

Notes to the Financial Statements

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

1 BACKGROUND OF THE COMPANY

China Southern Airlines Company Limited (the "Company") and its subsidiary companies (collectively the "Group") are principally engaged in the provision of domestic, Hong Kong and Macau and international passenger, cargo and mail airline services, with flights operating primarily from the new Guangzhou Baiyun International Airport, which is both the main hub of the Group's route network and the location of its corporate headquarters.

The Company is a joint stock limited company established by China Southern Air Holding Company ("CSAHC") pursuant to an approval document Ti Gai Sheng 【1994】 No. 139 from the State Commission for Economic Restructuring of the Peoples' Republic of China ("PRC"). CSAHC injected airline-related assets and liabilities as at 1 January 1994 into the Company in exchange for 2,200,000,000 domestic shares with a par value of RMB1.00 each. The Company was established on 25 March 1995, and took over the control of the airline business from CSAHC since that date.

Pursuant to an approval document Zheng Wei Fa 【1997】 No. 33 from the China Securities Regulatory Commission, the Company listed its 1,174,178,000 H Shares on both the Stock Exchange of Hong Kong Limited and the New York Stock Exchange in July 1997. Pursuant to an approval document (2003) No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000 A Shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

On 13 March 2003, the Company obtained an approval certificate Wai Jing Mao Zi Yi 【2003】 No. 273 from the Ministry of Foreign Trade & Economic Cooperation to change to a permanent joint stock limited company with foreign investments and obtained the business licence dated 17 October 2003 (Qi Gu Guo Fu Zi No. 000995) issued by the State Administration of Industry and Commerce of the PRC.

The Company acquired the airline operations and certain related assets of China Northern Airlines Company ("CNA") and Xinjiang Airlines Company ("XJA") with effect from 31 December 2004 (Note 46(c)(13)) (the "CNA/XJA Acquisitions"). As a result of the CNA/XJA Acquisitions with effect from 31 December 2004, the operating results of the airline operations and related assets are included in the Company's financial statements since 31 December 2004. Accordingly, certain items in the 2005 income statements fluctuated significantly as compared with 2004.

2 PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in the preparation of the financial statements are in conformity with the Accounting Standards for Business Enterprises and the "Accounting Regulations for Business Enterprises" issued by the Ministry of Finance ("MOF") of the PRC, "Accounting Method for Civil Aviation Enterprises" and other relevant regulations which are as follows:

(a) Accounting year

The accounting year of the Group is from 1 January to 31 December.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(b) Basis of consolidation

The consolidated financial statements have been prepared in accordance with "Accounting Regulations for Business Enterprises" and Cai Kuai Zi 【1995】 No.11 "Provisional regulations on consolidated financial statements" issued by the MOF.

The consolidated financial statements include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those entities in which the Company has more than 50% equity interest or those entities controlled by the Company. The consolidated income statement of the Company only includes the results of the subsidiaries during the period when the Company has more than 50% equity interest, or when the Company does not have more than 50% equity interest, but has control over those entities. The effect of minority interests on equity and profit/loss attributable to minority interests are separately shown in the consolidated financial statements. For those subsidiaries whose assets and results of operations are not significant and have no significant effect on the Group's consolidated financial statements, the Company does not consolidate these subsidiaries. They are accounted for under long-term equity investments.

Where the accounting policies adopted by subsidiaries are different from the policies adopted by the Company, the financial statements of the subsidiaries have been adjusted in accordance with the accounting policies adopted by the Company on consolidation. All significant intercompany balances and transactions, and any unrealised gains arising from inter-company transactions, have been eliminated on consolidation.

For those jointly controlled entities which the Company has joint control with other investors under contractual arrangements, the Company consolidates their assets, liabilities, revenues, costs and expenses in the consolidated financial statements based on the proportionate consolidation method according to its percentage of equity interest holding in those entities.

(c) Basis of preparation

The financial statements have been prepared on an accrual basis. Unless otherwise stated, the measurement basis used is historical cost.

(d) Reporting currency

The Company's reporting currency is the Renminbi.

(e) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the balance sheet date. Exchange gains and losses on foreign currency translation, except for the exchange gains and losses directly relating to the construction of fixed assets (see note 2(j)), are dealt with in the income statement.

(f) Cash equivalents

Cash equivalents are short-term, highly liquid investments which are readily convertible into known amounts of cash, and which are subject to an insignificant risk of change in value.

(g) Provision for bad and doubtful debts

The provision for bad debt losses is estimated by management based on individual accounts receivable which show signs of uncollectibility and an ageing analysis. Provision for other receivables is determined based on their specific nature and management's estimate of their collectibility.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(h) Inventories

Inventories, which consist primarily of expendable spare parts and consumables, are carried at the lower of cost and net realisable value. Inventories are measured at their actual cost upon acquisition. The cost of inventories is calculated using the weighted average method. Any excess of the cost over the net realisable value of each class of inventories is recognised as a provision for diminution in the value of inventories. Net realisable value is determined based on amount recoverable in the normal course of business after the balance sheet date or estimates made by management based on market conditions.

Inventories are recorded using the perpetual inventory method.

Consumables are amortised in full when issued for use.

(i) Investments

(i) Short-term investments

Short-term investments are carried at the lower of cost and market value. The cost of a short-term investment is the total price paid on acquisition of the investment. However, it does not include cash dividends which have been declared but which are unpaid or unpaid interest on debentures which was due at the time of acquisition.

Provision for diminution in value is made on an item-by-item basis for any shortfall of the market value over the cost of material short-term investments. Provision for diminution in value is also made for any shortfall of the market value over the cost of other short-term investments on an aggregate basis by each category of the investments.

With the exception of cash dividends which have been declared but which are unpaid at the time of acquisition and interest on debentures which is due but not yet paid at the time of acquisition, cash dividends and interest are set off against the carrying amount of the short-term investments when received by the Company. Upon the disposal of short-term investments, the difference between the carrying amount of the short-term investments and the proceeds received is recognised profit or loss for the current period.

(ii) Long-term equity investments

Where the Company has the power to control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the equity method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for any post acquisition change in the Company's share of the investors' equity in the investee enterprise.

Equity investment difference, which is the difference between the initial investment cost and the Company's share of investors' equity in the investee enterprise, is accounted for as follows:

- Any excess of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis. The amortisation period is determined according to the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the year end.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(i) Investments (Cont'd)

(ii) Long-term equity investments (Cont'd)

- If an investment was acquired before the MOF's issuance of the "Questions and Answers on Implementing Accounting Regulations for Business Enterprises and Related Accounting Standards (II)" (Cai Kuai 【2003】 No. 10), any shortfall of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis over the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the year end. Such shortfalls are recognised in the "Capital surplus - reserve for equity investment" if the investment was acquired after the issuance of Cai Kuai 【2003】 No. 10.

Where the Company does not control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the cost method, stating it at the initial investment cost. Investment income is recognised when the investee enterprise declares a cash dividend or distributes profits.

Upon the disposal of long-term equity investments, the difference between the proceeds received and the carrying amount of the investments is recognised in the income statement.

The Group makes provision for impairment losses on long-term equity investments (see note 2(n)).

(j) Fixed assets and construction in progress

Fixed assets are assets with comparatively high unit values held by the Group for use in the supply of services and administrative purposes. They are expected to be used for more than one year.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 2(n)). Construction in progress is stated in the balance sheet at cost less impairment losses (see note 2(n)). The revalued amount refers to the amount adjusted is value of assets based on the valuation amounts in accordance with the relevant rules and regulations.

All direct and indirect costs that are related to the construction of fixed assets and incurred before the assets are ready for their intended uses are capitalised as construction in progress. Those costs include borrowing costs (including foreign exchange differences arising from the loan principal and the related interest) on specific borrowings for the construction of the fixed assets during the construction period.

Construction in progress is transferred to fixed assets when it is ready for its intended use. No depreciation is provided against construction in progress.

Pursuant to an approval document Cai Kuai Han 【2004】 No. 39 "Reply from MOF relating to Agreement on Selection of China Southern Airlines as Pilot Site for Fixed Assets Management of High Value Rotables" issued by the MOF, the Group accounts for high value rotables as fixed assets.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(j) Fixed assets and construction in progress (Cont'd)

Fixed assets of the Group are depreciated using the straight-line over their estimated useful lives. The respective annual depreciation rates for fixed assets are as follows:

	Annual depreciation rate
Owned and finance leased aircraft	4.75%-6.33%
Other flight equipment:	
– Jet engines	4.75%-6.33%
– Others, including high value rotables	6.47%-12.50%
Buildings	3.23%-4.85%
Machinery and equipment	9.70%-19.40%
Motor vehicles	16.17%

Land use rights in used are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 2(n)), and are amortised on a straight-line basis over the period of land use rights.

(k) Leased assets

A lease can be classified as a finance lease or an operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of a leased asset to the lessee, whether or not the legal title to the asset is eventually transferred. An operating lease is a lease other than a finance lease.

(i) Assets acquired under finance leases

The Group's flight equipment acquired by way of finance leases are stated under fixed assets at an amount equal to the lower of their original carrying amount in the books of the legal owner (the lessor) and the present value of the minimum lease payments at the inception of the lease. Depreciation of leased assets is calculated using the straight-line method. Subsequent to the revaluation (see Note 13), which was based on depreciated replacement costs, leased assets are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses.

If there is no reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over the shorter of the lease term or their estimated useful lives. If there is reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over their estimated useful lives.

At the inception of the lease, the minimum lease payments are recorded as payables under finance leases. The difference between the value of the leased assets and the minimum lease payments is recognised as unrecognised finance charges under finance leases. At the year end, payables under finance leases are netted against the unrecognised finance charges under finance leases and included in long-term payables in the balance sheet or long-term liabilities due within one year.

Unrecognised finance charges under finance leases are amortised using an effective interest rate method over the lease term.

The Group makes provision for impairment losses on assets acquired under finance leases (see note 2(n)).

Notes to the Financial Statements (Cont'd)

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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(k) Leased assets (Cont'd)

(ii) *Assets held for use in operating leases*

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and are depreciated in accordance with the Group's depreciation policies, as set out in note 2(j). Impairment losses are provided for in accordance with the accounting policy set out in note 2(n). Revenue derived from operating leases is recognised in the income statement using the straight-line method over the lease term.

(iii) *Operating lease charges*

Rental payments under operating leases are recognised as expenses on a straight-line basis over the lease term. Contingent rental payments are recognised as expenses in the accounting period in which they are incurred.

(l) Intangible assets

Intangible assets are stated in the balance sheet at cost or revalued amount less accumulated amortisation and impairment losses (see note 2(n)). The cost of the intangible assets is amortised on a straight-line basis over the contracted beneficial period or the effective period stipulated by law, whichever is shorter. Where the useful life is not stipulated by the contract or law, the amortisation is over a period of 10 years.

(m) Long-term deferred expenses

Custom duties and other direct costs incurred in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised on a straight-line basis over the terms of the related leases.

(n) Provision for impairment

The carrying amounts of assets (including long-term investments, fixed assets, construction in progress, lease and equipment deposit, intangible assets and other assets) are reviewed regularly at each balance sheet date to determine whether their recoverable amounts have declined below their carrying amounts. Assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount by which the carrying amount is reduced is the impairment loss.

The recoverable amount is the higher of the net selling price and the present value of the estimated future cash flows arising from the continuous use of the asset and from the disposal of the asset at the end of its useful life.

