Notes to the Financial Statements

1 GENERAL INFORMATION

The Company is a limited liability company incorporated in Hong Kong on 3rd February 1997, the shares of which were listed on the Main Board of The Stock Exchange of Hong Kong Limited in December 1997. The Company, its subsidiaries, its jointly controlled entities and its associates are principally engaged in the airline operations, airport ground handling services, airline catering services, logistics and other businesses.

The address of the Company's registered office is 5th Floor, CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Lantau.

The Directors regard Air China Limited ("Air China"), a company incorporated in the People's Republic of China ("PRC") and listed on the Main Board of The Stock Exchange of Hong Kong Limited, as being the immediate holding company. The parent company of Air China is China National Aviation Holding Company ("CNAH"), a state-owned enterprise established in the PRC (note 38).

2 BASIS OF PREPARATION

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") and Hong Kong Accounting Standards ("HKAS") and interpretations ("HKAS-Int") (collectively the "HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"). The financial statements have been prepared under the historical cost convention except that, as disclosed in the accounting policies below, available-for-sale investment and derivative financial instruments are carried at fair value.

The preparation of the financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 5.

3 CHANGES IN ACCOUNTING POLICIES

3.1 Effect of adoption of the new/revised HKFRSs

In 2005, the Group adopted the new/revised HKFRSs below, which are relevant to its operations. The comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Investments in Joint Ventures
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 (Amendment)	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS-Int 12 (Amendment)	Scope of HKAS-Int 12 Consolidation - Special Purpose Entities
HKAS-Int 15	Operating Leases – Incentives
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations

The following is a summary of material changes in significant accounting policies or presentation of financial statements as a result of the adoption of the new HKFRSs:

(i) *HKAS 1*

The adoption of HKAS 1 has affected the presentation of minority interests, share of net after-tax results of associates and other disclosures.

(ii) *HKAS 16*

The adoption of revised HKAS 16 has resulted in a change in the accounting policy relating to the capitalisation of costs of regular overhaul and major checks of owned aircraft and engines as a separate component of property, plant and equipment and is subject to depreciation over the maintenance cycle. In prior years, costs of regular overhaul and major checks are expensed as and when incurred.

(iii) *HKAS 17*

The adoption of revised HKAS 17 has resulted in a change in the reclassification of land use right from property, plant and equipment. The up-front prepayments made for the land use right are expensed in the income statement on a straight-line basis over the term of the land use right or where there is impairment, the impairment is expensed in the income statement.

Notes to the Financial Statements (Cont'd)

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

(iv) *HKAS 24*

The adoption of HKAS 24 has affected the identification of related parties and some other related-party disclosures. Related parties include CNAH and its related parties, other state-owned enterprises and their subsidiaries directly or indirectly owned by the central government of the Peoples' Republic of China (the "PRC government"), other entities and corporations in which the Company is able to control or exercise significant influence, key management personnel of the Company and CNAH Group as well as their close family members.

(v) *HKAS 31*

The Group adopted the proportionate consolidation under HKAS 31 to account for its interests in jointly controlled entities. In prior years, the Group's interests in jointly controlled entities were accounted for by using the equity method. The adoption of the proportionate consolidation approach under HKAS 31 represents a change in accounting policy.

(vi) *HKASs 32 and 39*

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of available-for-sale financial assets. It has also resulted in the recognition of financial instruments at fair value and the change in the recognition and measurement of hedging activities.

(vii) *HKFRS 2*

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31st December 2004, the provision of share options to employees did not result in an expense in the income statement. Effective on 1st January 2005, the fair value of the employee services received in the exchange for the grant of the options is recognised as an expense.

(viii) *HKFRS 3, HKAS 36 and HKAS 38*

The adoption of HKFRS 3, HKAS 36 and HKAS 38 has resulted in a change in the accounting policy for goodwill. Until 31st December 2004, goodwill was:

– Amortised on a straight line basis over its estimated useful lives of not more than 20 years; and

– Assessed for an indication of impairment at each balance sheet date.

In accordance with the provisions of HKFRS 3:

– The Group ceased amortisation of goodwill from 1st January 2005;

– Accumulated amortisation as at 31st December 2004 has been eliminated with a corresponding decrease in the cost of goodwill; and

– From 1st January 2005 onwards, goodwill is tested annually for impairment, as well as when there are indications of impairment.

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

(viii) HKFRS 3, HKAS 36 and HKAS 38 (Cont'd)

The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of HKAS 38. No adjustment resulted from this reassessment.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards, whenever applicable. All standards adopted by the Group require retrospective application other than:

- HKAS 39 – does not permit to recognise, derecognise and measure financial assets and liabilities in accordance with this standard on a retrospective basis. The Group applied the previous Statement of Standard Accounting Practice ("SSAP") 24 "Accounting for investments in securities" to investments in securities and also to hedge relationships for the 2004 comparative information. The adjustments required for the accounting differences between SSAP 24 and HKAS 39 are determined and recognised at 1st January 2005;

- HKFRS 2 – only retrospective application for all equity instruments granted after 7th November 2002 and not vested at 1st January 2005; and

- HKFRS 3 – prospectively after the adoption date.

Notes to the Financial Statements (Cont'd)

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

The following is a summary of effects of adopting the new HKFRSs on the financial statements:

(a) Consolidated income statement

For the year ended 31st December 2005

	Increase/(decrease) Effect of adopting					
	HKAS 1 HK$'000	HKAS 16 HK$'000	HKAS 31 HK$'000	HKASs 32 & 39 HK$'000	HKFRS 3 HK$'000	Total HK$'000
Turnover	–	–	268,649	–	–	268,649
Other revenues	–	–	–	–	–	–
Total revenues	–	–	268,649	–	–	268,649
Other gains	–	–	365	11,957	–	12,322
Staff costs	–	–	114,946	–	–	114,946
Passenger catering and service costs	–	–	129,151	–	–	129,151
Depreciation and amortisation costs	–	–	11,516	–	(33,974)	(22,458)
Sales and promotion costs	–	–	1,407	–	–	1,407
Other operating costs	–	–	9,840	–	–	9,840
Total operating expenses	–	–	266,860	–	(33,974)	232,886
Operating loss	–	–	2,154	11,957	33,974	48,085
Finance costs	–	–	(2,960)	–	–	(2,960)
Share of profit less losses of associates	(29,437)	1,069	–	(1,033)	3,056	(26,345)
Share of profit less losses of jointly controlled entities	–	–	940	–	–	940
Profit before income tax	(29,437)	1,069	134	10,924	37,030	19,720
Income tax expenses	29,437	–	(134)	–	–	29,303
Profit for the year	–	1,069	–	10,924	37,030	49,023
Earnings per share	HK cents	HK cents	HK cents	HK cents	HK cents	HK cents
– Basic	–	0.03	–	0.33	1.12	1.48
– Diluted	–	0.03	–	0.32	1.11	1.46

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

(a) *Consolidated income statement*

For the year ended 31st December 2004

	Increase/(decrease) Effect of adopting			
	HKAS 1 HK$'000	HKAS 16 HK$'000	HKAS 31 HK$'000	Total HK$'000
Turnover	–	–	18,947	18,947
Other revenues	–	–	–	–
Total revenues	–	–	18,947	18,947
Other gains	–	–	78	78
Staff costs	–	–	5,648	5,648
Passenger catering and service costs	–	–	9,671	9,671
Depreciation and amortisation costs	–	–	2,537	2,537
Sales and promotion costs	–	–	122	122
Other operating costs	–	–	166	166
Total operating expenses	–	–	18,144	18,144
Operating profit	–	–	881	881
Finance costs	–	–	(375)	(375)
Share of profit less losses of associates	(83,293)	(6,501)	–	(89,794)
Share of profit less losses of jointly controlled entities	–	–	(506)	(506)
Profit before income tax	(83,293)	(6,501)	–	(89,794)
Income tax expenses	83,293	–	–	83,293
Profit for the year	–	(6,501)	–	(6,501)
Earnings per share	HK cents	HK cents	HK cents	HK cents
– Basic	–	(0.20)	–	(0.20)
– Diluted	–	(0.19)	–	(0.19)

Notes to the Financial Statements (Cont'd)

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

(b) Consolidated balance sheet

As at 31st December 2005

	Increase/(decrease) Effect of adopting					
	HKAS 16 HK$'000	HKAS 17 HK$'000	HKAS 31 HK$'000	HKASs 32 & 39 HK$'000	HKFRS 3 HK$'000	Total HK$'000
Property, plant and equipment	–	(2,274)	123,892	–	–	121,618
Land use right	–	2,274	–	–	–	2,274
Intangible assets	–	–	241,937	–	33,974	275,911
Interests in associates	(12,359)	–	–	5,263	3,056	(4,040)
Interests in jointly controlled entities	–	–	(368,617)	–	–	(368,617)
Deferred income tax assets	–	–	13,346	–	–	13,346
Derivative financial instruments	–	–	–	11,957	–	11,957
Inventories	–	–	6,478	–	–	6,478
Trade and other receivables	–	–	58,103	–	–	58,103
Cash and cash equivalents	–	–	47,625	–	–	47,625
Pledged bank deposits	–	–	9	–	–	9
Total assets	(12,359)	–	122,773	17,220	37,030	164,664
Trade and other payables	–	–	61,019	–	–	61,019
Current income tax liabilities	–	–	2,257	–	–	2,257
Short-term bank loans – unsecured	–	–	25,371	–	–	25,371
Provision for housing allowances	–	–	34,126	–	–	34,126
Total liabilities	–	–	122,773	–	–	122,773
Total equity	(12,359)	–	–	17,220	37,030	41,891

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.1 Effect of adoption of the new/revised HKFRSs (Cont'd)

(b) *Consolidated balance sheet (Cont'd)*

As at 31st December 2004

	Increase/(decrease) Effect of adopting			
	HKAS 16 HK$'000	HKAS 17 HK$'000	HKAS 31 HK$'000	Total HK$'000
Property, plant and equipment	–	(2,355)	126,308	123,953
Land use right	–	2,355	–	2,355
Intangible assets	–	–	241,937	241,937
Interests in associates	(13,428)	–	–	(13,428)
Interests in jointly controlled entities	–	–	(345,532)	(345,532)
Deferred income tax assets	–	–	2,483	2,483
Investment securities	–	–	18,313	18,313
Inventories	–	–	7,574	7,574
Trade and other receivables	–	–	55,867	55,867
Cash and cash equivalents	–	–	21,201	21,201
Pledged bank deposits	–	–	6,235	6,235
Total assets	(13,428)	–	134,386	120,958
Trade and other payables	–	–	62,833	62,833
Current income tax liabilities	–	–	2,336	2,336
Short-term bank loans – unsecured	–	–	69,217	69,217
Total liabilities	–	–	134,386	134,386
Total equity	(13,428)	–	–	(13,428)

The adoption of HKASs 32 and 39 has resulted in a decrease in opening reserves and interests in associates at 1st January 2005 by the same amount of approximately HK$19,023,000.

