

**26 Reserves** (cont'd)

Notes:

- (a) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer 10% of their annual net profits after taxation, as determined under PRC accounting regulations, to a statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory surplus reserve can be used to offset prior years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholding or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital.

- (b) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer between 5% to 10% of their annual net profits after taxation, as determined under PRC accounting regulations, to the statutory public welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's and the relevant subsidiaries' employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than in liquidation. The transfers to this reserve must be made before distribution of a dividend to shareholders.
- (c) The transfer to this reserve from the profit and loss account is subject to the approval of shareholders at general meetings. Its usage is similar to that of statutory surplus reserve.
- (d) Under PRC Company Law and the Company's Articles of Association, the net profit after taxation as reported in the PRC statutory financial statements of the Company can only be distributed as dividends after allowances have been made for:
- (i) making up cumulative prior years' losses, if any;
  - (ii) allocations to the statutory surplus reserve of at least 10% of after-tax profit, until the fund aggregates to 50% of the Company's registered capital;
  - (iii) allocations of 5% to 10% of after-tax profit, as determined under PRC accounting rules and regulations, to the Company's statutory public welfare fund;
  - (iv) allocations to the discretionary surplus reserve, if approved by the shareholders.

Pursuant to the Articles of Association of the Company, the net profit of the Company for the purpose of profit distribution is deemed to be the lesser of (i) the net profit determined in accordance with the PRC accounting principles and financial regulations and (ii) the net profit determined in accordance with IAS; or if the financial statements of the Company are not prepared in accordance with IAS, the accounting standards of one of the countries in which its shares are listed.

At 31 December, 2000, based on the PRC statutory financial statements of the Company prepared in accordance with the PRC accounting principles and financial regulations, no reserve was available for distributions to shareholders of the Company (1999: Nil).

*(Expressed in Renminbi)***27 Related party transactions**

Substantially all transactions undertaken by the Group during the year were effected with such counter parties and on such terms as have been determined by the CAAC and other relevant PRC authorities.

Both domestic and international routes on which the Group and other PRC airlines offer scheduled services are allocated by the CAAC. International airfares are subject to bilateral agreements between the CAAC, acting on behalf of the PRC government, and other governments. Domestic airfares are regulated jointly by the CAAC and the PRC Price Administrative Bureau.

Furthermore, the Group employed various supplementary administrative and financial services provided by the SA Group and its affiliates during the normal course of its business.

The following is a summary of significant recurring transactions carried out in the normal course of business between the Group and its fellow subsidiaries, the SA Group, the CAAC and its affiliates during the year:

	Note	<b>2000</b> <b>RMB'000</b>	1999 RMB'000
<i>Expenses</i>			
Handling charges	(a)	<b>13,783</b>	15,476
Jet fuel supplies	(b)	<b>2,387,646</b>	1,660,041
Aircraft insurance	(c)	<b>85,431</b>	88,079
Wet lease rentals	(d)	<b>108,699</b>	—
Guarantee fees	(e)	<b>23,698</b>	26,451
Ticket reservation service charges	(f)	<b>82,725</b>	75,664
Passenger departure and cargo handling charges	(g)	<b>40,584</b>	37,824
Aircraft and traffic servicing charges	(h)	<b>1,327,413</b>	1,219,533
Advertising expenses	(i)	<b>10,712</b>	9,478
Sundry aviation supplies	(j)	<b>72,054</b>	52,094
Commission expense	(k)	<b>554,102</b>	442,577
Air catering expense	(l)	<b>17,941</b>	16,401
Repairing charges	(m)	<b>471,044</b>	448,607
Contributions to retirement schemes	(n)	<b>68,829</b>	55,144
Post retirement medical and other welfare benefits	(o)	<b>16,900</b>	16,900
Housing benefits	(p)	<b>85,000</b>	85,000
Lease charges for land and buildings	(q)	<b>15,224</b>	15,224
<i>Income</i>			
Ground services income	(r)	<b>20,933</b>	11,460
Finance sublease income	(s)	—	1,383
Interest income	(t)	<b>35,728</b>	36,577
Commission income	(u)	<b>100,994</b>	113,292

**27 Related party transactions** (cont'd)

Notes:

- (a) Handling charges represent fees payable to China Aviation Supplies Import and Export Corporation, a corporation controlled by the CAAC, and Southern Airlines (Group) Import and Export Trading Company, a wholly owned subsidiary of the SA Group, in connection with the procurement of aircraft and flight equipment on the Group's behalf. Handling charges are calculated based on a fixed percentage of the purchase value and other charges.
- (b) Jet fuel supplies represent purchases of jet fuel at the then prevailing state controlled prices from China Aviation Oil Supply Company and Lan Tian Oil Supply Company, companies controlled by the CAAC.
- (c) Aircraft insurance represents insurance premiums payable to the CAAC which arranges aviation insurance covering hull, war and passenger liability risk on behalf of all PRC airlines with the People's Insurance (Property) Company of China. Insurance premiums are allocated to each individual PRC airline by the CAAC based on the value of the airline's aircraft and after taking into account the claims history of the airline.
- (d) These represent rentals paid to Zhongyuan Airlines, pursuant to wet lease agreements effected in August and November 2000, in respect of three Boeing 737-300 aircraft and two Boeing 737-37K aircraft.
- (e) Guarantee fees represent charges collected by the CAAC and paid to PRC banks in respect of guarantees provided by these banks in connection with aircraft acquisitions of the Group. At 31 December, 2000, back-to-back guarantees provided by the CAAC in favour of the Group to these banks amounted to approximately RMB1,240,715,000 (1999: RMB1,433,685,000). Guarantee fees are charged at rates ranging from 0.085% to 0.3% of the guaranteed amount.
- (f) Ticket reservation service charges represent fees payable to the CAAC in respect of computer reservation services rendered by the CAAC at charges determined based on the utilisation of the computer reservation system.
- (g) Passenger departure and cargo handling charges are payable to the CAAC for use of the computerised passenger departure and cargo handling systems installed at certain PRC airports. The charges are levied based on the utilisation of these systems.
- (h) Aircraft and traffic servicing charges represent take-off and landing fees payable to various PRC airports in respect of take-off and landing slots allocated to the Group and other ancillary services provided. Fees are payable by the Group based on the scale rates published by the CAAC.
- (i) Advertising expenses represent expense reimbursements to Southern Airlines Advertising Company, a subsidiary of the SA Group, for promotional services rendered to the Group.
- (j) Sundry aviation supplies represent purchases of other supplies from Southern Airlines (Group) Economic Development Company, a subsidiary of the SA Group. Prices charged by this supplier to the Group are similar to those charged to other PRC airlines.
- (k) Commission expense represents commission payable to the CAAC's sales offices, other PRC airlines and certain subsidiaries of the SA Group in connection with services provided in exchange for air tickets sold by them. Commission is calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value.
- (l) Air catering expense represents purchases of inflight meals and related services from Shenzhen Air Catering Company Limited, a cooperative joint venture established in the PRC, in respect of which the SA Group is entitled to 20% of its profits after tax.

**27 Related party transactions** (cont'd)

- (m) Repairing charges represent fees incurred by the Group in connection with comprehensive maintenance services rendered by Guangzhou Aircraft Maintenance Engineering Company Limited, an associated company of the Company.
- (n) The Group paid contributions through the SA Group towards certain defined contribution retirement schemes organised by PRC government for the benefit of employees. In addition, the Group paid contributions towards a supplementary defined contribution retirement scheme organised by the SA Group for the benefit of employees (see Note 28).
- (o) Post retirement medical and other welfare benefits represent a fixed annual fee payable to the SA Group in return for the SA Group providing medical and other welfare services to the retired employees of the Group (see Note 28).
- (p) Housing benefits represent a fixed annual fee payable to the SA Group in respect of the provision of quarters to the eligible employees of the Group (see Note 28).
- (q) Charges were paid to the SA Group under certain lease agreements in respect of certain land and buildings in the PRC (see Note 10).
- (r) Ground services income represents the attributable share of fees received from other airlines in respect of ground services at Guangzhou Baiyun International Airport provided by the Company together with Baiyun International Airport Group. The Company was entitled to 50% of the service fees for the year ended 31 December, 2000 (1999: 50%).
- (s) Finance sublease income represents finance lease charges receivable from a PRC airline under the supervision of the CAAC. The terms of the sublease agreements substantially coincide with those of the related head leases.
- (t) Interest income represents interest received from deposits placed with SA Finance. The applicable interest rate is determined in accordance with the savings rate published by the People's Bank of China (see Note 20).
- (u) Commission income represents commission receivable from other PRC airlines in connection with air tickets sold by the Group for which the carriage was provided by such airlines. Commission is calculated based on a fixed rate ranging from 3% to 9% on the ticket value.

Furthermore, in 1999, the Group acquired certain buildings, machinery, equipment, ground services vehicles, electronic devices and low-value consumables at an aggregate consideration of RMB73,264,000. The consideration was determined with reference to the valuation report dated 18 August, 1999 prepared by GAAC and was settled by offsetting against part of a purchase deposit in the amount of RMB123,140,000 placed with the SA Group at 31 December, 1998. The remaining balance in respect of the purchase deposit of approximately RMB49,876,000 was refunded to the Group during 1999.