Provision for impairment loss is calculated on an item by item basis and recognised as an expense in the income statement. However, when a shortfall of the initial investment cost over the Group's share of the investors' equity of the investee enterprise has been credited to the capital reserve, any impairment losses for long-term equity investment are firstly set off against the difference initially recognised in the capital reserve relating to the investment and any excess impairment losses are then recognised in the income statement.

If there is an indication that there has been a change in the estimates used to determine the recoverable amount and as a result the estimated recoverable amount is greater than the carrying amount of the asset, the impairment loss recognised in prior years is reversed. Reversals of impairment losses are recognised in the income statement. Impairment losses are reversed to the extent of the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. In respect of the reversal of an impairment loss for a long-term equity investment, the reversal starts with the impairment losses that had previously been recognised in the income statement and then the impairment losses that had been charged to the capital reserve.

Notes to the Financial Statements (Cont'd)

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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(o) Income tax

Income tax is recognised using the tax effect accounting method. Income tax for the year comprises current tax paid and payable and movement of deferred tax assets and liabilities.

Current tax is calculated at the applicable tax rate on taxable income.

Deferred tax is provided using the liability method for the differences between the accounting profits and the taxable profits arising from the timing differences in recognising income, expenses or losses between the accounting and tax regulations. When the tax rate changes or a new type of tax is levied, adjustments are made to the amounts originally recognised for the timing differences under the liability method. The current tax rates are used in arriving at the reversal amounts when the timing differences are reversed.

Deferred tax assets arising from tax losses, which are expected to be utilised against future taxable profits, are set off against the deferred tax liabilities (only for the same taxpayer within the same jurisdiction). When it is not probable that the tax benefits of deferred tax assets will be realised, the deferred tax assets are reduced to the extent that the related tax benefits are expected to be realised.

(p) Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligations and a reliable estimate can be made.

Where it is not probable that the settlement of the above obligation will cause an outflow of economic benefits, or the amount of the outflow cannot be estimated reliably, the obligation is disclosed as a contingent liability.

(q) Revenue recognition

When it is probable that the economic benefits will flow to the Group and the revenue and costs can be measured reliably, revenue is recognised in the income statement according to the following methods:

- (i) Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage;
- (ii) Revenues from airline-related businesses are recognised when the relevant services are rendered;
- (iii) Interest income is recognised on a time proportion basis according to the principal outstanding and the applicable rate;
- (iv) Dividend income is recognised when the Group's right to receive the dividend is established; and
- (v) Subsidy income is recognised in the income statement upon receipt of the subsidy.

(r) Traffic commissions

Traffic commissions are expensed when the transportation is provided and the related revenue is recognised. Traffic commissions for transportation not yet provided are recorded on the balance sheet as a prepaid expense.

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2 PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(s) Borrowing costs

Borrowing costs incurred on specific borrowings for the construction of fixed assets are capitalised into the cost of the fixed assets during the construction period until the fixed assets are ready for their intended uses.

Except for the above, other borrowing costs are recognised as financial expenses in the income statement when incurred.

(t) Repairs and maintenance expenses

Routine repair and maintenance expenses (including major overhaul expenses) are recognised in the income statement when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of overhauls that are required to be performed on the related aircraft prior to their return to the lessors.

(u) Dividends appropriation

Cash dividends appropriated to shareholders are recognised in the income statement and profit appropriation statement when approved. Cash dividends approved after the balance sheet date, but before the date on which the financial statements are authorised for issue, are separately disclosed in the investors' equity in the balance sheet..

(v) Retirement benefits

Pursuant to the relevant laws and regulations in the PRC, the Group has joined certain defined contribution retirement schemes for the employees arranged by the governmental organisations. The Group makes contributions to the retirement schemes at the applicable rates based on the employees' salaries. The contributions are charged to the income statement on an accrual basis. The Group has no obligation for the payment of pension benefits beyond the contributions described above.

(w) Frequent flyer award programmes

The Group maintains two frequent flyer award programmes, namely, the China Southern Airlines Sky Pearl Club and Egret Mileage Plus, which provide travel awards to members based on accumulated mileage. The estimated incremental cost to provide free travel is recognised as an expense and accrued as a current liability as members accumulate mileage. As members redeem awards or their entitlements expire, the incremental cost liability is reduced accordingly, to reflect the acquittal of the outstanding obligations.

Revenue from mileage sales to third parties under the frequent flyer award programmes is recognised when the related transportation services are provided.

(x) Related parties

If the Group has the power, directly or indirectly, to control, jointly control or exercise significant influence over another party, or vice versa, or where the Group and one or more parties are subject to common control from another party, they are considered to be related parties. Related parties may be individuals or enterprises.

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3 TAXATION**(a) Major taxes applicable to the rendering of services by the Group are as follows:**

Type of taxes	Tax rate	Basis of tax
Business tax	3% or 5%	Traffic revenue, ground services income and commission income. All inbound international and Hong Kong and Macau flights are exempted from business tax
City construction tax	7%	Business tax
Education surcharge	3%	Business tax

Pursuant to Article 5 of 【1985】Cai Sui Zi No. 069 "Ministry of Finance's Rules on Certain Questions on City Construction Tax Provisional Regulations" and Article 2 of 【1994】No. 23 "State Council Supplementary Notice on Exemption of Education Surcharge", the Company, after having becoming a foreign investment enterprise as described in Note 1, is exempted from city construction tax and education surcharge since 1 October 2003.

(b) Income tax

The income tax rate applicable to the Company and certain of its subsidiaries is 15%.

In respect of the Group's overseas airline activities, the Group has either obtained exemptions from overseas taxation pursuant to the bilateral aviation agreements between the overseas governments and PRC government, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for the year.

Except for the following subsidiaries and jointly controlled entities which are entitled to a preferential income tax rate, other subsidiaries, jointly controlled entities and branches are subject to an income tax rate of 33% according to the PRC related tax laws and regulations.

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3 TAXATION (Cont'd)

(b) Income tax (Cont'd)

Certain subsidiaries and jointly controlled entities of the Company have been granted with preferential tax treatments as set out below:

Name of subsidiaries	Applicable tax rate	Reasons for granting concession
Zhuhai Airlines Company Limited	15%	Operates in a special economic zone and accordingly enjoys a reduced income tax rate pursuant to documents Cai Shui Zi (86) No. 122 and Cai Shui Zi (87) No. 115.
Southern Airlines (Group) Shantou Airlines Company Limited	15%	Ditto
Xiamen Airlines Company Limited	15%	Ditto
Guangzhou Nanland Air Catering Company Limited	27%	Pursuant to Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC, the applicable state income tax rate is 24% and local income tax rate is 3%.
Zhuhai Xiang Yi Aviation Technology Company Limited	7.5%	Pursuant to Zhu Guo Shui Hang 【2003】 94 issued by Zhuhai Municipal State Tax Bureau, the entity enjoys a reduced income tax rate.
CSN – ETC e-commerce Limited	15%	Pursuant to the preferential treatment as stipulated in the PRC Corporate Income Tax Provisional Regulations, the applicable income tax rate is 15%.
Name of jointly controlled entities		
Guangzhou Aircraft Maintenance Engineering Company Limited	15%	Pursuant to Sui Guo Shui Zhi Fa 【2001】 No. 77 issued by Guangzhou Municipal State Tax Bureau, the applicable income tax rate is 15% since 2000.
MTU Maintenance Zhuhai Company Limited	15%	Pursuant to Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC, the applicable income tax rate is 15%.

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	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Enterprise income tax	31	41	–	–
Business tax	335	239	156	127
City construction tax	16	16	4	8
Value added tax	2	15	1	–
Others	18	13	19	6
Total	402	324	180	141

4 CASH AT BANK AND ON HAND

	The Group				The Company			
	2005		2004		2005		2004	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB Million
Cash on hand								
Renminbi		3		6		2		6
US Dollars	–	5	–	4	–	5	–	1
Other currencies	–	6	–	3	–	6	–	1
		14		13		13		8
Cash at bank								
Renminbi		1,927		2,084		1,064		1,233
US Dollars	27	215	40	334	23	184	41	342
HK Dollars	22	23	83	88	8	8	24	25
Japanese Yen	1,161	80	1,267	101	1,093	75	1,242	99
Singapore Dollars	2	10	2	8	2	8	2	8
Thai Bahts	53	10	47	10	40	8	38	8
Malaysian Ringgit	14	30	32	70	8	18	31	68
Euro	3	29	3	38	3	29	3	36
Korean Won	5,224	42	6,835	54	4,483	36	6,329	50
Vietnam Dong	36,736	18	28,588	15	36,736	18	28,588	15
Australian Dollars	23	135	6	40	8	45	5	35
Other currencies	–	17	–	13	–	16	–	13
		2,536		2,855		1,509		1,932
Deposits in SA Finance Renminbi		557		406		480		362
Other monetary funds Renminbi time deposit		23		–		–		–
Total		3,130		3,274		2,002		2,302

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4 CASH AT BANK AND ON HAND (Cont'd)

Deposits in SA Finance represent deposits with China Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associate of the Group (see Note 46).

At 31 December 2005, the Group pledged a fixed deposit of RMB23 million to secure a bank loan of RMB17 million (see Note 19).

At 31 December 2005, the Group's overseas bank deposits amounted to RMB384 million (2004: RMB388 million). These overseas bank deposits are not subject to any significant risk of uncollectibility.

The above cash and bank deposits denominated in foreign currencies are translated into Renminbi at the following exchange rates:

	2005	2004
US Dollar	8.0694	8.2765
HK Dollar	1.0407	1.0637
Japanese Yen	0.06857	0.079701
Singapore Dollar	4.8543	5.0550
Thai Bahts	0.1967	0.2122
Malaysian Ringgit	2.177	2.177
Euro	9.5535	11.2627
Korean Won	0.007967	0.007900
Vietnam Dong	0.0005	0.0005247
Australian Dollar	5.9066	6.4428

Note: Balances denominated in foreign currencies in these financial statements are translated into Renminbi at the above rates, unless otherwise stated.

5 DIVIDENDS RECEIVABLE

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Guangzhou Aircraft Maintenance Engineering Company Limited	-	-	37	37
Southern Airlines (Group) Shantou Airlines Company Limited	-	-	13	-
Guangzhou Nanland Air Catering Company Limited	-	-	-	7
Travelsky Technology Limited	4	-	-	-
Total	4	-	50	44

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	At 1 January 2005 RMB million	Disposal during the year RMB million	At 31 December 2005 RMB million
Equity investments			
– Investments in securities	509	509	–
Debt investments			
– Government bonds	160	160	–
Total	669	669	–

The Company

	At 1 January 2005 RMB million	Disposal during the year RMB million	At 31 December 2005 RMB million
Equity investments			
– Investments in securities	487	487	–

The market value, if available, of the above short-term investments as at the year end are as follows:

The Group

	2005		2004	
	Carrying amount RMB million	Market value RMB million	Carrying amount RMB million	Market value RMB million
Equity investments	–	–	509	529
Debt investments	–	–	160	160

The Company

	2005		2004	
	Carrying amount RMB million	Market value RMB million	Carrying amount RMB million	Market value RMB million
Equity investments	–	–	487	502

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6 SHORT-TERM INVESTMENTS (Cont'd)

The market value information is extracted from Shanghai Stock Exchange, Shenzhen Stock Exchange and chinabond.com.cn.