(c) There is no material impact of adopting the new HKFRSs on either the Company's balance sheets as at 31st December 2004 and 2005 or the income statements for the years then ended except for the reclassification and separate disclosure of loan to an associate from interests in associates.

Notes to the Financial Statements (Cont'd)

3 CHANGES IN ACCOUNTING POLICIES (Cont'd)

3.2 Standards, interpretations and amendments to published standards that are not yet effective

The HKICPA has issued the following amendments, new standards and interpretations which are not yet effective as of the date of these financial statements:

	Effective for accounting periods beginning on or after
HKFRS Interpretation 4 "Determining whether an Arrangement contains a Lease"	1st January 2006
Amendments to HKAS 19 "Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures"	1st January 2006
Amendments to HKAS 39 "Financial Instruments: Recognition and Measurement":	
– Cash Flow Hedge Accounting of Forecast Intragroup Transactions	1st January 2006
– The Fair Value Option	1st January 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
– HKAS 1 "Presentation of Financial Statements"	1st January 2006
– HKAS 27 "Consolidated and Separate Financial Statements"	1st January 2006
– HKFRS 3 "Business Combinations"	1st January 2006
Amendments to HKAS 39 "Financial Instruments: Recognition and Measurement" and HKFRS 4 "Insurance Contracts" – "Financial Guarantee Contracts"	1st January 2006
HKFRS 7 "Financial Instruments: Disclosures"	1st January 2007
Amendments to HKAS 1 "Presentation of Financial Statements: Capital Disclosures"	1st January 2007

The Group has not early adopted of the above standards, interpretations and amendments in the financial statements for the year ended 31st December 2005. The Group has already commenced an assessment of the related impact to the Group but is not yet in a position to state whether substantial changes to the Group's accounting policies and presentation of the financial statements will be resulted.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these financial statements are set out below:

4.1 Group accounting

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to 31st December.

(a) *Subsidiaries*

Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

(b) *Associates*

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Notes to the Financial Statements (Cont'd)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.1 Group accounting (Cont'd)

(b) Associates (Cont'd)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the interests in associates are stated at cost less provision for impairment losses. The results of associates are accounted for by the Company on the basis of dividend received and receivable.

(c) Jointly controlled entities

The Group's interests in jointly controlled entities are accounted for by proportionate consolidation. The Group combines its share of the jointly controlled entities' individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements. The Group recognises the portion of gains or losses on the sale of assets by the Group to the jointly controlled entity that it is attributable to the other venturers. The Group does not recognise its share of profits or losses from the jointly controlled entity that result from the Group's purchase of assets from the jointly controlled entity until it resells the assets to an independent party. However, a loss on the transaction is recognised immediately if the loss provides evidence of a reduction in the net realisable value of current assets, or an impairment loss.

4.2 Segment reporting

In accordance with the Group's internal financial reporting policies, the Group has determined that the primary segment reporting is by business segments and the secondary segment reporting is by geographical segments.

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

Unallocated costs represent corporate expenses. Segment assets consist primarily of intangible assets, property, plant and equipment, land use right, lease and equipment deposits, derivative financial instruments, inventories, trade and other receivables and operating cash and mainly exclude interests in associates and non-operating bank balances and cash. Segment liabilities comprise operating liabilities and mainly exclude current income tax liabilities. Capital expenditure comprises additions to intangible assets, land use right and property, plant and equipment, including additions resulting from acquisitions through business combinations.

In respect of geographical segment reporting, turnover and operating profit by geographical segments is based on the following criteria:

(i) Traffic revenue from inbound and outbound services between Macau and overseas markets is attributed to the geographical area in which the relevant overseas origin/destination lies.

(ii) Revenue from sale of goods is attributed on the basis of where the goods are sold.

Total assets and capital expenditure are where the assets are located.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.3 Foreign currency translation

(a) *Functional and presentation currency*

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The functional currency of the Company is Macau Patacas. As the Company is incorporated and listed in Hong Kong, the Directors of the Company regard Hong Kong dollar as the presentation currency of the Company. Accordingly, the financial statements are presented in Hong Kong dollar.

(b) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Translation difference on non-monetary financial assets, such as equities classified as available-for-sale investments, are included in the investments revaluation reserve in equity.

(c) *Group companies*

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

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

Notes to the Financial Statements (Cont'd)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.4 Property, plant and equipment

Buildings comprise mainly factories and offices. All property, plant and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Costs of regular major checks and overhauls are capitalised and amortised over the maintenance cycle. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	20 to 30 years
Leasehold improvement	6 years
Aircraft and engines	10 to 20 years
Flight equipment and rotable spares	7 to 20 years
Machinery, other equipment, furniture and motor vehicles	3 to 20 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

4.5 Land use right

Land use right represents operating lease prepayment for land less accumulated amortisation and impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of operating lease prepayment for land over the remaining lease term.

4.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiaries/associates/jointly controlled entities at the date of acquisition. Goodwill on acquisitions of subsidiaries and jointly controlled entities is included in intangible assets. Separately recognised goodwill on acquisitions of associates is included in interests in associates. Separately recognised goodwill is tested annually for impairment or when an indication of impairment exists and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Each of those cash-generating units represents the Group's investment in each country of operation by each primary reporting segment (note 4.7).

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.6 Intangible assets (Cont'd)

(b) *Trademark*

Trademark is shown at historical cost. Trademark has a definite useful life and is carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademark over its estimated useful life.

(c) *Deferred expenditure*

Transaction fees and transportation charges in relation to placing the leased aircraft into operation are deferred and amortised over the terms of the related leases.

4.7 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment and are reviewed for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

4.8 Financial assets

The Group classifies its investments into: loans and receivables and available-for-sale investments. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(a) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

(b) *Available-for-sale investments*

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available for-sale investments are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains or losses from investment securities.

Notes to the Financial Statements (Cont'd)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.8 Financial assets (Cont'd)

(b) Available-for-sale investments (Cont'd)

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the securities are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in note 4.10.

4.9 Inventories

Inventories comprise expendable spare parts and supplies, are stated at the lower of cost and net realisable value, and are expensed when used in operations. Cost is calculated on the average cost basis except for aircraft spare parts, cost of which is calculated on the first-in-first-out basis. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

4.10 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivables is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

4.11 Manufacturers' credits

Manufacturers' credits received in connection with leasing of aircraft, which the Group can apply those credits to reduce future costs of acquiring aircraft spares or rental payments, are either deferred and amortised as income or as a reduction of rental expenses for aircraft over relevant leases.

4.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

4.13 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.14 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and jointly controlled entities, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

4.15 Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees of the company. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity or paternity leave are not recognised until the time of leave.

(ii) Retirement benefit costs

Contributions to the defined contribution schemes are charged to the profit and loss account in the year in which the contributions relate.

(iii) Share-based compensation

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Notes to the Financial Statements (Cont'd)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.15 Employee benefits (Cont'd)

(iv) Housing allowances

A jointly controlled entity of the Group provides housing benefits to its employees. The entitlement to these benefits is usually conditional on the completion of a minimum service period. This obligation is calculated annually by an independent qualified actuary using the projected unit credit method. Actuarial gains and losses arising from experience adjustments, and changes in actuarial assumptions, are recognised in the income statement over the expected average remaining working lives of the related employees.

4.16 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

4.17 Provision for overhaul and major checks

A provision is made for the estimated costs of major checks and overhauls required to be conducted to fulfill the requirements under the relevant leases based on the maintenance cycle of each aircraft.

4.18 Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

4.19 Revenue recognition

Revenue comprises the fair value for the sale of goods and services, net of value-added tax, rebates and discounts and after eliminating sales within the Group. Ticket sales for transportation net yet provided are included in current liabilities as sales in advance of carriage. Revenues are recognised as follows:

(i) Passenger, cargo and mail revenues

Passenger, cargo and mail revenues are recognised when the transportation is provided.

(ii) Sale of goods

Revenue, net of sales discounts, from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time of delivery.

(iii) Inflight sales commission

Inflight sales commission is recognised when services are rendered.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

4.19 Revenue recognition (Cont'd)

(iv) Rental income

Rental income is recognised on a straight-line basis over the terms of the leases.

(v) Dividend income

Dividend income is recognised when the right to receive payment is established.

4.20 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the income statement on a straight-line basis over the period of the lease.

4.21 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other borrowing costs are charged to the income statement in the period in which they are incurred.

4.22 Dividend distribution

Dividend distribution to the Company's equity holders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's equity holders.

5 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 4.6(a). The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates (note 17).