In addition to the above, certain business undertakings of the SA Group provided transportation, hotel and other services to the Group during the year. The total amount involved is not material to the results of the Group for the year.

The directors of the Company are of the opinion that the above transactions with related parties were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions.

## 28 Retirement and housing benefits

Employees of the Group participate in several defined contribution retirement schemes organised separately by PRC municipal governments in regions where the major operations of the Group are located. The Group is required to contribute to these schemes at the rates ranging from 13% to 17% (1999: 13% to 17%) of salary costs including certain allowances. A member of the retirement schemes is entitled to pension benefits equal to a fixed proportion of the salary at the retirement date. The retirement benefit obligations of all existing and future retired staff of the Group are assumed by these schemes. In accordance with the comprehensive services agreement (the "Services Agreement") dated 22 May, 1997 between the Company and the SA Group, the Group makes payments of the retirement scheme contributions to the SA Group which undertakes to submit the contributions on behalf of the Group to the scheme administrators in a timely manner.

In addition, the Group was selected as one of the pilot enterprises to establish a supplementary defined contribution retirement scheme for the benefit of employees. In this connection, employees of the Group participate in a supplementary defined contribution retirement scheme organised by the SA Group whereby the Group is required to make defined contributions at a rate of 4.5% of total salaries. The Group has no obligation for the payment of pension benefits beyond the contributions described above. Contributions to the retirement schemes are charged to the profit and loss account as and when incurred.

The Group is also required to provide retirees with medical benefits, transportation subsidies and other welfare facilities. Pursuant to the Services Agreement, the SA Group undertakes the post-retirement medical and other welfare benefits payments to current and future retirees of the Group for a ten-year period from 1 January, 1997 to 31 December, 2006. In this connection, a fee of RMB16,900,000 (1999: RMB16,900,000) was paid by the Group to the SA Group for the year ended 31 December, 2000. The fee will be revised every three years and the next revision will be made in the year 2003.

Furthermore, pursuant to the Services Agreement, the SA Group agrees to provide adequate quarters to eligible employees of the Group as and when required. In return, the Group agrees to pay a fixed annual fee of RMB85,000,000 to the SA Group for a ten-year period effective 1 January, 1995.

During 1999, the Group provided additional quarters at its own expense to certain employees who are not eligible for quarters pursuant to the Services Agreement. These quarters were provided to the respective employees in accordance with the relevant PRC housing reform policy. The excess of the cost of these additional quarters over the considerations received by the Group from the employees of RMB104,468,000 was charged to expenses for 1999. No such expense was incurred for 2000.

(Expressed in Renminbi)

**29 Commitments**(a) **Capital commitments**

As at 31 December, 2000, the Group and the Company had capital commitments as follows:

	<b>The Group</b>		<b>The Company</b>	
	<b>2000</b> <b>RMB'000</b>	1999 RMB'000	<b>2000</b> <b>RMB'000</b>	1999 RMB'000
Commitments in respect of aircraft and related equipment ( <i>Note</i> ) - authorised and contracted for	<b>3,161,539</b>	568,788	<b>3,161,539</b>	17,908
Commitments in respect of investments at Guangzhou new airport - authorised and contracted for	<b>38,937</b>	—	<b>38,937</b>	—
- authorised but not contracted for	<b>3,501,513</b>	3,560,000	<b>3,501,513</b>	3,560,000
	<b>3,540,450</b>	3,560,000	<b>3,540,450</b>	3,560,000
Other commitments - authorised and contracted for	<b>131,255</b>	123,675	<b>121,710</b>	110,463
- authorised but not contracted for	<b>590,688</b>	539,573	<b>296,533</b>	154,889
	<b>721,943</b>	663,248	<b>418,243</b>	265,352
	<b>7,423,932</b>	4,792,036	<b>7,120,232</b>	3,843,260

*Note:*

At 31 December, 2000, the Group had on order two Boeing 747-400 freighters and certain flight equipment, scheduled for deliveries in 2002. Deposits of RMB3,315,000 have been made towards the purchase of these aircraft and related equipment. At 31 December, 2000, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment are as follows:

	<b>The Group</b>		<b>The Company</b>	
	<b>2000</b> <b>RMB'000</b>	1999 RMB'000	<b>2000</b> <b>RMB'000</b>	1999 RMB'000
<b>Year ended/ending 31 December,</b>				
2000	—	568,788	—	17,908
2001	<b>1,024,832</b>	—	<b>1,024,832</b>	—
2002	<b>2,136,707</b>	—	<b>2,136,707</b>	—
	<b>3,161,539</b>	568,788	<b>3,161,539</b>	17,908