In 2004, the Company and an independent third party jointly appointed Centergate Securities Company Limited to manage and invest cash from the Company and the independent third party of RMB500 million and RMB75 million, respectively. The entrusted investments consist mainly of investment in securities. The entrusting period was from 27 July 2004 to 26 July 2005. In accordance with the contract, the independent third party has the responsibility to ensure that the Company has a reasonable return on investment, and avoid any loss from investment. In May 2005, the Company early terminated the assets management arrangement and recovered the investment amount.

7 TRADE RECEIVABLES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Trade receivables	1,750	1,687	1,193	1,379
Less: Provision for bad and doubtful debts	52	95	38	82
Total	1,698	1,592	1,155	1,297

The ageing analysis of trade receivables is as follows:

The Group

	2005				2004			
	Amount	% of total trade receivables	Bad debt provision	% of bad debt provision	Amount	% of total trade receivables	Bad debt provision	% of bad debt provision
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Within 1 year	1,710	97.7%	17	1.0%	1,576	93.4%	5	0.3%
Over 1 year but within 2 years	9	0.5%	7	77.8%	14	0.8%	9	64.3%
Over 2 years but within 3 years	7	0.4%	5	71.4%	25	1.5%	9	36.0%
Over 3 years	24	1.4%	23	95.8%	72	4.3%	72	100.0%
Total	1,750	100.0%	52	3.0%	1,687	100.0%	95	5.6%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**7 TRADE RECEIVABLES (Cont'd)****The Company**

	2005				2004			
	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total trade receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	1,164	97.7%	9	0.8%	1,282	92.9%	6	0.5%
Over 1 years but within 2 years	7	0.5%	7	100.0%	8	0.6%	3	37.5%
Over 2 years but within 3 years	5	0.4%	5	100.0%	23	1.7%	7	30.4%
Over 3 years	17	1.4%	17	100.0%	66	4.8%	66	100.0%
Total	1,193	100.0%	38	3.2%	1,379	100.0%	82	5.9%

Provision for bad and doubtful debts is analysed as follows:

	The Group		The Company	
	2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
At 1 January	95	70	82	57
Add: Charge for the year	7	26	1	27
Additions through the CNA/XJA Acquisitions	–	44	–	44
Less: Reversal during the year	2	–	–	–
Write-off during the year	48	45	45	46
At 31 December	52	95	38	82

Except for the balances disclosed in Note 46, there was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of trade receivables.

During the year, the Group and the Company had no recovery of individually significant doubtful debts that had been fully or substantially provided for in prior years.

During the year, the Group and the Company wrote off non-recoverable bills receivable and charter flights receivable with ageing over three years of RMB48 million and RMB45 million, respectively. These balances were not associated with related party transactions.

At 31 December 2005, the Group and the Company did not have any individually significant trade receivables balances that were aged over three years.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



7 TRADE RECEIVABLES (Cont'd)

At 31 December 2005, total amounts of the Group's and the Company's trade receivables from the top five parties were as follows:

	The Group		The Company	
	2005	2004	2005	2004
Amounts (RMB million)	909	408	693	345
% of total trade receivables	51.9%	24.2%	58.1%	25.0%

8 OTHER RECEIVABLES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Due from subsidiaries	–	–	704	745
Due from related companies	15	62	30	55
Others	989	847	870	557
	1,004	909	1,604	1,357
Less: Provision for bad and doubtful debts	10	74	10	74
Total	994	835	1,594	1,283

Provision for bad and doubtful debts is analysed as follows:

	The Group and the Company	
	2005	2004
	RMB million	RMB million
At 1 January	74	30
Add: Charge for the year	–	2
Additions through the CNA/XJA Acquisitions	–	59
Less: Write-off during the year	64	17
At 31 December	10	74

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**8 OTHER RECEIVABLES (Cont'd)**

Ageing analysis of other receivables is as follows:

The Group

	2005				2004			
	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	729	72.6%	–	0.0%	625	68.7%	2	0.3%
Over 1 year but within 2 years	92	9.2%	–	0.0%	60	6.6%	–	0.0%
Over 2 years but within 3 years	39	3.8%	–	0.0%	35	3.9%	–	0.0%
Over 3 years	144	14.4%	10	6.9%	189	20.8%	72	38.1%
Total	1,004	100.0%	10	1.0%	909	100.0%	74	8.1%

The Company

	2005				2004			
	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	% of bad debt provision %
Within 1 year	1,080	67.3%	–	0.0%	1,043	76.9%	2	0.2%
Over 1 year but within 2 years	336	20.9%	–	0.0%	91	6.7%	–	0.0%
Over 2 years but within 3 years	63	3.9%	–	0.0%	35	2.6%	–	0.0%
Over 3 years	125	7.9%	10	8.0%	188	13.8%	72	38.3%
Total	1,604	100.0%	10	0.6%	1,357	100.0%	74	5.5%

Except for the balances disclosed in Note 46, there was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of other receivables.

During the year, the Group and the Company had no recovery of individually significant doubtful debts that had been fully or substantially provided for in prior years.

As at 31 December 2005, other receivables of the Group and the Company included an amount due from Zhongyuan Airlines Company Limited ("Zhongyuan Airlines") of RMB98 million (2004: RMB104 million). As at 31 December 2005 and up to date of approval of these financial statements, the Group is in the process of applying for transfer of certain properties held by Zhongyuan Airlines for settlement of the balance.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



8 OTHER RECEIVABLES (Cont'd)

During the year, the Group and the Company wrote off non-recoverable deposits and manufacturers' credits aged over three years totalling RMB64 million. Their balances were not associated with related party transactions.

At 31 December 2005, the Group and the Company did not have any individually significant other receivables that were aged over three years.

At 31 December 2005, total amounts of the Group's and the Company's other receivables from the top five parties were as follows:

	The Group		The Company	
	2005	2004	2005	2004
Amounts (RMB million)	548	309	1,057	944
% of total other receivables	54.6%	34.0%	65.9%	69.6%

9 ADVANCE PAYMENTS

All advance payments are aged within one year.

There was no amount due from shareholders who hold 5% or more voting right of the Company included in the balance of advance payments.

10 INVENTORIES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Expendable spare parts	1,590	1,313	1,200	904
Consumables	73	61	67	58
Aviation on-board supplies	27	27	25	24
Others	45	43	13	13
Subtotal	1,735	1,444	1,305	999
Less: Provision for diminution in value of inventories	259	46	209	–
Total	1,476	1,398	1,096	999

Provision for diminution in value of inventories is analysed as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
At 1 January	46	45	–	–
Provision made for the year	213	1	209	–
At 31 December	259	46	209	–

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**10 INVENTORIES** (Cont'd)

All the above inventories are obtained through purchases.

The Group's and the Company's cost of inventories charged to costs and expenses in the income statement is as follows:

	2005	2004
	RMB million	RMB million
The Group	721	448
The Company	596	275

11 PREPAID EXPENSES

	Note	The Group		The Company	
		2005	2004	2005	2004
		RMB million	RMB million	RMB million	RMB million
Operating lease rental	(a)	191	167	148	105
Ticket sales commission	(b)	-	20	-	-
Consumables	(c)	101	79	-	-
Insurance premiums	(d)	40	40	36	36
Aviation training fee	(e)	-	-	104	47
Others		18	40	13	11
Total		350	346	301	199

Notes:

- (a) Pursuant to aircraft operating lease agreements, the Group is required to prepay one to six months' rentals to lessors. The operating lease rentals are recognised as expenses on a straight-line basis over the lease term. The balance at the year end represents the unamortised balance of the prepaid rentals.
- (b) The Group pays sales commission to sales agents for tickets sales. The sales commission are initially recorded as prepaid expenses and charged as expenses to the income statement upon the provision of the related transportation services.
- (c) A jointly controlled entity of the Group is principally engaged in the provision of engine repairs and maintenance services. Consumables consumed prior to the completion of the related engine repairs and maintenance are recorded as prepaid expenses and charged to income statement upon the completion of the related engine repairs and maintenance services.
- (d) The Group prepays the insurance premiums to an insurance company. The prepaid insurance premiums are then amortised over the relevant period. The balance at the year end represents the unamortised balance of the prepaid insurance premiums.
- (e) The principal activities of a subsidiary of the Group is to provide aviation training services. The prepaid aviation training fees by the Company are initially recorded as prepaid expenses and then charged to the income statement upon the provision of the related training services.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



12 LONG-TERM EQUITY INVESTMENTS

The Group

	Investments in associates RMB million	Other investments in securities RMB million	Other equity investments RMB million	Total RMB million
At 1 January 2005	467	118	156	741
Add: Additions	–	–	47	47
Adjustment under the equity accounting method	(235)	–	1	(234)
Less: Disposals	–	3	–	3
At 31 December 2005	232	115	204	551

The Company

	Investments in subsidiaries RMB million	Investments in associates RMB million	Investments in jointly controlled entities RMB million	Other investments in securities RMB million	Other equity investments RMB million	Total RMB million
At 1 January 2005	3,262	357	610	69	101	4,399
Add: Additions	324	–	–	–	–	324
Adjustment under the equity accounting method	(105)	(125)	5	–	5	(220)
Amortisation of equity investment difference	2	–	–	–	–	2
Less: Dividends received	66	–	–	–	2	68
Reclassification of investment in non-consolidated subsidiaries	4	–	–	–	(4)	–
At 31 December 2005	3,413	232	615	69	108	4,437

At 31 December 2005, no provision for impairment losses of individually material long-term equity investments was made by the Group and the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS (Cont'd)**

Assets of the Group were revalued in 1996 in connection with the Group's overseas listing. As a result, a net revaluation deficit amounting to RMB30,284,000 was reported on the Company's subsidiaries. The Company made a corresponding adjustment amounting to RMB20,498,000 to investments in subsidiaries which was recorded as equity investment difference. The difference is amortised on a straight-line basis over 10 years, which represent the estimated remaining useful lives of the revalued assets of the subsidiaries. The equity investment difference is analysed as follows:

	Equity investment difference
	RMB million
Original net amount:	20
Accumulated amortisation:	
At 1 January 2005	16
Amortisation for the year	2
At 31 December 2005	18
Unamortised balance:	
At 31 December 2005	2
At 31 December 2004	4

Details of the Group's principal associates and jointly controlled entities and the Company's principal subsidiaries are set out in Note 50.

(a) The Group*(i) Associates*

At 31 December 2005, the Group's investments in associates, which are accounted for under equity accounting method, are analysed as follows:

	SA Finance	Sichuan Airlines Corporation Limited (Note 1)	Others	Total
	RMB million	RMB million	RMB million	RMB million
Attributable equity interest:				
Direct	32.00%	39.00%		
Indirect	17.30%	–		
Initial investment cost (At 1 January 2005)	246	137	88	471
At 1 January 2005	236	209	22	467
Add: Adjustment under equity accounting method	(236)	1	–	(235)
At 31 December 2005	–	210	22	232

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



12 LONG-TERM EQUITY INVESTMENTS (Cont'd)

(a) The Group (Cont'd)

(i) Associates (Cont'd)

Note 1: The principal accounting policies of Sichuan Airlines Corporation Limited ("Sichuan Airlines") are different from the Group's principal accounting policies. The differences in accounting policies are mainly relating to maintenance expenses and finance charges on obligations under finance leases. Maintenance expenses of rotables are expensed as and when incurred in the Group's financial statements whereas such expenses are capitalised and amortised over 6 years in Sichuan Airlines' financial statements. Finance charges on obligations under finance leases are charged to the income statement using effective interest method in the Group's financial statements whereas such charges are amortised on a straight-line basis over the lease period in Sichuan Airlines' financial statements.