(ii) Provision for overhaul and major checks

The Group is required to perform relevant overhaul on engines and cycle checks on airframes during the lease period in order to fulfil certain requirements under the corresponding lease agreements and accordingly, provision is made for overhaul and major checks. The provision is made based on the estimated major checks and overhaul costs to completion over the proportion of monthly flying hours to remaining flying hours of the maintenance cycle. Significant judgement is required in determining the estimated major check costs and overhaul costs and the total flying hours in the maintenance cycle.

Notes to the Financial Statements (Cont'd)

5 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Cont'd)

(iii) Provision for housing allowances

A jointly controlled entity provides cash allowances to its employees pursuant to a staff housing policy adopted during the year. The expected cost of providing these deferred housing allowances is calculated by an independent qualified actuary using the projected unit credit method, which involves a number of actuarial assumptions including the discount rate and employees' turnover rate before retirement.

6 REVENUES AND SEGMENT INFORMATION

Revenues recognised during the year are as follows:

	2005 HK$'000	Restated 2004 HK$'000
Turnover		
Traffic revenues		
– Passenger services	**1,544,125**	1,355,391
– Cargo and mail services	**807,259**	516,372
Airline catering revenue	**268,649**	18,947
	2,620,033	1,890,710
Other revenues		
Inflight sales commission	**5,453**	3,136
Rental from sub-lease of aircraft	**41,532**	9,855
	46,985	12,991
Total revenues	**2,667,018**	1,903,701

The Group, its jointly controlled entities and its associates are organised into four main business segments including airline operation, airport ground handling, airline catering, logistics and other businesses.

6 REVENUES AND SEGMENT INFORMATION (Cont'd)

Primary reporting format – Business segments

	Year ended and as at 31st December 2005				
	Airline operation HK$'000	Airport ground handling HK$'000	Airline catering HK$'000	Logistics and other businesses HK$'000	Total HK$'000
Segment revenues	**2,398,369**	–	**268,649**	–	**2,667,018**
Segment results	**(51,954)**	–	**1,789**	–	**(50,165)**
Interest income					**20,159**
Unallocated costs					**(22,311)**
Operating loss					**(52,317)**
Finance costs					**(2,960)**
Share of profits less losses of associates	**130,062**	**139,591**	**11,097**	**(3,507)**	**277,243**
Profit before income tax					**221,966**
Income tax expenses					**(10,042)**
Profit for the year					**211,924**
Segment assets	**1,168,150**	–	**488,620**	–	**1,656,770**
Interests in associates	**1,365,917**	**165,445**	**122,178**	**(25,946)**	**1,627,594**
Loans to associates	–	**18,060**	–	**47,097**	**65,157**
Unallocated assets					**867,522**
Total assets					**4,217,043**
Segment liabilities	**741,313**	–	**115,658**	–	**856,971**
Unallocated liabilities					**6,883**
Total liabilities					**863,854**
Capital expenditure	**45,145**	–	**9,155**	–	**54,300**
Depreciation	**66,696**	–	**11,435**	–	**78,131**
Amortisation	**9**	–	**81**	–	**90**
Provision for/(reversal of) impairment of trade receivables	**3,599**	–	**(147)**	–	**3,452**

Notes to the Financial Statements (Cont'd)

6 REVENUES AND SEGMENT INFORMATION (Cont'd)

Primary reporting format – Business segments (Cont'd)

	Year ended and as at 31st December 2004 (Restated)				
	Airline operation HK$'000	Airport ground handling HK$'000	Airline catering HK$'000	Logistics and other businesses HK$'000	Total HK$'000
Segment revenues	1,884,754	–	18,947	–	1,903,701
Segment results	52,791	–	803	–	53,594
Interest income					4,891
Unallocated costs					(41,752)
Operating profit					16,733
Finance costs					(375)
Share of profits less losses of associates	275,547	122,915	44	(8,056)	390,450
Profit before income tax					406,808
Income tax expenses					(12,344)
Profit for the year					394,464
Segment assets	1,093,645	–	479,918	–	1,573,563
Interests in associates	1,391,299	106,722	115,114	(22,977)	1,590,158
Loans to associates	–	34,560	–	47,543	82,103
Unallocated assets					689,437
Total assets					3,935,261
Segment liabilities	559,319	–	134,386	–	693,705
Unallocated liabilities					5,056
Total liabilities					698,761
Capital expenditure	38,251	–	127,584	–	165,835
Depreciation	64,740	–	1,266	–	66,006
Amortisation	18,883	–	1,271	–	20,154
Provision for impairment of trade receivables	1,175	–	235	–	1,410

6 REVENUES AND SEGMENT INFORMATION (Cont'd)

Secondary reporting format - Geographical segments

The Group and its jointly controlled entities operate in three main geographical areas including China mainland, Taiwan and other regions (mainly Macau, Thailand and Philippines). The airline operation business is mainly operated in places in China mainland, Taiwan and other regions. The airline catering business is operated in China mainland.

	Segment revenues		Segment results	
		Restated		Restated
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
China mainland	**1,223,674**	772,856	**(112,269)**	(26,144)
Taiwan	**1,301,998**	1,025,639	**140,221**	134,486
Other regions	**141,346**	105,206	**(78,117)**	(54,748)
Total	**2,667,018**	1,903,701	**(50,165)**	53,594
Interest income			**20,159**	4,891
Unallocated costs			**(22,311)**	(41,752)
Operating (loss)/profit			**(52,317)**	16,733

The major revenue-earning assets of the Group are its aircraft fleet, all of which are registered in Macau. Since the Group's aircraft fleet is deployed flexibly across its route network, the Directors consider that there is no meaningful basis to allocating such assets to geographical segments.

The assets and capital expenditure of jointly controlled entities in respect of airline catering business are located in China mainland.

The assets and capital expenditure of the Group, other than those of jointly controlled entities and its aircraft fleet as mentioned in the above, are mainly located in Macau.

7 OTHER GAINS

		Restated
	2005	2004
	HK$'000	HK$'000
Derivative instruments	**19,109**	5,156
Interest income	**20,159**	4,891
	39,268	10,047

Notes to the Financial Statements (Cont'd)

8 STAFF COSTS

	2005	Restated 2004
	HK$'000	HK$'000
Wages and salaries (including Directors' emoluments)	**324,664**	248,528
Pension costs – defined contribution plans (note (a))	**18,674**	1,258
Housing allowances (note (b))	**45,311**	–
	388,649	249,786

(a) Pension costs – Defined contribution plans

The Company contributes to the mandatory provident fund scheme ("MPF Scheme") established under the Hong Kong Mandatory Provident Fund Scheme Ordinance which is available to eligible employees in Hong Kong.

The subsidiary in Macau operates defined contribution pension plans which are available to eligible employees. The assets of the plans are held separately from the subsidiary in independently administrated funds. Monthly contributions made by the subsidiary are calculated based on certain percentages of the applicable payroll costs or fixed sums as stipulated under the relevant requirements, as appropriate.

The jointly controlled entities in China mainland participate in defined contribution retirement schemes organised by the municipal governments of the provinces in which the jointly controlled entities operate.

The retirement benefit costs represent gross contributions paid and payable to the MPF Scheme in Hong Kong, the defined contribution pension plans in Macau and defined contribution retirement schemes in China mainland (collectively the "Retirement Schemes"). Contributions totalling HK$2,215,000 (2004: HK$2,502,000) payable to the Retirement Schemes as at 31st December 2005 are included in trade and other payables. Forfeited contribution totalling HK$1,553,000 (2004: HK$1,490,000) were utilised during the year leaving no balance available at the year end to reduce future contributions (2004: Nil).

(b) Housing allowances

During the year, Beijing Air Catering Co., Ltd. ("BACL"), a jointly controlled entity of the Group, approved a staff housing policy (the "Staff Housing Policy"), pursuant to which those eligible staff who have not been allocated with any housing quarters or have not been allocated with a quarter up to the minimum areas as set out in the Staff Housing Policy are entitled to a cash allowance. The cash allowance is calculated based on the certain rates of allowances, year of services and area of quarter entitled as set out in the Staff Housing Policy and would be paid over a period of 10 years. The eligible staff's entitlement would be ceased upon termination of his/her employment with BACL.

8 STAFF COSTS (Cont'd)

(c) Directors' emoluments

The remuneration of the Directors for the year ended 31st December 2005 is set out below:

Name	Fees	Salaries and remuneration	Other benefits (note)	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Executive Directors:				
Kong Dong	–	1,498	552	2,050
Chuang Shih Ping	–	385	–	385
Zhang Xianlin	–	1,282	420	1,702
Zhao Xiaohang	–	385	552	937
Tsang Hing Kwong, Thomas	466	1,112	420	1,998
Gu Tiefei	70	385	–	455
	536	5,047	1,944	7,527
Independent non-executive Directors:				
Lok Kung Nam	60	–	–	60
Hu Hung Lick, Henry	60	–	–	60
Ho Tsu Kwok, Charles	60	–	–	60
Li Kwok Heem, John	60	–	–	60
Chan Ching Har, Eliza	60	–	–	60
	300	–	–	300
	836	5,047	1,944	7,827

Notes to the Financial Statements (Cont'd)

8 STAFF COSTS (Cont'd)

(c) Directors' emoluments (Cont'd)

The remuneration of the Directors for the year ended 31st December 2004 is set out below:

Name	**Fees** HK$'000	**Salaries and remuneration** HK$'000	**Other benefits** (note) HK$'000	**Total** HK$'000
Executive Directors:				
Kong Dong	–	1,498	552	2,050
Chuang Shih Ping	–	385	–	385
Zhang Xianlin	–	1,281	420	1,701
Zhao Xiaohang	–	225	322	547
Tsang Hing Kwong, Thomas	466	1,112	420	1,998
Gu Tiefei	70	385	–	455
	536	4,886	1,714	7,136
Independent non-executive Directors:				
Lok Kung Nam	40	–	–	40
Hu Hung Lick, Henry	40	–	–	40
Ho Tsu Kwok, Charles	40	–	–	40
Li Kwok Heem, John	40	–	–	40
Chan Ching Har, Eliza	14	–	–	14
	174	–	–	174
	710	4,886	1,714	7,310

Note: Other benefits include housing allowances.

