changes in government policies and regulations, may not always have a positive effect on the operations of the Company. In addition, the automotive industry has been designated as a pillar industry by the PRC government and as a result remains highly regulated. With China's accession to the World Trade Organization, the industry will eventually be more accessible to foreign invested enterprises. The PRC legal system has also seen marked changes since 1978; however, current enforcement of existing laws may be uncertain and sporadic, and implementation and interpretation there of may be inconsistent, resulting in a higher than usual degree of uncertainty as to the outcome of any litigation or legal process.

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash, cash equivalents, and accounts receivable. As of December 31, 2005, substantially all of the Company's cash and cash equivalents were held in financial institutions located in the PRC. Trade receivables are typically unsecured, denominated in Renminbi, and are derived from revenues earned from customers primarily located in the PRC. The Company performs ongoing credit evaluations of its customers and, if necessary, maintains reserves for potential credit losses. Historically, such losses have been within management's expectations.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

By: */s/ MARSHA L. HUNT*
Marsha L. Hunt
Vice President Corporate Controller
(Principal Accounting Officer)

Date: March 10, 2006