(ii) Investments in securities

At 31 December 2005, the Group's other investments in securities, which are accounted for under cost accounting method are analysed as follows:

Name of investees	Type of Security	No. of shares	Market price at year end	Percentage of equity interest held	Initial investment cost RMB million	2005 RMB million	2004 RMB million
The Company:							
CITIC Ocean Helicopter Co., Ltd	Domestic shares	28,224,000	117	5.5%	69	69	69
Subsidiaries:							
Travelsky Technology Limited	Domestic shares	21,924,500	–	2.5%	33	33	33
Bank of Communications Others	Domestic shares	7,480,000	–	0.008%	11	11 2	11 5
Subsidiaries total						46	49
The Group total						115	118

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS (Cont'd)****(b) The Company***(i) Subsidiaries*

At 31 December 2005, the Company's investments in subsidiaries, which are accounted for under the equity accounting method, are analysed as follows:

	Xiamen Airlines Company Limited	Southern Airlines (Group) Shantou Airlines Company Limited	Guangxi Airlines Company Limited	Zhuhai Airlines Company Limited	Guizhou Airlines Company Limited	Other subsidiaries (Note 1)	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Attributable equity interest:							
Direct	60%	60%	95%	60%	60%	–	
Period of operations	–	16 years	–	20 years	–	–	
Initial investment cost (At 1 January 2005)	420	168	103	150	48	536	1,425
At 1 January 2005 (Note 2)	2,148	204	131	53	75	651	3,262
Add: Additions	–	–	85	–	–	239	324
Adjustment under equity accounting method	74	(45)	(100)	39	(5)	(68)	(105)
Amortisation of equity investment difference	4	–	(2)	3	–	(3)	2
Less: Dividends received	–	26	3	–	–	37	66
Reclassification of investment in non-consolidated subsidiaries	–	–	–	–	–	4	4
At 31 December 2005	2,226	133	111	95	70	778	3,413

Note 1: During the year, the Company made capital contributions to its subsidiaries, Guangzhou Baiyun International Logistic Company Limited, Southern Airlines Ka Yuen (Guangzhou) Aviation Supply Company Limited, Guangzhou Nanland Air Catering Company Limited and Zhuhai Xiangyi Aviation Technology Company Limited amounting to RMB115 million, RMB5 million, RMB61 million and USD7 million, respectively.

Note 2: During the year, the Company made reclassification of other receivables and long-term equity investments as at 1 January 2005.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**12 LONG-TERM EQUITY INVESTMENTS** (Cont'd)**(b) The Company** (Cont'd)*(ii) Associates*

At 31 December 2005, the Company's investments in associates, which are accounted for under the equity accounting method, are analysed as follows:

	SA Finance RMB million	Sichuan Airlines (Note 1) RMB million	Others RMB million	Total RMB million
Attributable equity interest:				
Direct	32.00%	39.00%		
Initial investment cost (At 1 January 2005)	127	137	87	351
At 1 January 2005	126	209	22	357
Add: Adjustment under equity accounting method	(126)	1	–	(125)
At 31 December 2005	–	210	22	232

Note 1: The principal accounting policies of Sichuan Airlines Corporation Limited ("Sichuan Airlines") are different from the Company's principal accounting policies. The differences in accounting policies mainly relating to maintenance expenses and finance charges on obligations under finance leases. Maintenance expenses of rotables are expensed as and when incurred in the Company's financial statements whereas such expenses are capitalised and amortised over 6 years in Sichuan Airlines' financial statements. Finance charges on obligations under finance leases are charged to the income statement using effective interest method in the Company's financial statements whereas such charges are amortised on a straight-line basis over the lease period in Sichuan Airlines' financial statements.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS** (Cont'd)**(b) The Company** (Cont'd)*(iii) Jointly controlled entities*

At 31 December 2005, the Company's investments in jointly controlled entities, which are accounted for under the equity accounting method, are analysed as follows:

	China Postal Airlines Limited RMB million	Guangzhou Aircraft Maintenance Engineering Company Limited RMB million	MTU Maintenance Zhuhai Co., Ltd. RMB million	Beijing Southern Ground Services Company Limited RMB million	Total RMB million
Attributable equity interest:					
Direct	49%	50%	50%	50%	
Period of operations	15 years	40 years	30 years	16 years	
Initial investment cost (At 1 January 2005)	150	87	261	9	507
At 1 January 2005	91	367	147	5	610
Add: Adjustment under equity accounting method	(7)	15	1	(4)	5
At 31 December 2005	84	382	148	1	615

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



12 LONG-TERM EQUITY INVESTMENTS (Cont'd)

(c) Other equity investments of the Group and the Company

At 31 December 2005, the Group's and the Company's other equity investments, which are accounted for under cost accounting method, are analysed as follows:

Name of investees	Investment period	Initial investment cost RMB million	Percentage of equity interest held	2005 RMB million	2004 RMB million
The Company:					
Haikou Meilan Airport International Co., Ltd.	–	100	6.73%	100	100
Others				8	1
The Company total				108	101
Subsidiaries:					
Xiamen Aviation Industrial Company Limited	–	20	10.0%	20	20
CAAC Express Ltd.	–	8	4.29%	8	8
Shantou Hua Kang Aviation Food Co. Ltd. (Note)	–	11	70.0%	11	–
Pacific Ocean Insurance Company Ltd.	–	13	0.23%	13	13
Others				44	14
Subsidiaries total				96	55
The Group total				204	156

Note: Shantou Hua Kang Aviation Food Co. Ltd. does not have significant impact on the Group's operating results. Accordingly, it is accounted for under cost method.

At 31 December 2005, the ratio of the total carrying amounts of the Group's and the Company's short-term investments and long-term equity investments to net assets are as follows:

	The Group		The Company	
	2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Carrying amount of short-term investments	–	669	–	487
Carrying amount of long-term equity investments	551	741	4,437	4,399
Carrying amount of investments	551	1,410	4,437	4,886
Net assets	9,951	11,653	9,951	11,653
Ratio of carrying amounts to net assets	5.5%	12.1%	44.6%	41.9%

The Group and the Company does not have significant restrictions on the realisation of investments and the remittance of investment returns.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**13 FIXED ASSETS****The Group**

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotable spares RMB million	Machinery, equipment and motor vehicles RMB million	Total RMB million
		Owned RMB million	Held under finance leases RMB million			
Cost or valuation:						
At 1 January 2005	7,467	27,134	14,405	9,323	2,997	61,326
Additions	72	1,827	8,146	1,521	302	11,868
Transfer from construction in progress	526	–	–	–	87	613
Transfer to inventory	–	–	–	(126)	–	(126)
Disposals	(254)	–	–	(223)	(92)	(569)
At 31 December 2005	7,811	28,961	22,551	10,495	3,294	73,112
Accumulated depreciation						
At 1 January 2005	802	4,330	2,894	4,281	1,399	13,706
Charge for the year	250	1,546	1,064	1,061	551	4,472
Written back on disposal	(84)	–	–	(144)	(86)	(314)
At 31 December 2005	968	5,876	3,958	5,198	1,864	17,864
Net book value:						
At 31 December 2005	6,843	23,085	18,593	5,297	1,430	55,248
At 31 December 2004	6,665	22,804	11,511	5,042	1,598	47,620

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



13 FIXED ASSETS (Cont'd)

The Company

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotable spares RMB million	Machinery, equipment and motor vehicles RMB million	Total RMB million
		Owned RMB million	Held under finance leases RMB million			
Cost or valuation:						
At 1 January 2005	4,017	22,133	14,405	7,468	1,876	49,899
Additions	35	128	8,146	1,182	64	9,555
Transfer from construction in progress	87	-	-	-	56	143
Transfer to inventory	-	-	-	(126)	-	(126)
Disposals	(75)	-	-	(202)	(29)	(306)
At 31 December 2005	4,064	22,261	22,551	8,322	1,967	59,165
Accumulated depreciation						
At 1 January 2005	424	3,158	2,894	3,491	808	10,775
Charge for the year	138	1,255	1,064	786	338	3,581
Written back on disposal	(60)	-	-	(101)	(13)	(174)
At 31 December 2005	502	4,413	3,958	4,176	1,133	14,182
Net book value:						
At 31 December 2005	3,562	17,848	18,593	4,146	834	44,983
At 31 December 2004	3,593	18,975	11,511	3,977	1,068	39,124

As at 31 December 2005, no provision for the impairment losses of fixed assets was made by the Group and the Company.

As at 31 December 2005, the original cost of the fixed assets that have been fully depreciated but are still in use was RMB51 million and RMB36 million for the Group and the Company, respectively (2003: RMB54 million and RMB38 million, respectively).

The respective periods of land use rights range from 30 to 70 years. As at 31 December 2005, the remaining useful lives ranged from 15 years to 63 years.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**13 FIXED ASSETS (Cont'd)**

At 31 December 2005, certain aircraft and other flight equipment of the Group and the Company were mortgaged under certain loan and finance lease agreements (see Notes 27 and 28). The net book value of these fixed assets is analysed as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Aircraft				
Mortgaged under bank loans	11,735	11,927	7,833	10,179
Mortgaged under finance leases	18,593	11,511	18,593	11,511
Sub-total	30,328	23,438	26,426	21,690
Other flight equipment				
Mortgaged under bank loans	238	7	–	–
Total	30,566	23,445	26,426	21,690

The Company entered into two separate arrangements (the "Arrangements") with certain independent third parties during each of 2002 and 2003. Under each of the Arrangements, the Company sold an aircraft and then immediately leased back the aircraft for an agreed period. The lease payment obligations, with pre-determined net present value, are to be satisfied solely out of the sale proceeds and such amount has been placed irrevocably by the Company in form of deposits and debt securities in favour of the lessors. The Company has an option to purchase the aircraft at a pre-determined date and an agreed purchase price to be satisfied by the balances of the deposits and debt securities outstanding at that date. In the event that the lease agreement is early terminated by the Company, the Company is liable to pay a pre-determined penalty to the lessor. Provided that the Company complies with the lease agreements, the Company is entitled to the continued possession and operation of the aircraft. Since the Company retains substantially all risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to their use as before the Arrangements, no adjustment has been made to the property, plant and equipment. At 31 December 2005, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,376 million (2004: RMB2,462 million). As a result of the Arrangements, the Company received net cash benefits which were recognised as income in the relevant period.