8 STAFF COSTS (Cont'd)

(d) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include three Directors (2004: three) whose emoluments are set out in note 8(c) above. The emoluments payable to the remaining two (2004: two) individuals during the year are as follows:

	2005 HK$'000	2004 HK$'000
Wages, salaries and allowances	**3,108**	3,059
Pension costs – defined contribution plans	**207**	155
	3,315	3,214

The emoluments of the employees fell within the following bands:

	Number of individuals	
	2005	2004
Emolument bands		
HK$1,000,001 - HK$1,500,000	**1**	1
HK$1,500,001 - HK$2,000,000	**1**	1
	2	2

During the year, the Group did not pay to the Directors or the five highest paid individuals any inducement to join or upon joining the Group, or as compensation for loss of office. No Directors waived or agreed to waive any emoluments during the year.

Notes to the Financial Statements (Cont'd)

9 OPERATING (LOSS)/PROFIT

The following items have been included in arriving at operating (loss)/profit:

	2005 HK$'000	Restated 2004 HK$'000
Crediting		
Gain on disposal of property, plant and equipment	**41**	–
Gain on disposal of an available-for-sale investment	**1,207**	–
Write-back of payables	**1,794**	–
Amortisation of manufacturers' credits	**1,388**	1,393
Net exchange gains	**–**	6,474
Charging		
Amortisation of intangible assets	**9**	20,144
Amortisation of land use right	**81**	10
Auditors' remuneration	**1,710**	1,275
Cost of inventories expensed	**147,206**	38,681
Depreciation of property, plant and equipment	**78,131**	66,006
Loss on disposal of property, plant and equipment	**–**	334
Operating lease rentals		
– Aircraft and related equipments	**471,833**	374,580
– Buildings	**19,601**	20,298
Provision for overhaul and major checks costs (note 29)	**138,427**	84,772
Net exchange losses	**5,162**	–

10 FINANCE COSTS

	2005 HK$'000	Restated 2004 HK$'000
Interest expenses on short-term bank loans	**2,960**	375

11 INCOME TAX EXPENSES

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profit for the year. On 7th July 2005, the Macau Legislative Assembly approved Law No. 4/2005 to reduce the Macau Complementary Tax rate from 15.75% to 12%, accordingly the Macau complementary tax has been provided at the rate of 12% (2004: 15.75%) on the estimated assessable profit for the year.

The Group has two jointly controlled entities in China mainland, namely BACL and Southwest Air Catering Company Limited ("SWACL"). Pursuant to the Circular (2001) No. 202 issued by the Ministry of Finance, State Administration of Taxation and General Administration of Customs, SWACL is subject to a reduced income tax rate of 15% for the years from 2001 to 2010. BACL is subject to the income tax rate of 27%.

Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries in which the Group operates.

	2005 **HK$'000**	Restated 2004 HK$'000
Current income tax		
– Taxation outside Hong Kong and Macau	**11,700**	1,308
– Over provisions in prior years	**(8)**	(5)
Deferred income tax (note 33)	**(1,650)**	11,041
	10,042	12,344

Share of taxation of associates amounting to HK$29,437,000 (2004: HK$79,202,000) is included in the consolidated income statement as share of profits less losses of associates.

Notes to the Financial Statements (Cont'd)

11 INCOME TAX EXPENSES (Cont'd)

The income tax expenses on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate prevailing in Macau, where the Group's principal subsidiary operates, as follows:

	2005 HK$'000	Restated 2004 HK$'000
Profit before income tax	**221,966**	406,808
Calculated at the tax rate of 12% (2004: 15.75%)	**26,636**	64,072
Tax effect on share of associates' profit less losses	**(33,269)**	(61,496)
Effect of different taxation rates in other territories	**547**	945
Income not subject to taxation	**(1,841)**	(737)
Expenses not deductible for taxation purposes	**556**	3,197
Tax losses not recognised	**8,208**	3,926
Write down of tax losses previously recognised (note)	**4,619**	–
Over provision for taxation in prior years	**(8)**	(5)
Decrease in taxation resulting from a reduction in tax rate	**4,594**	–
Under provision for deferred taxation in prior years	**–**	2,608
Others	**–**	(166)
Tax expenses	**10,042**	12,344

Note:

At 31st December 2005, the Group re-assessed the recoverability of deferred income tax assets. The carrying amount of deferred income tax assets was written down to the extent that it is not probable that future taxable profit would be available against which the tax losses previously recognised could be utilised prior to their expiry.

12 PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of HK$203,468,000 (2004: HK$64,735,000).

13 EARNINGS PER SHARE

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of shares in issue during the year.

	2005 **HK$'000**	Restated 2004 HK$'000
Profit attributable to equity holders of the Company	**225,000**	360,969
Weighted average number of shares in issue (thousands)	**3,312,680**	3,312,680
Basic earnings per share (HK cents per share)	**6.79**	10.90

Diluted

Diluted earnings per share is calculated based on the profit attributable to the equity holders of the Company and the weighted average number of shares in issue during the year, after adjusting for the number of dilutive potential shares deemed to be issued at no considerations as if all outstanding share options granted by the Company had been exercised.

	2005 **HK$'000**	Restated 2004 HK$'000
Profit attributable to the equity holders of the Company	**225,000**	360,969
Weighted average number of shares in issue (thousands)	**3,312,680**	3,312,680
Adjustment for assumed conversion of share options (thousands)	**35,844**	28,068
Weighted average number of shares for diluted earnings per share (thousands)	**3,348,524**	3,340,748
Diluted earnings per share (HK cents per share)	**6.72**	10.81

14 DIVIDENDS

	2005 **HK$'000**	2004 HK$'000
Interim dividend, paid, of HK0.8 cent (2004: HK0.6 cent) per share	**26,501**	19,876
Final dividend, proposed, of HK1.0 cent (2004: HK1.0 cent) per share	**33,127**	33,127
	59,628	53,003

The Directors proposed a final dividend of HK1.0 cent per share. This proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31st December 2006.

Notes to the Financial Statements (Cont'd)

15 PROPERTY, PLANT AND EQUIPMENT

	Group					
	Buildings (notes (i) and (ii))	**Leasehold improvements**	**Aircraft and engines**	**Flight equipment and rotable spares**	**Machinery, other equipment, furniture and motor vehicles**	**Total**
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1st January 2004						
Cost	–	28,941	418,040	243,797	56,326	747,104
Accumulated depreciation	–	(22,257)	(137,126)	(153,371)	(34,972)	(347,726)
Net book amount	–	6,684	280,914	90,426	21,354	399,378
Year ended 31st December 2004						
Opening net book amount	–	6,684	280,914	90,426	21,354	399,378
Acquisition of jointly controlled entities (note 34(b))	87,393	–	–	–	37,668	125,061
Additions	13	1,229	12,160	3,868	21,139	38,409
Disposals	–	(597)	–	(158)	(301)	(1,056)
Depreciation	(534)	(1,465)	(31,809)	(23,246)	(8,952)	(66,006)
Closing net book amount	86,872	5,851	261,265	70,890	70,908	495,786
At 31st December 2004						
Cost	87,355	17,056	430,200	246,499	107,215	888,325
Accumulated depreciation	(483)	(11,205)	(168,935)	(175,609)	(36,307)	(392,539)
Net book amount	86,872	5,851	261,265	70,890	70,908	495,786

15 PROPERTY, PLANT AND EQUIPMENT (Cont'd)

	Group						
	Buildings (notes (i) and (ii))	**Leasehold improvements**	**Aircraft and engines**	**Flight equipment and rotable spares**	**Machinery, other equipment, furniture and motor vehicles**	**Construction-in-progress**	**Total**
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Year ended 31st December 2005							
Opening net book amount as at 1st January 2005, as previously reported	–	5,851	261,265	70,890	33,827	–	371,833
Proportionate consolidation of interests in jointly controlled entities	86,872	–	–	–	37,081	–	123,953
Opening net book amount as at 1st January 2005, as restated	86,872	5,851	261,265	70,890	70,908	–	495,786
Additions	286	1,285	25,029	15,708	10,177	1,815	54,300
Disposals	–	–	–	(131)	(132)	–	(263)
Depreciation	(5,786)	(1,577)	(31,681)	(23,354)	(15,733)	–	(78,131)
Closing net book amount as at 31st December 2005	81,372	5,559	254,613	63,113	65,220	1,815	471,692
At 31st December 2005							
Cost	87,641	18,235	455,229	261,576	113,502	1,815	937,998
Accumulated depreciation	(6,269)	(12,676)	(200,616)	(198,463)	(48,282)	–	(466,306)
Net book amount	81,372	5,559	254,613	63,113	65,220	1,815	471,692

Notes to the Financial Statements (Cont'd)

15 PROPERTY, PLANT AND EQUIPMENT (Cont'd)

(i) As at 31st December 2005, property, plant and equipment included buildings of net book amount of approximately HK$37,988,000 (2004: HK$40,763,000) relating to the buildings of BACL situated on pieces of allocated land held by a related party. Air China Limited ("Air China"), the immediate holding company of the Company, is procuring to transfer those land from the related party to Air China in order to ensure Air China will legally and/or beneficially own the interests and benefits of such land. Air China agrees that BACL can continue to use the land at nominal consideration until such time Air China obtains the legal title of the land. A lease agreement would then be entered into between Air China and BACL for a term of up to 30th April 2023 at a rent to be calculated on the basis of the original costs for obtaining such land use right. Accordingly, the Directors of the Company did not take into account any losses and costs arising from the inability to use any land currently used by BACL in the preparation of these financial statements.

Air China has further agreed to complete, at its expense, the formal procedures for transferring the building ownership rights of part of the production facilities from Air China to BACL. Such part of the production facilities were agreed to be injected by Air China into BACL as part of its initial capital contribution when BACL was established. No lease agreement has been entered between BACL and Air China.

(ii) As at 31st December 2005, property, plant and equipment included buildings of net book amount of approximately HK$39,866,000 (2004: HK$38,044,000) relating to an inflight meals production building held by SWACL which was put into use in 2004. However, SWACL was advised by Chengdu Shuangliu International Airport on 7th August 2003 that this inflight meals production building is situated in an area where the extension of airport premises will be located. As a result, this inflight meals production building might need to be demolished on or before 2015.

The Directors of the Company consider that this is only a suggestion proposed by Chengdu Shuangliu International Airport and so far SWACL has not received any formal notification from the relevant government authorities regarding this. Nevertheless, the Directors of the Company consider that SWACL had obtained all necessary approvals before constructing this production building and they are confident that SWACL is able to receive fair compensations from Chengdu Shuangliu International Airport should SWACL be requested to demolish the production building. The Directors of the Company consider that this matter is currently at a preliminary stage of development, accordingly, it is too early to consider any potential impact to SWACL and the Group.

16 LAND USE RIGHT

The Group's interests in land use right in China mainland represent operating lease prepayments for land with a lease term of 50 years. The movement of land use right during the year is as follows:

	2005 **HK$'000**	Restated 2004 HK$'000
At 1st January	**2,355**	–
Acquisition of a jointly controlled entity	**–**	2,365
Amortisation	**(81)**	(10)
At 31st December	**2,274**	2,355

17 INTANGIBLE ASSETS

	Group			
	Goodwill HK$'000	**Trademark** HK$'000	**Deferred expenditure** HK$'000	**Total** HK$'000
At 1st January 2004				
Cost	339,111	928	2,733	342,772
Accumulated amortisation	(32,970)	(928)	(2,679)	(36,577)
Net book amount	306,141	–	54	306,195
Year ended 31st December 2004				
Opening net book amount as at 1st January 2004	306,141	–	54	306,195
Acquisition of jointly controlled entities (note 34(b))	243,198	–	–	243,198
Amortisation	(20,099)	–	(45)	(20,144)
Closing net book amount as at 31st December 2004	529,240	–	9	529,249
At 31st December 2004				
Cost	582,309	928	2,733	585,970
Accumulated amortisation	(53,069)	(928)	(2,724)	(56,721)
Net book amount	529,240	–	9	529,249
Year ended 31st December 2005				
Opening net book amount as at 1st January 2005, as previously reported	287,301	–	9	287,310
Acquisition of jointly controlled entities	241,939	–	–	241,939
Opening net book amount as at 1st January 2005, as restated	529,240	–	9	529,249
Amortisation	–	–	(9)	(9)
Closing net book amount as at 31st December 2005	529,240	–	–	529,240
At 31st December 2005				
Cost	529,240	–	–	529,240
Accumulated amortisation	–	–	–	–
Net book amount	529,240	–	–	529,240

Notes to the Financial Statements (Cont'd)

17 INTANGIBLE ASSETS (Cont'd)

Impairment tests for goodwill

Goodwill acquired through the business combinations has been allocated to the cash-generating unit ("CGU") within the business segments of airline operation, airport ground handling and airline catering.

The recoverable amount of CGU is determined based on value-in-use calculation. These calculations use cash flow projections based on actual financial results for the year ended 31st December 2005. Cash flows after one year up to the end of joint venture period are extrapolated using the estimated growth rates stated below.

Key assumptions used in the value-in-use calculation

	Airline operation	**Airport ground handling**	**Airline catering**
Growth rate	7%	4%	10%
Discount rate	10%	10%	10%

Management determined budgeted net margin based on the past performance and its expectations for the market development. The weighted average growth rates used are consistent with the industry forecasts. The discount rates used reflect specific risks relating to the relevant industry.

18 INTERESTS IN SUBSIDIARIES

	Company	
	2005	2004
	HK$'000	HK$'000
Unlisted shares, at cost	**803,666**	803,666
Amounts due from subsidiaries	**1,211,154**	1,178,194
	2,014,820	1,981,860

The amounts due from subsidiaries are unsecured, interest free and have no fixed terms of repayment. The Directors of the Company have confirmed that they will not request for repayment of the amounts due to the Company until such time as and when the subsidiaries are in a position to repay. Accordingly, the Directors of the Company classified these amounts due from subsidiaries as non-current assets.

18 INTERESTS IN SUBSIDIARIES (Cont'd)

Details of the subsidiaries at 31st December 2005 are set out below:

	Name	Place of incorporation	Place of operation	Principal activities	Particulars of issued shares/capital	Group equity interest 2005	Group equity interest 2004
[1,2]	Air Macau Company Limited	Macau	Macau	Airline operator	4,000,000 ordinary shares of MOP100 each	**51%**	51%
[2]	China National Aviation Corporation (Macau) Company Limited	Macau	Macau	Investment holding	Quota capital of MOP10,000,000	**100%**	100%
	Skylink Global Limited	British Virgin Islands	Hong Kong	Investment holding	10 ordinary shares of US$1 each	**100%**	100%
	Fly Top Limited	British Virgin Islands	Hong Kong	Investment holding	10 ordinary shares of US$1 each	**100%**	100%
	Kingston International Limited	British Virgin Islands	Hong Kong	Investment holding	2 ordinary shares of US$1 each	**100%**	100%
	Queenston International Limited	British Virgin Islands	Hong Kong	Investment holding	2 ordinary shares of US$1 each	**100%**	100%
	Serfil Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US$1	**100%**	100%
	Skyrise Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US$1	**100%**	100%
	Wington Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US$1	**100%**	100%
	China National Aviation Logistics Company Limited	Hong Kong	Hong Kong	Investment holding	2 ordinary shares of HK$10 each	**100%**	100%

Notes to the Financial Statements (Cont'd)

18 INTERESTS IN SUBSIDIARIES (Cont'd)

Details of the subsidiaries at 31st December 2005 are set out below: (Cont'd)

	Name	Place of incorporation	Place of operation	Principal activities	Particulars of issued shares/capital	Group equity interest 2005	Group equity interest 2004
	China National Aviation Technology Company Limited	Hong Kong	Hong Kong	Investment holding	2 ordinary shares of HK$10 each	**100%**	100%
[2]	China National Aviation CyberWorks Limited	Bermuda	Hong Kong	Dormant	1,000,000 ordinary shares of HK$0.1 each	**100%**	100%

All subsidiaries are limited liability companies.

[1] Subsidiary not audited by PricewaterhouseCoopers, the net assets and turnover of which amounted to approximately 19% (2004: 22%) and 100% (2004: 100%) respectively.

[2] Subsidiaries held indirectly by the Company.

19 INTERESTS IN ASSOCIATES AND LOANS TO ASSOCIATES

(a) Interests in associates

	Group 2005 HK$'000	Group Restated 2004 HK$'000
At 1st January, as previously reported	**1,685,689**	1,287,042
Reclassification of loans to associates	**(82,103)**	(82,103)
Share of effect on adoption of HKAS 16	**(13,428)**	(6,927)
Share of opening adjustment on adoption of HKAS 39	**(19,023)**	–
At 1st January, as restated	**1,571,135**	1,198,012
Acquisition of an associate	**–**	115,069
Share of profits less losses	**277,243**	390,450
Dividends received	**(246,187)**	(110,960)
Share of deficit on revaluation of investment securities	**–**	(2,464)
Share of fair value gains of derivative financial instruments	**25,319**	–
Share of currency translation differences not realised in net profit	**84**	51
At 31st December	**1,627,594**	1,590,158

Interests in associates at 31st December 2005 include goodwill of HK$52,708,000 (2004: HK$52,708,000).

19 INTERESTS IN ASSOCIATES AND LOANS TO ASSOCIATES (Cont'd)

(a) Interests in associates (Cont'd)

	Company	
	2005	2004
	HK$'000	HK$'000
Unlisted shares, at cost	**51,789**	51,789

The shares of Tradeport Hong Kong Limited, an associate, held by the Group were pledged as securities for a banking facility granted to the associate (note 37).

The financial information of the Group's interest in associates is set out as follows:

Name	**Assets**	**Liabilities**	**Revenues**	**Profit**
	HK$'000	HK$'000	HK$'000	HK$'000
Hong Kong Dragon Airlines Limited	4,815,519	3,449,609	4,699,228	130,061
Others	556,002	347,026	629,171	147,182
	5,371,521	3,796,635	5,328,399	277,243

The following is a list of associates, all of which are unlisted, at 31st December 2005:

Name	**Place of incorporation and operation**	**Principal activities**	**Particulars of issued shares/capital**	**Group equity interest**	
				2005	2004
[1] Hong Kong Dragon Airlines Limited ("Dragonair")	Hong Kong	Airline operator	500,000,000 ordinary shares of HK$1 each	**43.29%**	43.29%
[2] LSG Lufthansa Service Hong Kong Limited	Hong Kong	Airline catering	501 ordinary shares of HK$1 each	**20.20%**	20.20%
Jardine Airport Services Limited	Hong Kong	Airport ground handling services	1,000 ordinary shares of HK$10 each	**50.00%**	50.00%
[2] Tradeport Hong Kong Limited	Hong Kong	Development and operation of a logistic center	400 ordinary shares of HK$1 each	**25.00%**	25.00%

Notes to the Financial Statements (Cont'd)

19 INTERESTS IN ASSOCIATES AND LOANS TO ASSOCIATES (Cont'd)

(a) Interests in associates (Cont'd)

Name	Place of incorporation and operation	Principal activities	Particulars of issued shares/capital	Group equity interest 2005	Group equity interest 2004
[2] Menzies Macau Airport Services Limited ("Menzies Macau")	Macau	Airport ground handling services	Quota capital of MOP10,000,000	**33.65%**	33.65%
[2] Macau Aircraft Repair and Conversion Company Limited	Macau	Aircraft repair and conversion	Quota capital of MOP100,000	**25.05%**	25.05%

[1] 1.47% of the Group's equity interest in Dragonair is held directly by the Company, while the remaining 41.82% is held indirectly through subsidiaries.