As at 31 December 2005 and up to the date of approval of these financial statements, the Group is in the process of applying for the land use right certificates and property title certificates in respect of the properties located in Guangzhou Baiyun International Airport, in which the Group has interests and for which such certificates have not been granted. At 31 December 2005, carrying value of such properties of the Group and the Company amounted to RMB2,316 million and RMB1,527 million, respectively. The directors of the Company are of the opinion that the use of and the conduct of operating activities at the properties referred to above are not affected by the fact that the Group has not yet obtained the relevant land use right certificates and property title certificates.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



14 CONSTRUCTION IN PROGRESS

At 31 December 2005, the construction in progress of the Group and the Company analysed by major projects are as follows:

Project	Budget RMB million	At		Transfer to fixed assets RMB million	At 31		% of progress	Source of funding
		1 January 2005 RMB million	Additions RMB million		December 2005 RMB million			
The Company								
Buyer furniture equipment and capitalised interest of pre-delivered aircraft	157	27	126	(80)	73	97%	80% bank loan	
Zhengzhou ticket selling office	49	22	-	-	22	45%	Self-financing	
Material and engineering system	39	22	10	-	32	82%	Self-financing	
Guangzhou new airport supporting area	89	55	11	-	66	74%	Self-financing	
B777 engine upgrading project	21	18	2	(18)	2	95%	Self-financing	
Shenzhen cargo centre	65	22	40	-	62	95%	Self-financing	
Beijing air terminal	891	-	95	-	95	11%	Self-financing	
Long Jia Airport	139	-	109	-	109	78%	Self-financing	
Dalian Warehouse	31	-	30	-	30	98%	Self-financing	
Others	217	53	60	(45)	68	52%	Self-financing	
The Company total	1,698	219	483	(143)	559			
Subsidiaries total								
Guangzhou new airport cargo centre	490	303	105	(406)	2	83%	35% bank loan	
Fuzhou Chang Le airport facilities	181	20	17	-	37	20%	Self-financing	
Others	454	68	86	(30)	124	34%	Self-financing	
Subsidiaries total	1,125	391	208	(436)	163			
Jointly controlled entities								
Guangzhou new airport facilities	24	13	10	(22)	1	96%	Self-financing	
Others	18	3	12	(12)	3	83%	Self-financing	
Jointly controlled entities total	42	16	22	(34)	4			
Group total	2,865	626	713	(613)	726			

At 31 December 2005, no provision for the impairment losses of construction in progress was made by the Group and the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**14 CONSTRUCTION IN PROGRESS** (Cont'd)

The capitalisation rate used to determine and the borrowing costs to be capitalised of the Group and the Company was as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Capitalisation rate	4.14%-5.27%	1.51%-3.48%	4.14%-5.17%	1.51%-3.48%
Borrowing costs capitalised	98	23	84	23

15 LEASE AND EQUIPMENT DEPOSITS

	The Group				The Company			
	2005		2004		2005		2004	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB Million
Advance payments for purchase of aircraft (US\$)	788	6,355	560	4,640	676	5,455	486	4,024
Rental deposits for aircraft under operating leases (US\$)	113	911	92	757	103	835	75	650
		7,266		5,397		6,290		4,674

Pursuant to aircraft purchase agreements, the Group and the Company are generally required to pay a deposit equal to approximately 30% of the purchase price of the aircraft to aircraft manufacturers prior to delivery.

Pursuant to aircraft operating lease agreements, the Group and the Company are generally required to pay lessors rental deposits equal to approximately three months' rentals.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



16 INTANGIBLE ASSETS

	The Group RMB million	The Company RMB million
Cost or valuation:		
At 1 January 2005	519	333
Additions	204	118
Disposals	45	25
At 31 December 2005	678	426
Accumulated amortisation:		
At 1 January 2005	52	37
Charge for the year	46	34
At 31 December 2005	98	71
Carrying value:		
At 31 December 2005	580	355
At 31 December 2004	467	296

The intangible assets of the Group and the Company comprise mainly land use rights and software which were all obtained through purchase from third parties.

As at 31 December 2005, remaining useful lives of the above land use rights and software ranged from 23 years to 50 years and 3 years to 10 years respectively.

17 LONG-TERM DEFERRED EXPENDITURE

	The Group RMB million	The Company RMB million
Cost:		
At 1 January 2005	164	120
Additions	22	11
At 31 December 2005	186	131
Accumulated amortisation:		
At 1 January 2005	33	11
Charge for the year	117	104
At 31 December 2005	150	115
Carrying value:		
At 31 December 2005	36	16
At 31 December 2004	131	109

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**17 LONG-TERM DEFERRED EXPENDITURE (Cont'd)**

Long-term deferred expenditure comprises mainly custom duties and other direct costs incurred in relation to modifying, introducing and certifying certain operating lease aircraft of the Group and the Company. The balance is amortised on a straight-line basis over the respective lease periods of the aircraft.

At 31 December 2005, the remaining unamortised period ranged from 2 to 3 years.

18 LONG-TERM RECEIVABLES

Long-term receivables represent insurance premiums deposited with a PRC insurance company. Pursuant to the relevant insurance agreement, the insurance premiums will be fully refunded to the Group upon the expiry of the agreement in 2007.

19 SHORT-TERM LOANS

Details of short term loans are analysed as follows:

Note	The Group				The Company			
	2005		2004		2005		2004	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB Million
Unsecured loans								
US Dollars	1,511	12,193	683	5,650	1,435	11,579	678	5,612
Hong Kong Dollars	1,821	1,895	2,678	2,842	1,640	1,707	2,678	2,842
Renminbi		25		1,270		-		766
Sub-total		14,113		9,762		13,286		9,220
Guaranteed loans (a)								
US Dollars	6	48		-		-		-
Renminbi		300		411		-		-
Sub-total		348		411		-		-
Secured loans (b)								
Renminbi		17		-		-		-
Total		14,478		10,173		13,286		9,220

(a) The loans were guaranteed by CSAHC.

(b) The loan was secured by a fixed deposit of the Group (see Note 4).

At 31 December 2005, the Group's and the Company's weighted average interest rates on short-term borrowings were both at 4.83% per annum (2004: 1.60% and 1.56% per annum, respectively).

At 31 December 2005, the Group and the Company had no overdue short-term loans (2004: Nil).

There was no short-term loan payable to shareholders who hold 5% or more of the voting rights of the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



20 BILLS PAYABLE

The Group

	2005		2004	
	RMB million	%	RMB million	%
Bank acceptance bills	–	–	72	52.6%
Commercial acceptance bills	896	100.0%	65	47.4%
	896	100.0%	137	100.0%

The Company

	2005		2004	
	RMB million	%	RMB million	%
Bank acceptance bills	–	–	71	52.2%
Commercial acceptance bills	896	100.0%	65	47.8%
	896	100.0%	136	100.0%

All of the bills payables are expected to be settled within one year.

There was no bills payable to shareholders who hold 5% or more of the voting rights of the Company.

21 TRADE PAYABLES

Except as disclosed in Note 46, there was no balance of trading nature payable to shareholders who hold 5% or more of the voting rights of the Company.

At 31 December 2005, the Group and the Company did not have any individually significant trade payables that were aged over three years.

22 SALES IN ADVANCE OF CARRIAGE

Sales in advance of carriage represent the proceeds from sales of air tickets in advance of carriage received by the Group and the Company. At 31 December 2005, the Group and the Company did not have any individually significant sales in advance of carriage balances that were aged over three years.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**23 OTHER COMPULSORY PAYABLES**

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Airport construction surcharge	542	316	482	266
CAAC Infrastructure Development Fund (Note)	178	162	125	108
Education surcharges	11	10	5	5
Others	5	7	3	–
	736	495	615	379

Note: Pursuant to the notice No. 94 [2004] Civil Aviation Cai Fa "Rules and Regulations for Implementation of the Levy of Civil Aviation Infrastructure Development Fund", effective from 1 April 2004 CAAC infrastructure development fund is payable which is calculated based on the rates as stipulated in the notice Cai Zong [2004] No. 38 "Ministry of Finance Provisional Regulations on the Levy and Use of Civil Aviation Infrastructure Development Fund". The new rates for CAAC infrastructure development fund are determined based on route category, maximum weight, flying distance and the change rates. The amount was recognised in cost of principal operations.

CAAC Infrastructure development fund payable is analysed as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
At 1 January	162	354	108	293
Add: Charge for the year	978	433	740	303
Additions through the CNA/XJA Acquisitions	–	37	–	37
Less: Payment during the year	962	662	723	525
At 31 December	178	162	125	108

24 OTHER PAYABLES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Amount due to subsidiaries	–	–	51	–
Amount due to other related companies	20	2,094	181	2,094
Others	2,883	2,338	2,097	1,762
	2,903	4,432	2,329	3,856

Except as disclosed in Note 46, there was no payable to shareholders who hold 5% or more of the voting rights of the Company in the balance of other payables.

At 31 December 2005, the Group and the Company did not have any individually significant other payables that were aged over three years.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



25 ACCRUED EXPENSES

	Note	The Group		The Company		
		2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million	
Custom duties and value added tax	(a)	12	71	12	45	Accrued but not paid
Landing and take-off fees	(b)	1,096	1,383	890	1,100	Accrued but not paid
Jet fuel costs	(b)	686	377	493	226	Accrued but not paid
Aircraft and engine repair charges	(b)	806	901	960	983	Accrued but not paid
Air catering expenses	(b)	132	98	131	118	Accrued but not paid
Staff housing allocations and lump sum housing allowances	(c)	92	108	92	108	Accrued but not paid
Interest expense	(d)	339	249	312	229	Accrued but not paid
Provision for major overhauls – current portion (Note 29)		151	75	123	62	Accrued but not paid
Seat reservation charges		190	144	105	100	Accrued but not paid
Operating lease rentals		86	25	86	15	Accrued but not paid
Property management and repair expenses		37	–	37	–	Accrued but not paid
Others		202	271	156	188	Accrued but not paid
Sales commissions		13	14	6	14	Accrued but not paid
Aircraft insurance premiums		6	13	–	3	Accrued but not paid
		3,848	3,729	3,403	3,191	

Notes:

(a) Custom duties and value added tax

Custom duties and value added tax mainly represent custom duties and value added tax payable by the Group in connection with purchases of aircraft. These custom duties and value added tax payable have been capitalised as part of cost of aircraft. The amounts are paid in installments by the Group.

(b) Landing and take-off fees, jet fuel costs, aircraft and engine repair charges, and air catering expenses

The transaction volume and amounts involved for landing and take-off fees, aircraft and engine repair expenses, jet fuel costs and air catering expenses are significant and their settlements generally take one to three months. Accordingly, such expenses were accrued at the year end to match with the revenues.

(c) Staff housing allocations and lump sum housing allowances

Pursuant to Cai Kuai Zi [2001] No. 5 issued by the MOF, staff housing allocations charge and lump sum housing allowances payable to employees who joined the Company before 1998 but not yet allocated with staff housing were recorded as accrued expenses. These expenses were charged against retained earnings at the beginning of 2001.