[2] Associates held indirectly by the Company.

(b) Loans to associates

The loans to associates are unsecured, interest free and have no fixed terms of repayment. The Directors of the Company have confirmed that they will not request for repayment of the loans due to the Company until such time as and when the associates are in a position to repay. Accordingly, the Directors of the Company classified these loans as non-current assets.

20 LOAN TO AN ASSOCIATE

The loan to an associate is unsecured, interest free and has no fixed terms of repayment.

21 INTERESTS IN JOINTLY CONTROLLED ENTITIES

The following amounts represent the Group's proportionate share of the assets, liabilities, revenues and expenses of the jointly controlled entities and are included in the consolidated balance sheet and income statement:

	2005 HK$'000	2004 HK$'000
Non-current assets	**137,247**	135,026
Current assets	**112,206**	102,955
	249,453	237,981
Non-current liability	**(34,126)**	–
Current liabilities	**(88,647)**	(134,386)
	(122,773)	(134,386)
Net assets	**126,680**	103,595
Revenues	**268,649**	18,947
Other gains	**365**	78
Operating expenses	**(266,860)**	(16,883)
Finance costs	**(2,960)**	(375)
(Loss)/profit before income tax	**(806)**	1,767
Income tax expense	**(134)**	(247)
Net (loss)/profit	**(940)**	1,520

The following is a list of jointly controlled entities at 31st December 2004 and 2005:

Name	**Place of establishment and operation**	**Principal activities**	**Percentage of interest in ownership/voting power/profit sharing**
Beijing Air Catering Co., Ltd.	PRC	Airline catering	60%/56%/60%
Southwest Air Catering Company Limited	PRC	Airline catering	60%/60%/60%

Notes to the Financial Statements (Cont'd)

22 INVESTMENT SECURITIES

	Group 2005 HK$'000	Restated 2004 HK$'000
Unlisted investment	**–**	18,313

Unlisted investment represented BACL's equity investment of 10% in 國航集團財務有限公司 ("Finance Company"). Pursuant to a share transfer agreement entered into between BACL and CNAH in August 2004, BACL agreed to dispose of its investment in the Finance Company to CNAH at a consideration of RMB34,561,000 (equivalent to HK$33,222,000). The disposal was completed in 2005.

23 DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2005 HK$'000	2004 HK$'000
Fuel price forward and option contracts	**11,957**	–

At 31st December 2005, the Group had six derivative contracts outstanding to lock in future fuel price at a certain range covering fuel of 65,000 barrels (2004: Nil). According to the contracts, the Group is entitled to receive from the counter-party the applicable difference between the fuel price and the strike price for the notional quantity if the fuel prices rises above the strike price and pay the counter-party the difference between the fuel price and the strike price if the fuel price falls below the strike price. These contracts will be expired during the year ending 31st December 2006.

24 INVENTORIES

	Group 2005 HK$'000	Restated 2004 HK$'000
Expendable spare parts and maintenance materials	**40,071**	41,205
Inflight/catering supplies	**11,240**	11,379
Others	**1,962**	1,461
	53,273	54,045

25 TRADE AND OTHER RECEIVABLES

	Group		Company	
		Restated		
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
Trade receivables (notes a, c and d)	**204,991**	184,304	**–**	–
Due from (notes b and c):				
Immediate holding company	**29,412**	36,245	**–**	–
An associate	**1,088**	1,017	**–**	–
A fellow subsidiary	**240**	–	**–**	–
Related companies	**1,994**	3,934	**–**	–
Less: Provision for impairment of receivables	**(4,467)**	(4,218)	**–**	–
	233,258	221,282	**–**	–
Prepayments, deposits and other receivables	**50,286**	37,183	**921**	687
	283,544	258,465	**921**	687

(a) The credit terms granted to sales agents and other trade customers are generally ranging from 15 to 90 days.

(b) The amounts due from immediate holding company, an associate, a fellow subsidiary and related companies are unsecured, interest free and have credit periods ranging from 15 to 90 days.

(c) The age analysis of the net trade receivable with third parties, immediate holding company, an associate, a fellow subsidiary and related companies is as follows:

	Group		Company	
		Restated		
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
Within 31 days	**194,210**	180,828	**–**	–
31 – 60 days	**20,414**	19,433	**–**	–
61 – 90 days	**8,882**	8,661	**–**	–
Over 90 days	**9,752**	12,360	**–**	–
	233,258	221,282	**–**	–

(d) There is no concentration of credit risk with respect to trade receivables, as the Group has a large number of customers, internationally dispensed.

(e) Approximately 44% (2004: 39%) and 37% (2004: 41%) of the gross trade receivables balance of the Group as at 31st December 2005 are denominated in Renminbi ("RMB") and Taiwanese Dollars respectively. The remaining balances are mainly denominated in Macau Patacas and United States Dollars ("USD").

Notes to the Financial Statements (Cont'd)

26 CASH AND CASH EQUIVALENTS AND PLEDGED BANK DEPOSITS

	Group		Company	
		Restated		
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
Cash at bank and in hand	**365,532**	260,314	**25,884**	45,710
Short-term bank deposits	**723,244**	553,934	**483,256**	336,259
	1,088,776	814,248	**509,140**	381,969
Less: Pledged bank deposits against				
– Financial derivative facilities	**(4,724)**	(4,897)	**–**	–
– Bank guarantees on aircraft leasing	**(84,006)**	(56,323)	**–**	–
– Others	**(213)**	(6,235)	**–**	–
Total pledged bank deposits	**(88,943)**	(67,455)	**–**	–
Cash and cash equivalents	**999,833**	746,793	**509,140**	381,969

Cash and cash equivalents and pledged bank deposits include HK$250,442,000 (2004: HK$81,855,000) denominated in RMB which are held by the Group and its jointly controlled entities with bank accounts operating in China mainland where exchange controls apply.

The effective interest rate on short-term bank deposits was 3.587% (2004: 1.016%); these deposits have an average maturity of approximately 54 days (2004: 45 days).

The carrying amount of cash and bank balances is denominated in the following currencies:

	Group		Company	
		Restated		
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
Hong Kong Dollars	**376,551**	287,410	**368,787**	276,091
RMB	**322,817**	203,467	**–**	–
USD	**302,154**	230,161	**140,353**	105,878
Others	**87,254**	93,210	**–**	–
	1,088,776	814,248	**509,140**	381,969

27 SHARE CAPITAL

	Ordinary shares of HK$0.10 each	
	Number of shares	HK$'000
Authorised:		
At 1st January 2004, 2005 and 31st December 2005	4,000,000,000	400,000
Issued and fully paid:		
At 1st January 2004, 2005 and 31st December 2005	3,312,680,000	331,268

(a) Share options

At an Annual General Meeting of the Company held on 29th May 2002, a share option scheme ("Share Option Scheme") was approved by the shareholders of the Company. Under the terms of the Share Options Scheme, the Directors may, at their discretion, grant to any Director, employee, supplier, customer or other relevant business partners of the Group, share options to subscribe for the Company's shares at the subscription price of the highest of (i) the closing price of the Company's shares as stated in The Stock Exchange of Hong Kong Limited's (the "Stock Exchange") daily quotations sheets on the date of grant; (ii) the average closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares. A nominal consideration at HK$1 was paid by the grantees for the acceptance of the grant of share options.

The maximum number of shares may be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option scheme of the Group must not exceed 30% of the number of issued shares of the Company from time to time.

The total number of shares to be granted under the Share Option Scheme and any other share option scheme of the Group shall not exceed 331,268,000, representing 10% of the number of issued shares at the date of adoption of the Share Option Scheme.

An option may be exercised in accordance with the terms of the Share Option Scheme at any time during a period, in relation to the relevant option, to be notified by the Directors to the grantee, such period not exceeding six years commencing on the date falling three months after the date of grant and expiring on the last day of the said period.

The Share Option Scheme will remain in force for a period of ten years commencing on the date on which it was adopted.

Notes to the Financial Statements (Cont'd)

27 SHARE CAPITAL (Cont'd)

(a) **Share options** (Cont'd)

Movements in the number of share options outstanding during the year and their related weighted average exercise price are as follows:

	2005		2004	
	Weighted average price	**Number of options**	Weighted average price	Number of options
At 1st January	**1.140**	**104,378,000**	1.064	136,729,800
Lapsed	**–**	**–**	0.820	(32,351,800)
At 31st December (note ii)	**1.140**	**104,378,000**	1.140	104,378,000

Notes:

(i) No share options were granted or exercised during the year ended 31st December 2005 (2004: Nil).

(ii) Share options outstanding at end of the year have the following terms:

Expiry date	**Exercise price**	**Number of options 2005**	Number of options 2004	**Vested percentages 2005**	Vested percentages 2004
Directors					
25th October 2009	1.14	**104,378,000**	104,378,000	**100%**	100%

28 RESERVES

Group

	Share premium HK$'000	Capital redemption reserve HK$'000	Legal reserve HK$'000	Investments revaluation reserve HK$'000	Exchange reserve HK$'000	Cashflow hedge reserve HK$'000	Retained earnings (note) HK$'000	Total HK$'000
Balance at 1st January 2004, as previously reported	1,434,558	663	3,666	2,464	–	–	869,712	2,311,063
Share of effect on adoption of HKAS 16 by an associate	–	–	–	–	–	–	(6,927)	(6,927)
Balance at 1st January 2004, as restated	1,434,558	663	3,666	2,464	–	–	862,785	2,304,136
Share of currency translation differences of associates	–	–	–	–	–	–	51	51
Share of deficit on revaluation of investments in securities of an associate	–	–	–	(2,464)	–	–	–	(2,464)
Net (expense)/income recognised directly in equity	–	–	–	(2,464)	–	–	51	(2,413)
Profit for the year	–	–	–	–	–	–	360,969	360,969
Total recognised income/(loss) for 2004	–	–	–	(2,464)	–	–	361,020	358,556
Transfer (note)	–	–	43	–	–	–	(43)	–
Dividends	–	–	–	–	–	–	(39,752)	(39,752)
Balance at 31st December 2004	1,434,558	663	3,709	–	–	–	1,184,010	2,622,940

Representing:	
Proposed final dividend	33,127
Others	2,589,813
	2,622,940

Notes to the Financial Statements (Cont'd)

28 RESERVES (Cont'd)

Group (Cont'd)

	Share premium HK$'000	Capital redemption reserve HK$'000	Legal reserve HK$'000	Exchange reserve HK$'000	Cashflow hedge reserve HK$'000	Retained earnings (note) HK$'000	Total HK$'000
Balance at 1st January 2005, as previously reported	1,434,558	663	3,709	–	–	1,197,438	2,636,368
Share of effect on adoption of HKAS 16 by an associate	–	–	–	–	–	(13,428)	(13,428)
	1,434,558	663	3,709	–	–	1,184,010	2,622,940
Share of opening adjustments on adoption of HKAS 39 by associates (note 3(b))	–	–	–	–	(20,056)	1,033	(19,023)
Balance at 1st January 2005, as restated	1,434,558	663	3,709	–	(20,056)	1,185,043	2,603,917
Share of currency translation differences of associates	–	–	–	–	–	84	84
Share of fair value gains of derivative financial instruments of associates	–	–	–	–	25,319	–	25,319
Currency translation differences	–	–	–	(123)	–	–	(123)
Net income recognised directly in equity	–	–	–	(123)	25,319	84	25,280
Profit for the year	–	–	–	–	–	225,000	225,000
Total recognised income/(loss) for 2005	–	–	–	(123)	25,319	225,084	250,280
Transfer (note)	–	–	6,599	–	–	(6,599)	–
Dividends	–	–	–	–	–	(59,628)	(59,628)
Balance at 31st December 2005	1,434,558	663	10,308	(123)	5,263	1,343,900	2,794,569
Representing:							
Proposed final dividend							33,127
Others							2,761,442
							2,794,569

Note: A subsidiary in Macau and jointly controlled entities in China mainland have transferred 10% of their profits to non-distributable legal reserve in accordance with local rules and regulations respectively.

28 RESERVES (Cont'd)

Company

	Share premium HK$'000	Capital redemption reserve HK$'000	Retained earnings HK$'000	Total HK$'000
At 1st January 2004	1,434,558	663	655,050	2,090,271
Profit for the year	–	–	64,735	64,735
Dividends	–	–	(39,752)	(39,752)
At 31st December 2004	1,434,558	663	680,033	2,115,254
Representing:				
Proposed final dividend				33,127
Others				2,082,127
				2,115,254
At 1st January 2005	**1,434,558**	**663**	**680,033**	**2,115,254**
Profit for the year	**–**	**–**	**203,468**	**203,468**
Dividends	**–**	**–**	**(59,628)**	**(59,628)**
At 31st December 2005	**1,434,558**	**663**	**823,873**	**2,259,094**
Representing:				
Proposed final dividend				**33,127**
Others				**2,225,967**
				2,259,094

29 PROVISION FOR OVERHAUL AND MAJOR CHECKS

	Group	
	2005 HK$'000	2004 HK$'000
At beginning of year	**91,939**	64,869
Charged during the year (note 9)	**138,427**	84,772
Utilised during the year	**(75,462)**	(57,702)
At end of year	**154,904**	91,939

Notes to the Financial Statements (Cont'd)

30 PROVISION FOR HOUSING ALLOWANCES

	2005 HK$'000	2004 HK$'000
At beginning of year	–	–
Charged during the year (note 8)	45,311	–
Utilised during the year	(6,156)	–
At end of year	39,155	–
Current portion included in other payables and accruals	(5,029)	–
	34,126	–

31 TRADE AND OTHER PAYABLES

	Group		Company	
	2005 HK$'000	Restated 2004 HK$'000	2005 HK$'000	2004 HK$'000
Trade payables (note a)	229,602	133,836	–	–
Due to (notes a and b):				
Associates	14,075	14,698	–	–
Fellow subsidiaries	17,390	15,720	31	–
Immediate holding company	–	15,892	–	–
Related companies	11,878	4,039	–	–
Other payables and accruals	241,678	232,387	4,337	4,343
	514,623	416,572	4,368	4,343

(a) The age analysis of trade payable with third parties, an associate, fellow subsidiaries and related companies is as follows:

	Group		Company	
	2005 HK$'000	Restated 2004 HK$'000	2005 HK$'000	2004 HK$'000
Within 31 days	191,664	103,314	–	–
31 - 60 days	47,243	39,569	–	–
61 - 90 days	17,038	12,393	–	–
Over 90 days	9,674	9,040	–	–
	265,619	164,316	–	–

31 TRADE AND OTHER PAYABLES (Cont'd)

(b) The amounts due to associates, fellow subsidiaries, immediate holding company and related companies are unsecured and interest free. Except for the amount due to immediate holding company as at 31st December 2004 which had no fixed terms of repayment, other balances have the credit terms generally ranging from 30 to 90 days.

(c) Approximately 67% (2004: 49%) and 19% (2004: 29%) of the trade payables balance of the Group as at 31st December 2005 are denominated in USD and RMB respectively. The remaining balances are mainly denominated in Macau Patacas and Taiwanese Dollars.

32 SHORT-TERM BANK LOANS

	Group	
		Restated
	2005	2004
	HK$'000	HK$'000
Short-term bank loans, unsecured	**25,371**	69,217

The average effective interest rate at the balance sheet date was 5.02% (2004: 4.59%).

The carrying amounts of short-term bank loans approximate their fair value and are denominated in RMB.

Notes to the Financial Statements (Cont'd)

33 DEFERRED INCOME TAX ASSETS

Deferred income taxes are calculated in full on temporary differences under the liability method using the statutory profits tax rate prevailing in which the Group's principal operating subsidiary operates of 12%. (2004: 15.75%)

The movement in deferred income tax assets during the year is as follows:

	Accelerated depreciation allowances HK$'000	**Provisions** HK$'000	**Tax losses** HK$'000	**Total** HK$'000
At 1st January 2004	–	–	30,333	30,333
Acquisition of jointly controlled entities (note 34(b))	2,438	47	–	2,485
(Charged)/credited to income statement (note 11)	(24)	22	(11,039)	(11,041)
At 31st December 2004	2,414	69	19,294	21,777
At 1st January 2005, as previously reported	–	–	19,294	19,294
Proportionate consolidation of interests in jointly controlled entities (note 3(b))	2,414	69	–	2,483
At 1st January 2005, as restated	2,414	69	19,294	21,777
Decrease in opening deferred taxation resulting from a reduction in tax rate (note 11)	–	–	(4,594)	(4,594)
Credited/(charged) to income statement	291	10,572	(4,619)	6,244
At 31st December 2005	2,705	10,641	10,081	23,427

	2005 **HK$'000**	2004 HK$'000
Deferred tax assets to be recovered after more than 12 months	**23,427**	21,777

Deferred income tax assets are recognised for tax losses carry forwards to the extent that realisation of the related tax benefit through the future taxable profits is probable. The Group has unrecognised tax losses of HK$141,638,000 (2004: HK$78,703,000) to carry forward against future taxable income, in which losses of HK$90,185,000 (2004: HK$70,923,000) have no expiry date and losses of HK$51,453,000 (2004: HK$7,780,000) will be expired from 2006 to 2008.

The Company has not recognised tax losses of HK$90,185,000 (2004: HK$70,923,000) that can be carried forward against future taxable income. These tax losses have no expiry date.

34 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Cash generated from operations

	2005 HK$'000	Restated 2004 HK$'000
Operating (loss)/profit	**(52,317)**	16,733
Adjustments for:		
Depreciation	**78,131**	66,006
Amortisation of intangible assets	**9**	20,144
Amortisation of land use right	**81**	10
Gain on disposal of an available-for-sale investment	**(1,207)**	–
Fair value gains on derivative financial instruments	**(10,593)**	–
(Gain)/loss on disposal of property, plant and equipment	**(41)**	334
Provision for housing allowances	**39,155**	–
Provision for impairment of loan to an associate	**446**	–
Write-off of an investment security	**–**	249
Interest income	**(20,159)**	(4,891)
	33,505	98,585
Changes in working capital:		
Inventories	**772**	1,452
Lease and equipment deposits	**8,653**	14,279
Trade and other receivables	**(26,443)**	(30,321)
Trade and other payables	**92,899**	39,988
Sales in advance of carriage	**14,333**	10,592
Provision for overhaul and major checks	**62,965**	27,070
Cash generated from operations	**186,684**	161,645

(b) Purchase of jointly controlled entities

In April 2004, the Group entered into share transfer contracts with Air China International Corporation ("Air China International") pursuant to which the Group agreed to acquire 60% of equity interests in BACL and SWACL from Air China International at the considerations of RMB294 million and RMB67 million respectively (the "Acquisitions"). The Acquisitions were completed on 16th November 2004.

Notes to the Financial Statements (Cont'd)

34 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

Details of share of net assets of jointly controlled entities acquired and goodwill are as follows:

	2004 HK$'000
Net assets acquired	
Property, plant and equipment (note 15)	125,061
Land use right	2,365
Deferred income tax assets (note 33)	2,485
Investment securities	18,562
Inventories	4,673
Trade and other receivables	74,088
Cash and cash equivalents	18,520
Pledged bank deposits	6,120
Trade and other payables	(51,386)
Amount due to immediate holding company	(15,892)
Short-term bank loans, unsecured	(80,506)
Current tax liabilities	(2,015)
	102,075
Goodwill (note 17)	243,198
	345,273
Satisfied by	
Cash	345,273

No intangible asset was individually identified and separately recognised in the Acquisitions as the Directors of the Company consider that no item can meet the identifiability criterion in the definition of an intangible asset.