(d) Interest expense

Accrual for interest expense was mainly for finance lease obligations and loans in respect of aircraft purchases. The Group is generally required to repay the principal and interest amounts every three or six months. Interest expense was accrued at the year end.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

26 LONG-TERM LIABILITIES DUE WITHIN ONE YEAR

	The Group				The Company			
	2005		2004		2005		2004	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB Million
Long-term loans due within one year (Note27)								
Guaranteed (RMB)		2		1		–		–
Unsecured (USD)	107	865	10	82	103	835	10	82
Unsecured (RMB)		–		16		–		–
Mortgaged and guaranteed (US\$)	72	582	60	496	55	440	31	254
Mortgaged and guaranteed (RMB)		1		–		–		–
Mortgaged (US\$)	57	458	119	989	13	103	94	780
Mortgaged (RMB)		–		26		–		26
Sub-total		1,908		1,610		1,378		1,142
Obligations under finance leases due within one year (Note 28)								
Mortgaged and guaranteed								
– US Dollars	304	2,453	246	2,032	304	2,453	246	2,032
– Japanese Yen	12,825	879	615	49	12,825	879	615	49
Sub-total		3,332		2,081		3,332		2,081
Total		5,240		3,691		4,710		3,223

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



27 LONG-TERM LOANS

The Group

Interest rate (at 31 December 2005)	2005		2004	
	Original currency million	RMB million	Original currency million	RMB million
Renminbi denominated loans:				
Non-interest bearing loan from a municipal government authority repayable on demand		3		3
Floating interest rates ranging from 4.94% to 5.51% per annum, with maturities through 2011		890		1,217
United States Dollars denominated loans:				
Fixed interest rates ranging from 4.43% to 7.73% per annum, with maturities through 2015	299	2,414	323	2,676
Floating interest rates ranging from 3-month LIBOR+0.65% to 0.90% per annum, with maturities through 2012	496	4,000	212	1,753
Floating interest rates ranging from 6-month LIBOR+0.30% to 1.20% per annum, with maturities through 2013	957	7,722	1,000	8,276
Hong Kong Dollars denominated loans:				
Floating interest rates ranging from 6-month HIBOR+0.85% per annum, with maturities through 2006	9	9	9	9
		15,038		13,934
Less: Long-term loans due within one year (Note 26)		1,908		1,610
		13,130		12,324

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**27 LONG-TERM LOANS** (Cont'd)**The Company**

Interest rate (at 31 December 2005)	2005		2004	
	Original currency million	RMB million	Original currency million	RMB million
Renminbi denominated loans:				
Floating interest rates at 5.51% per annum, with maturities through 2011		550		1,217
United States Dollars denominated loans:				
Fixed interest rates ranging from 4.43% to 7.73% per annum, with maturities through 2015	227	1,835	281	2,326
Floating interest rates ranging from 3-month LIBOR+0.75% to 0.90% per annum, with maturities through 2008	241	1,946	172	1,426
Floating interest rates ranging from 6-month LIBOR+0.30% to 1.20% per annum, with maturities through 2013	931	7,511	811	6,713
		11,842		11,682
Less: Long-term loans due within one year (Note 26)		1,378		1,142
		10,464		10,540

The borrowing terms of long-term loans of the Group and the Company are analysed as follows:

	Note	The Group		The Company	
		2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Unsecured loans		6,216	4,538	5,665	4,459
Guaranteed loans	(a)	386	2,424	223	1,812
Mortgaged loans	(b)	5,748	4,800	3,844	4,240
Mortgaged and guaranteed loans	(c)	2,688	2,172	2,110	1,171
		15,038	13,934	11,842	11,682

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**27 LONG-TERM LOANS** (Cont'd)

(a) Above guaranteed loans were provided by the following parties:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
CSAHC	357	2,415	223	1,812
Shenzhen Yingshun Investment Development Company Limited	22	–	–	–
SA Finance	7	9	–	–
	386	2,424	223	1,812

(b) The guaranteed loans were secured by mortgages over certain of the Group's and the Company's aircraft (see Note 13).

(c) The mortgaged and guaranteed loans were secured by mortgages over certain of the Group's and the Company's aircraft (see Note 13), and were guaranteed by the following parties:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Export-Import Bank of the United States	1,171	1,732	593	969
Bank of China	155	291	155	53
Industrial and Commercial Bank of China	111	149	111	149
CSAHC	1,251	–	1,251	–
	2,688	2,172	2,110	1,171

The maturity analysis of the long-term loans of the Group and the Company is as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Within 1 year	1,908	1,610	1,378	1,142
1 to 2 years	4,356	1,698	3,475	1,476
2 to 3 years	2,473	4,436	1,785	3,817
After 3 years	6,301	6,190	5,204	5,247
	15,038	13,934	11,842	11,682

There were no payables to shareholders who hold 5% or more of the voting rights of the Company in the balance of long-term loans.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**28 OBLIGATIONS UNDER FINANCE LEASES****The Group and the Company**

	2005 RMB million	2004 RMB million
At 1 January	11,619	6,841
Add: Additions	6,938	–
Additions through the CNA/XJA Acquisitions	–	6,001
Effect due to fluctuations of foreign exchange rates	(793)	49
Less: Payments during the year	2,014	1,272
At 31 December	15,750	11,619
Less: Obligations under finance leases due within one year (Note 26)	3,332	2,081
	12,418	9,538

Certain lease financing arrangements comprised finance leases between the Company and certain of its subsidiaries, and corresponding borrowings between such subsidiaries and certain banks. The Company has guaranteed the subsidiaries' obligations under the bank borrowing arrangements and accordingly, the relevant leased assets and obligations are recorded in the Company's balance sheet as owned assets and bank loans to reflect the substance of these transactions.

The Group and the Company have commitments under finance lease agreements in respect of aircraft and related equipment. These leases terms will expire during the years 2006 to 2017. As at 31 December 2005, the weighted average interest rates on obligations under finance leases were 6%, future payments under these finance leases for the Group and the Company are as follows:

	2005 RMB million	2004 RMB million
Within 1 year	3,332	2,081
1 to 2 years	2,889	2,829
2 to 3 years	2,607	2,559
After 3 years	6,922	4,150
	15,750	11,619

Under the terms of the leases, the Group and the Company have an option to purchase, at or near the end of the lease term, certain aircraft at fair market value and other aircraft at either fair market value or a percentage of the respective lessor's defined cost of the aircraft.

Securities, including charges over the assets concerned and relevant insurance policies, are provided to the lessors. As at 31 December 2005, certain of the Group's and the Company's aircraft were mortgaged to secure finance lease obligations as disclosed in Note 13.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



28 OBLIGATIONS UNDER FINANCE LEASES (Cont'd)

At 31 December 2005, certain of the Group's and the Company's obligation under finance leases were guaranteed by the following parties:

	2005 RMB million	2004 RMB million
Bank of China	7,186	7,134
Industrial and Commercial Bank of China	6,403	4,485
Agriculture Bank of China	1,548	-
Obligation under finance leases without guarantee	613	-
	15,750	11,619

At 31 December 2005, currency analysis of long term payable for obligations under finance leases of the Group and the Company is as follows:

	2005		2004	
	Original currency million	RMB million	Original currency million	RMB million
US dollars	1,242	10,020	698	5,775
Japanese Yen	34,970	2,398	47,215	3,763
		12,418		9,538

Balance due within one year is disclosed in Note 26 to the financial statements. There was no amount due to shareholders who hold 5% or more of the voting rights of the Company included in the balance of obligations under finance leases.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**29 PROVISION FOR MAJOR OVERHAULS**

	The Group RMB million	The Company RMB million
At 1 January 2005	359	248
Including current portion	75	62
Add: Provision for the year	144	86
Less: Provision utilised during the year	37	25
At 31 December 2005	466	309
Less: Current portions included in accrued expenses (Note 25)	151	123
	315	186

30 DEFERRED CREDITS**The Group**

	Gain on sales and leaseback transactions RMB million	Rebates on Aircraft under operating leases RMB million	Rebates on Aircraft under finance leases RMB million	Total RMB million
Cost:				
At 1 January 2005	259	60	21	340
Additions	11	56	418	485
31 December 2005	270	116	439	825
Accumulated amortisation:				
At 1 January 2005	79	21	–	100
Amortisation for the year	31	11	28	70
At 31 December 2005	110	32	28	170
Carrying value:				
At 31 December 2005	160	84	411	655
At 31 December 2004	180	39	21	240

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**30 DEFERRED CREDITS (Cont'd)****The Company**

	Gain on sales and leaseback Transactions RMB million	Rebates on Aircraft under operating leases RMB million	Rebates on Aircraft under finance leases RMB million	Total RMB million
Cost:				
At 1 January 2005	259	60	21	340
Additions	–	56	418	474
31 December 2005	259	116	439	814
Accumulated amortisation:				
At 1 January 2005	79	21	–	100
Amortisation for the year	30	11	28	69
At 31 December 2005	109	32	28	169
Carrying value:				
At 31 December 2005	150	84	411	645
At 31 December 2004	180	39	21	240

The gain on sales and leaseback transaction, being the surplus of the sale proceeds over the aircraft's net book value and related disposal costs, was recorded as deferred credit and amortised over the respective lease terms.

Pursuant to certain aircraft operating lease arrangements, the Group received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases.

Pursuant to certain aircraft finance lease arrangements, the Group received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases on a straight line basis.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**31 DEFERRED TAXATION**

The movements of net deferred tax (liabilities)/assets are analysed as follows:

	The Group	The Company
	RMB million	RMB million
At 1 January 2005	(282)	55
Less: Changes during the year ((Note 45))	27	19
At 31 December 2005	(255)	74

The deferred tax (liabilities)/assets at 31 December 2005 were made up of the following tax effects:

	Note	The Group		The Company	
		2005	2004	2005	2004
		RMB million	RMB million	RMB million	RMB million
Deferred tax assets:					
Tax losses	(a)	159	39	159	39
Repairs and maintenance accruals	(b)	143	129	143	125
Rotable repair charges capitalised	(c)	275	254	220	195
Accrued expenses	(d)	32	143	32	143
Gains on sales and leaseback transactions	(e)	22	27	22	27
Others		20	18	6	22
Total deferred tax assets		651	610	582	551
Deferred tax liabilities:					
Repairs and maintenance accruals	(b)	54	74	-	-
Depreciation of fixed assets	(f)	832	751	508	459
Others		20	67	-	37
Total deferred tax liabilities		906	892	508	496
Net balance		(255)	(282)	74	55

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**31 DEFERRED TAXATION** (Cont'd)

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Net deferred tax asset recognised on the balance sheet	85	55	74	55
Net deferred tax liability recognised on the balance sheet	(340)	(337)	–	–
	(255)	(282)	74	55

Notes:

(a) Tax losses

Pursuant to the relevant tax regulations, tax losses are available for carry forward to set off against future PRC assessable income for a maximum period of five years. The deferred tax is recognised based on the unutilised taxable losses and estimated future taxable profits.

(b) Repairs and maintenance accruals

Certain of the Group's and the Company's overhaul expenses were deductible on a cash payment basis for taxation purposes. According to the accounting policies adopted in these financial statements, overhaul expenses are expensed as and when incurred. The Group and the Company recognised the deferred tax for these timing differences.

(c) Rotables repair charges capitalised

Pursuant to the relevant tax regulations, repair charges for rotables are initially capitalised and amortised over five years for taxation purposes. According to the accounting policies adopted in these financial statements, repair charges for rotables are expensed when incurred. The Group and the Company recognised the deferred tax for these timing differences.

(d) Accrued expenses

Certain of the Group's and the Company's expenses are deductible on a cash payment basis for taxation purposes. In the preparation of these financial statements, these expenses are accounted for on an accrual basis. The Group and the Company recognised a deferred tax for these timing differences.

(e) Gains on sales and leaseback transactions

Pursuant to the relevant tax regulations, gains on sales and leaseback transactions are taxable in the period they arise. According to the accounting policies adopted in these financial statements, these gains are recorded as deferred credits and amortised over the terms of the leases. The Group and the Company recognised the deferred tax on these timing differences.

(f) Depreciation of fixed assets

Deferred tax was recognised for the timing difference arising from the difference between the aircraft depreciation rates for accounting purposes and the rates used for taxation purposes.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**32 SHARE CAPITAL****The Group and the Company**

	2005 RMB million	2004 RMB million
Registered, issued and paid up capital:		
2,200,000,000 domestic state-owned shares of RMB1.00 each	2,200	2,200
1,174,178,000 H shares of RMB1.00 each	1,174	1,174
1,000,000,000 A shares of RMB1.00 each	1,000	1,000
	4,374	4,374

KPMG Huazhen verified the above capital contributions, and issued related capital verification reports on 31 December 1994, 10 September 1997 and 17 July 2003 respectively.

33 CAPITAL RESERVE

	The Group		The Company	
	2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Share premium				
At 1 January and 31 December	5,801	5,801	5,801	5,801
Government grants				
At 1 January	-	-	-	-
Additions	53	-	53	-
At 31 December	53	-	53	-
Others				
At 1 January	-	-	-	-
Additions	39	-	39	-
At 31 December	39	-	39	-
Total	5,893	5,801	5,893	5,801

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



34 SURPLUS RESERVES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Statutory surplus reserve				
At 1 January	402	361	349	339
Add: Profit appropriation	8	41	–	10
At 31 December	410	402	349	349
Statutory public welfare fund				
At 1 January	193	173	177	172
Add: Profit appropriation	5	20	–	5
At 31 December	198	193	177	177
Discretionary surplus reserve				
At 1 January	77	77	77	77
Add: Profit appropriation	6	–	–	–
At 31 December	83	77	77	77
Total	691	672	603	603

Note: In accordance with relevant regulations, appropriations to reserve were made by the profitable subsidiaries in 2005.

35 PROFIT APPROPRIATION

On 19 April 2006, the Board of Directors approved not to appropriate dividend to ordinary shareholders.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**36 REVENUE FROM PRINCIPAL OPERATIONS**

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Passenger	35,363	21,624	27,523	14,481
Cargo and mail	3,376	2,315	2,845	2,022
Others	313	255	275	232
	39,052	24,194	30,643	16,735

Revenue from principal operations represents revenue from airline businesses. The Group's segmental information is set out in Note 47.

The total amount of the Group's and the Company's revenue from principal operations from the top five customers are as follows:

	The Group		The Company	
	2005	2004	2005	2004
Amounts (RMB million)	833	209	639	173
% of total revenue from principal operations	2.1%	0.9%	2.1%	1.0%

37 COST OF PRINCIPAL OPERATIONS

Cost of principal operations represents cost for airlines business operations. The Group's segmental information is set out in Note 47.

38 BUSINESS TAXES AND SURCHARGES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Business tax	1,092	673	849	447
City construction tax	25	11	8	5
Education surcharge	12	8	4	4
	1,129	692	861	456

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



39 PROFIT FROM OTHER OPERATIONS

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Ground services income	195	112	184	110
Others	(25)	133	35	78
	170	245	219	188

40 FINANCIAL EXPENSES

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Interest expense incurred	1,780	734	1,544	586
Less: Borrowing costs capitalised	98	23	84	23
Net interest expense	1,682	711	1,460	563
Interest income	(57)	(34)	(40)	(17)
Net foreign exchange (gains)/losses	(1,232)	20	(1,166)	14
Bank charges	46	30	40	25
	439	727	294	585

The net foreign exchange gain for the Group and the Company during the year were mainly related to the exchange gains on short term loans, long term loans and obligation under finance lease denominated in foreign currencies.

41 INVESTMENT (LOSS)/INCOME

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Equity investment (loss)/income accounted for				
Under cost method	32	14	14	–
Under equity method	(234)	49	(218)	224
	(202)	63	(204)	224

There were no major restrictions on the remittance of the Group's and the Company's investment returns.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

42 SUBSIDY INCOME

	Note	The Group		The Company	
		2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Subsidy income for relocation of airport	(a)	30	–	30	–
VAT refund	(b)	27	–	–	–
Others		20	–	16	–
		77	–	46	–

Notes:

- (a) Pursuant to the notice Yue Cai Wai 【2005】 No.80 issued by the Finance Bureau of Guangdong Province, the Company received a one-off subsidy amounted to Rmb30 million for the relocation of airport.
- (b) Pursuant to the notice “Caisui No. 【2000】 102” issued by the MOF and the State Administration of Taxation, to support development of aircraft repair and maintenance industry, the part of VAT paid by the Group for providing aircraft maintenance service which exceeds the rate of 6% would be refunded. The Group received subsidy income of RMB9 million and RMB18 million from Zhuhai State Tax Bureau and Guangzhou State Tax respectively.

43 NON-OPERATING INCOME

	The Group		The Company	
	2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Gain on disposal of fixed assets	17	50	7	40
Expired sales in advance of carriage	104	35	97	35
Others	31	41	22	31
	152	126	126	106

44 NON-OPERATING EXPENSES

	The Group		The Company	
	2005 RMB million	2004 RMB million	2005 RMB million	2004 RMB million
Loss on disposal of fixed assets	49	44	23	57
Donations	45	9	45	–
Technical fee	–	30	–	–
Others	18	44	13	1
	112	127	81	58

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



45 INCOME TAX

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Corporate income tax for the year	23	197	(31)	94
Deferred taxation (Note 31)	(27)	(110)	(19)	(118)
	(4)	87	(50)	(24)

46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS

(a) Related party with controlling relationship

	Registered place	Principal activities	Relation with the Company	Nature of ownership	Legal representative
The parent company					
CSAHC	PRC	Management of the companies' operation within the Group and the sale of products	The ultimate holding company	State owned	Liu Shao Yong
Principal subsidiaries under the control of the Company					
Guangxi Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Yang Guang Hua
Southern Airlines (Group) Shantou Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Yang Guang Hua
Zhuhai Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Zheng En Ren
Xiamen Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Yang Guang Hua
Guizhou Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Xu Jie Bo
Guangzhou Nanland Air Catering Company Limited	PRC	Air catering	Subsidiary	Sino-foreign equity joint venture company	Ren Ji Dong
Guangzhou Baiyun International Logistic Company Limited	PRC	Logistic operation	Subsidiary	Limited liability company	Zheng En Ren
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC	Provision of flight simulation training service	Subsidiary	Sino-foreign equity joint venture company	Liu Xian
Xinjiang Civil Aviation Property Management Limited	PRC	Property management	Subsidiary	Limited liability company	Ren Ji Dong
Guangzhou Air Cargo Company Limited	PRC	Cargo service	Subsidiary	Limited liability company	Li Kun
China Southern West Australian Flying College Pty Limited	Australia	Pilot training services	Subsidiary	Limited liability company	Liu Xian

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)****(a) Related party with controlling relationship (Cont'd)***Registered capital of related parties with controlling relationships and its changes*

	Currency	At 1 January 2005	Addition	At 31 December 2005
The parent company				
CSAHC	RMB	2,198,980,000	–	2,198,980,000
Principal subsidiaries under the control of the Company				
Guangxi Airlines Company Limited	RMB	170,900,000	–	170,900,000
Southern Airlines (Group) Shantou Airlines Company Limited	RMB	280,000,000	–	280,000,000
Zhuhai Airlines Company Limited	RMB	250,000,000	–	250,000,000
Xiamen Airlines Company Limited	RMB	700,000,000	–	700,000,000
Guizhou Airlines Company Limited	RMB	80,000,000	–	80,000,000
Guangzhou Nanland Air Catering Company Limited	RMB	55,980,000	64,020,000	120,000,000
Guangzhou Baiyun International Logistic Company Limited	RMB	20,000,000	30,000,000	50,000,000
Zhuhai Xiang Yi Aviation Technology Company	USD	29,800,000	13,820,849	43,620,849
Xinjiang Civil Aviation Property Management Limited	RMB	251,322,832	–	251,322,832
Guangzhou Air Cargo Company Limited	RMB	238,000,000	–	238,000,000
China Southern West Australian Flying College Pty Limited	AUD	100,000	–	100,000

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)****(a) Related party with controlling relationship (cont'd)**

Equity interests held by related parties with controlling relationships and their changes

	Currency	At 1 January 2005		Increase		At 31 December 2005	
		Amount	%	Amount	%	Amount	%
The movements of the equity interest of CSAHC in the Company							
CSAHC	RMB	2,200,000,000	50.3%	–	–	2,200,000,000	50.3%
Movements of the equity interest of the Company in its subsidiaries							
Guangxi Airlines Company Limited	RMB	102,540,000	60.0%	59,815,000	35.0%	162,355,000	95.0%
Southern (Group) Shantou Airlines Company Limited	RMB	168,000,000	60.0%	–	–	168,000,000	60.0%
Zhuhai Airlines Company Limited	RMB	150,000,000	60.0%	–	–	150,000,000	60.0%
Xiamen Airlines Company Limited	RMB	420,000,000	60.0%	–	–	420,000,000	60.0%
Guizhou Airlines Company Limited	RMB	48,000,000	60.0%	–	–	48,000,000	60.0%
Guangzhou Nanland Air Catering Company Limited	RMB	28,549,800	51.0%	61,450,200	24.0%	90,000,000	75.0%
Guangzhou Baiyun International Logistic Company Limited	RMB	12,200,000	61.0%	115,473,000	–	127,673,000	61.0%
Zhuhai Xiang Yi Aviations Technology Company Limited	USD	15,198,000	51.0%	7,048,633	–	22,246,633	51.0%
Xinjiang Civil Aviation Property Management Limited	RMB	130,276,998	51.8%	–	–	130,276,998	51.8%
Guangzhou Air Cargo Company Limited	RMB	166,600,000	70.0%	–	–	166,600,000	70.0%
China Southern West Australian Flying College Pty Limited	AUD	65,000	65.0%	–	–	65,000	65.0%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)

(b) Relationship between the Company and related parties without controlling relationships

(i) *Subject to common control from CSAHC, i.e. subsidiaries of CSAHC*

Southern Airlines (Group) Import and Export Trading Company
Southern Airlines (Group) Economic Development Company
Nanlung Travel & Express (H.K.) Ltd.
Southern Airlines (Group) Passengers and Cargo Agent Company
China Southern Airlines Group Finance Company Limited
Southern Airlines (Group) Air Catering Co., Ltd
Southern Airlines (Group) Hainan Company Limited
Southern Airlines (Group) Property Management Co., Ltd
CNA
XJA

(ii) *Company that is under the significant influence of CSAHC*

Shenzhen Air Catering Company Limited

(iii) *Jointly controlled entities of the Group*

Guangzhou Aircraft Maintenance Engineering Company Limited
MTU Maintenance Zhuhai Co., Ltd
Beijing China Southern Airlines Ground Service Company Ltd

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)

(c) The transactions between the Group and the related parties carried out during the year were as follows:

	Note	2005 RMB million	2004 RMB million
Expenses			
Handling charges	(1)	32	33
Air catering supplies	(2)	173	170
Commission expense	(3)	26	2
Sundry aviation supplies	(4)	88	66
Lease charges for aircraft	(5)	10	–
Lease charges for land and buildings	(6)	90	18
Property management fee and repair charges	(7)	28	–
Staff housing allocation benefits	(8)	–	85
Ground service expenses	(9)	16	–
Repairing charges	(10)	559	580
Interest expense	(11)	37	3
Income			
Interest income	(12)	3	4
Others			
CNA/XJA Acquisitions	(13)	–	15,398
Operating expenses recharged to related companies	(14)	–	65

Notes:

- (1) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company 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 procurement value by reference to market rates. The fees are usually paid by the end of the following month.
- (2) Air catering expenses represent fees payable to Shenzhen Air Catering Company Limited and Southern Airlines (Group) Catering Co., Ltd for providing in-flight meals to the Group. Prices are determined by reference to market prices. The payable amount is usually settled by the end of the following month.
- (3) Sales commission expenses represent commission payable to Nanlung Travel and Express (H.K.) Ltd. and China Southern Group Passenger and Cargo Agency Company in connection with air tickets sold by these sales agents on the Group's behalf. The commission rates are based on the rates stipulated by the CAAC. The sales commission expense payable is offset directly against the sales proceeds receivable from these sales agents.
- (4) Sundry aviation supplies represent purchases of sundry aviation supplies from Southern Airlines (Group) Economic Development Company. Prices are determined by reference to market prices. The payable amount is generally settled by the end of the following month.
- (5) Lease charges for aircraft represent the rental expenses for lease of an MD82 aircraft from China Southern Airlines (Group) Hainan Co., Ltd, a subsidiary of CSAHC.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)

- (c) The transactions between the Group and the related parties carried out in during the year were as follows: (Cont'd)
- (6) Lease charges for land and buildings represent rentals payable to CSAHC by the Group under certain lease agreements in respect of certain land and buildings of CSAHC. The rentals are determined based on market rents. The rentals payments are due in June and December each year.
 - (7) China Southern Airlines (Group) Property Management Co., Ltd, a subsidiary of CSAHC, provides property management services to the Group.
 - (8) Staff housing allocation benefits paid to CSAHC represent the difference between the cost of the quarters sold to the employees of the Group and the proceeds from sales of these quarters by CSAHC. The amount was fully settled at 31 December 2004.
 - (9) Ground service expenses represent the expenses for the ground services provided by Beijing Ground Service Co., Ltd. The charge rates are in accordance with relevant regulations issued by the CAAC. During the year, ground services fee amounting to RMB16 million were eliminated in applying the proportional consolidation method.
 - (10) Repair charges represent fees payable to Guangzhou Aircraft Maintenance Engineering Company Limited and MTU Maintenance Zhuhai Co. Ltd. in connection with aircraft repairs and maintenance services rendered to the Group. Fees are charged based on market prices. During the year, repair fees amounting to RMB559 million were eliminated in applying the proportional consolidation method.
 - (11) Interest expense represents the interest paid for the loans from SA Finance. The applicable interest is determined in accordance with the interest rate as published by the People's Bank of China. Loans from SA Finance at the year end are set out in Note 46 (d).
 - (12) Interest income represents the interest received from deposits placed with SA Finance by the Group (Note 4). The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China. Interest income is received quarterly. Deposits with SA Finance at the year end are set out in Note 46 (d).
 - (13) As disclosed in Note 1 to the financial statements, the Company acquired the airline operations and certain related assets of CNA and XJA on 31 December 2004 for a consideration of RMB15,398 million, which was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,439 million outstanding at 31 December 2004. The remaining consideration payable of RMB1,959 million was satisfied in cash in 2005.
 - (14) In 2004, the Group provided administrative services to CNA and XJA. Operating expenses amounted to RMB65 million were re-charged to CNA and XJA on a cost basis.

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

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)**

(d) The balances, deposits and loans with related parties are summarised as follows:

	Relationship	2005 RMB million	2004 RMB million
Cash at bank and on hand			
SA Finance	Other related company	557	406
Trade receivables			
Nanlung Travel and Express (H.K.) Ltd	Other related company	42	52
Other receivables			
Southern Airlines (Group) Import and Export Traveling Company Ltd	Other related company	3	15
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	8	22
MTU Maintenance Zhuhai Co., Ltd	Jointly controlled entity	4	–
Trade payables			
Southern Airlines (Group) Import and Export Traveling Company Ltd	Other related company	850	838
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	25	118
Other payables			
SA Finance	Other related company	5	–
CSAHC	Jointly controlled entity	12	2,094
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	3	–
Accrued expenses			
Guangzhou Southern Airlines (Group) Property Management Co., Ltd	Other related company	28	–
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	119	–
MTU Maintenance Zhuhai Co. Ltd	Jointly controlled entity	84	138
Beijing Ground service Company Ltd	Jointly controlled entity	33	10
Southern Airlines (Group) Economic Development Company	Other related company	10	3
Southern Airlines (Group) Catering Co., Ltd	Other related company	47	52
Short-term loans			
SA Finance	Other related company	300	256

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**46 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (Cont'd)****(e) Guarantees provided by related parties**

Other than the guarantees given by CSAHC and SA Finance to banks in respect of certain loans of the Group (Note 19 and Note 27), there were no guarantees provided by banks by other related parties in favour of the Group.

(f) 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.

47 SEGMENTAL INFORMATION

The Group engages in a single operation, i.e. the provision of airline services. Geographic information about the Group's profit from principal operations is as follows:

	Domestic RMB million	Hong Kong and Macau RMB million	International (Note) RMB million	Total RMB million
2005				
Net revenue from principal operations	31,004	1,343	6,705	39,052
Less: Cost of principle operations	26,582	1,208	6,507	34,297
Business taxes and surcharges	989	23	117	1,129
Profit from principal operations	3,433	112	81	3,626
2004				
Net revenue from principal operations	18,582	1,201	4,411	24,194
Less: Cost of principle operations	14,910	937	3,559	19,406
Business taxes and surcharges	532	34	126	692
Profit from principal operations	3,140	230	726	4,096

Note: Mainly routes between the PRC and Asian countries, the United States of America, the Netherlands, Belgium, Australia and France.

The major revenue-earning asset of the Group is its aircraft fleet, all are registered in the PRC. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis for allocating its assets to geographic segments. Most of the Group's non-aircraft assets are located in the PRC.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



48 CONTINGENT LIABILITIES

- (i) Pursuant to the Reorganisation of CSAHC effected from 25 March 1995 (subsequently revised on 22 May 1997), the Company assumed the airline and airline-related businesses together with the relevant assets and liabilities from CSAHC. The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the businesses assumed by the Company in the Reorganisation, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by CSAHC prior to the Reorganisation. There are not, however, any definitive PRC regulations or other pronouncements confirming such conclusion.
- (ii) The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou. The Group has a significant investment in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan, Haikou and Zhengzhou lack adequate documentation evidencing CSAHC's rights thereto.

Pursuant to the indemnity agreement signed with CSAHC on 22 May 1997, CSAHC has agreed to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of its land and buildings.

49 COMMITMENTS

(i) Capital commitments

At 31 December 2005, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Commitments in respect of aircraft and flight equipment				
– authorised and contracted for	45,628	11,776	33,955	10,121
– authorised but not contracted for	–	13,571	–	13,571
	45,628	25,347	33,955	23,692
Commitments in respect of investments in the Guangzhou new airport				
– authorised and contracted for	79	110	79	110
– authorised but not contracted for	761	714	761	714
	840	824	840	824
Other commitments				
– authorised and contracted for	11	132	11	117
– authorised but not contracted for	1,398	724	1,241	200
	1,409	856	1,252	317
	47,877	27,027	36,047	24,833

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**49 COMMITMENTS** (Cont'd)**(i) Capital commitments** (Cont'd)

At 31 December 2005, the total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and flight equipment are as follows:

	The Group RMB million	The Company RMB million
Within 1 year	7,341	5,914
1 to 2 years	8,945	7,240
2 to 3 years	14,354	13,046
After 3 years	14,988	7,755
	45,628	33,955

(ii) Operating lease commitments

The Group's and the Company's commitments under non-cancellable aircraft and flight equipment of operating leases were as follows:

	The Group		The Company	
	2005	2004	2005	2004
	RMB million	RMB million	RMB million	RMB million
Within 1 year	3,340	1,761	3,113	1,489
1 to 2 years	2,881	1,622	2,673	1,418
2 to 3 years	2,785	1,562	2,666	1,376
After 3 years	15,588	7,805	15,414	7,568
	24,594	12,750	23,866	11,851

(iii) Investing commitments

At 31 December 2005, the Group and the Company committed to make capital contributions in respect of:

	2005 RMB million	2004 RMB million
Subsidiaries	-	181
Jointly controlled entities	83	83
	83	264

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES

The particulars of the Company's principal subsidiaries, and the Group's associates and jointly controlled entities as at 31 December 2005 are as follows:

(i) Principal subsidiaries

Name of company	Place and date of establishment/ operation	Proportion of ownership interest held by the Company %	Issued/ registered capital (Note a)	Principal activities
Guangxi Airlines Company Limited	PRC 28 April 1994	95	170,900,000	Airline
Southern Airlines (Group) Shantou Airlines Company Limited	PRC 20 July 1993	60	280,000,000	Airline
Zhuhai Airlines Company Limited	PRC 8 May 1995	60	250,000,000	Airline
Xiamen Airlines Company Limited	PRC 11 August 1984	60	700,000,000	Airline
Guizhou Airlines Company Limited	PRC 12 November 1991	60	80,000,000	Airline
Guangzhou Nanland Air Catering Company Limited (Note b)	PRC 21 November 1989	75	120,000,000	Air catering
Guangzhou Baiyun International Logistic Company Limited	PRC 23 July 2002	61	50,000,000	Logistics operations
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC 10 July 2002	51	USD43,620,849	Provision of flight simulation services
Xinjiang Civil Aviation Property Management Limited	PRC 12 February 2002	51.8	251,322,832	Property management
Guangzhou Air Cargo Company Limited	PRC 31 March 2004	70	238,000,000	Cargo services
China Southern West Australian Flying College Pty Limited	Australia 26 January 1971	65	AUD100,000	Pilot training services

Notes:

(a) Expressed in RMB, unless otherwise stated.

(b) This subsidiary is a Sino-foreign equity joint venture company established in the PRC

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**50 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (Cont'd)****(ii) Principal associates and jointly controlled entities**

Name of company	Place and date of establishment/operation	Attributable equity interest		Issued/registered capital (Note a)	Principal activities
		Direct %	Indirect %		
Guangzhou Aircraft Maintenance Engineering Company Limited (b)	PRC 28 October 1989	50	–	US\$27,500,000	Provision of aircraft repair and maintenance services
China Southern Airlines Group Finance Company Limited	PRC 28 June 1995	32	17.3	424,330,000	Provision of financial services
MTU Maintenance Zhuhai Co., Ltd (Note b)	PRC 6 April 2001	50	–	US\$63,100,000	Provision of engine repair and maintenance services
China Postal Airlines Limited (Note b)	PRC 25 November 1996	49	–	394,900,000	Airline
Beijing Southern Airlines Ground Services Company Limited (Note b)	PRC 1 April 2004	50	–	18,000,000	Provision of airport ground service
Sichuan Airlines Corporation Limited	PRC 28 August 2002	39	–	350,000,000	Airline

Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) These are jointly controlled entities. They were proportionately consolidated in the Group's consolidated financial statements.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)



51 EXTRAORDINARY GAIN AND LOSSES

In accordance with the requirements of "Questions and Answers on the Preparation of Information Disclosures of Companies Issuing Public Shares No.1 – Extraordinary Gains and Losses" (revised 2004), the extraordinary gains and losses of the Group are set out below:

	2005 RMB million	2004 RMB million
Extraordinary gains and losses for the year		
Loss on disposal of fixed assets	(32)	6
Expired sales in advance of carriage	104	35
Technical fee	–	(30)
Net non-operating income and expenses excluding loss on disposal of fixed assets	(32)	–
Subsidy income for relocation of airport	30	–
Other subsidy income	20	–
Taxation effect of the above items	(13)	(2)
Total	77	9

52 COMPARATIVE FIGURES

Certain items in these comparative figures have been reclassified to conform with the current year's presentation to facilitate comparison.