Analysis of the net cash outflow in respect of the purchase of jointly controlled entities:

	2004 HK$'000
Cash consideration	345,273
Cash and cash equivalents acquired	(18,520)
Net cash outflow in respect of the purchase of jointly controlled entities	326,753

35 COMMITMENTS

(a) The Group is a party to an agreement with third parties (the "Consortium Partners") in respect of the joint development and operation of Tradeport Logistics Centre at the South Commercial District of the Hong Kong International Airport (the "Project"). The Group has 25% interest in the Project. The Group's attributable share of capital commitments in respect of the Project is approximately HK$78,000,000 (2004: HK$78,000,000).

In the event of default of any of the Consortium Partners, the Group will be required to provide additional funds for the Project. The Group and the Consortium Partners have jointly given a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the Project. Should the Group be required to perform its obligations under the guarantee in the event of default of all of the Consortium Partners, the maximum amount of the additional liabilities assumed, in additional to the Group's estimated share of capital commitments as disclosed above, would be approximately HK$234,000,000 (2004: HK$234,000,000).

(b) **Commitments under operating leases**

The Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of aircraft and related equipment as follows:

	Group	
	2005	2004
	HK$'000	HK$'000
Not later than one year	**644,852**	357,491
Later than one year and not later than five years	**873,291**	1,011,211
More than five years	**265,202**	407,760
	1,783,345	1,776,462

The above operating lease commitments included commitment for fixed rent only. Rentals payable in some cases include an additional rent, calculated according to exact flying hours, in excess of a fixed rent.

(c) **Future minimum rental payments receivables**

The Group had future minimum lease receipts under non-cancellable operating lease in respect of aircraft as follows:

	Group	
	2005	2004
	HK$'000	HK$'000
Not later than one year	**14,617**	10,241

(d) **Capital commitments**

The Group's attributable share of capital expenditure contracted for by the Group's jointly controlled entities at the balance sheet date but not yet incurred is as follows:

	Group	
	2005	2004
	HK$'000	HK$'000
Property, plant and equipment	**3,966**	–

Notes to the Financial Statements (Cont'd)

36 FINANCIAL RISK MANAGEMENT

In the normal course of business, the Group is exposed to a variety of financial risks, including the effects of movements in foreign exchange rates, interest rates and jet fuel prices. These exposures are managed, sometimes with the use of derivative financial instruments.

(a) Foreign currency risk

The Group generates a portion of its venture from sales in certain foreign jurisdictions giving rise to exposures to risk from changes in foreign exchange rates. The currencies giving rise to this risk are primarily Taiwanese Dollars and RMB. The Group continuously monitors its foreign currency positions and does not consider that it has a significant exposure to risk from any currency.

The Group uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from operational activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purpose.

The Group has no derivative financial instruments outstanding as at 31st December 2005.

(b) Interest rate risk

The Group did not have significant bank loans at the balance sheet date. Deposits placed with banks earn interest rates ranging from 0.5% to 4.15% per annum. The Group does not consider that it has a significant exposure to interest rate risk.

(c) Fuel price risk

In the normal course of business, the Group is exposed to fluctuations in jet fuel prices. As at 31st December 2005, the Group had six derivative contracts outstanding to lock in future fuel price at a certain range. The Group receives from the counter-party the applicable difference between the fuel price and the strike price, subject to a cap, for the notional quantity if the fuel price rises above the strike price. In return, the Group pays the counter-party the difference between the fuel price and the strike price if the fuel price falls below the strike price.

The Group does not anticipate any material adverse effect on its financial position resulting from its involvement in this instrument, nor does it anticipate non-performance by any of its counter-party.

(d) Insurance coverage risk

A commercial airline is required to have adequate liability insurance cover. Following the "911" event, certain airlines have difficulties in securing adequate liability insurance cover. The Group is able to obtain the required liability insurance cover with increased premium rates. Part of the increased insurance charge is recovered from passengers through a surcharge.

(e) Credit risk

It is the Group's policy to obtain certain collateral from customers and counter-parties who require credit. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. At 31st December 2005 there was no significant concentration of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

(f) Fair value

There are no material differences between the carrying amounts and estimated fair values of the Group's significant financial assets and liabilities as at 31st December 2004 and 2005.

37 CONTINGENT LIABILITIES

	Group and Company	
	2005	2004
	HK$'000	HK$'000
Guarantee for banking facilities granted by bank to:		
– An associate	**20,000**	15,000
– A jointly controlled entity (note)	**87,475**	–
	107,475	15,000

Note:

As at 31st December 2005, the Group had given to a bank for loan facilities granted to a jointly controlled entity of RMB115,000,000 (equivalent to approximately HK$110,545,000). Loans of RMB40,000,000 (equivalent to approximately HK$38,450,000) were drawdown by the jointly controlled entity as at 31st December 2005. The Group's proportionate share of bank loans of HK$23,070,000 had been included in the consolidated balance sheet as at 31st December 2005 (2004: Nil).

38 RELATED PARTY TRANSACTIONS

The Group is part of a larger group of companies under Air China and has extensive transactions and relationships with members of the Air China group. Because of these relationships, it is possible that the terms of transactions between the Group and members of Air China group are not the same as those that would result from transactions with or among other related parties or wholly unrelated parties.

Air China is controlled by CNAH, a state-owned enterprise which is wholly owned by the PRC government. As the Company is indirectly controlled by the PRC government, state-owned enterprises and their subsidiaries, in addition to the group companies of Air China, directly or indirectly owned by the PRC government are also related parties of the Group.

A portion of the Group's business activities are conducted with other state-owned enterprises. For the purpose of related party transactions disclosure, the Group has identified, to the extent practicable, those corporate customers and suppliers which are state-owned enterprises based on their immediate ownership structure. It should be noted, however, that a substantial portion of the Group's business activities are conducted in the PRC and the influence of the PRC government in the Chinese economy is pervasive. In this regard, the PRC government indirectly holds interests in many companies. In addition, a portion of the Group's services provided are of a retail nature to end users, which include transactions with the employees of state-owned enterprises on corporate business, their key management personnel and close family members. Due to the vast volume and the pervasiveness of these transactions, the Group is unable to determine the aggregate amount of these transactions for disclosure. Therefore, the revenue from provision of services disclosed below does not include retail transactions with these related parties. However, the Group believes that meaningful information in respect of related party transactions has been adequately disclosed.

Notes to the Financial Statements (Cont'd)

38 RELATED PARTY TRANSACTIONS (Cont'd)

The following is a summary of significant transactions carried out with related parties in the ordinary course of business for the year ended 31st December 2005:

(a) Revenue and expenses

	2005 **HK$'000**	Restated 2004 HK$'000
Revenues:		
Value of tickets sold to (note i):		
– Immediate holding company	**3,365**	1,545
– An associate	**1,391**	2,032
– Fellow subsidiaries	**2,944**	3,395
– Related companies	**8,568**	7,755
Lease of an aircraft to immediate holding company (note ii)	**41,532**	9,855
Sales of goods (note iii):		
– Immediate holding company	**136,663**	17,156
– An associate	**10,979**	2,428
– Related companies	**3,417**	142
– Other state-owned enterprises (note xi)	**19,468**	1,540
Interest income from other state-owned banks (note xi)	**14,999**	2,704
Operating expenses:		
Management fee paid to fellow subsidiaries (note iv and v)	**9,600**	9,600
Landing, loading, parking and other airport charges paid to:		
– A fellow subsidiary (note vi)	**86,343**	69,337
– Other state-owned enterprises (note xi)	**40,976**	34,811
Ground handling costs paid to an associate (note vii)	**129,777**	119,866
Technical and ground handling costs paid to an associate (note viii)	**2,634**	4,475
Inflight meal services expenses paid to a related company (note ix)	**51,491**	41,199
Lease rental paid to fellow subsidiaries (note x)	**1,652**	688
Fuel costs paid to an other state-owned enterprise (note xi)	**85,409**	10,236
Finance cost paid to other state-owned banks (note xi)	**2,960**	375
Project management fee paid to immediate holding company (xii)	**1,344**	–

38 RELATED PARTY TRANSACTIONS (Cont'd)

(a) Revenue and expenses (Cont'd)

(i) Air tickets were sold to the related ticket sales agents in accordance with the pricing policy of the Group.

(ii) The Group entered into a lease agreement with Air China pursuant to which the Group leases aircraft to Air China at a monthly fee of US$359,000 (equivalent to approximately HK$2,796,000) with monthly maintenance hour charge of US$470 (equivalent to approximately HK$4,000) per block hour.

(iii) The inflight meal services rendered were charged at terms pursuant to agreements entered into by BACL and SWACL with relevant related parties.

(iv) Pursuant to the management services agreement dated 27th August 2003 entered into between the Company and China National Aviation Corporation (Group) Limited ("CNACG"), a fellow subsidiary, CNACG agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of two years from 1st July 2003 to 30th June 2005 at a monthly fee of HK$500,000.

On 28th July 2005, the Company and CNACG renewed the management services agreement with the same terms under the management services agreement dated 27th August 2003 for a period of three years from 1st July 2005 to 30th June 2008 at a monthly fee of HK$500,000.

(v) Pursuant to the management services agreement dated 25th March 2002 entered into between the Group and CNAC (Macau) Aviation Limited ("CNACAL"), a fellow subsidiary, CNACAL agreed to provide general management services including but not limited to secretarial, personnel, accounting and general office administrative services to CNAC Macau for a period of three years from 25th March 2002 to 24th March 2005 at a monthly fee of HK$300,000.

On 4th November 2005, CNAC Macau and CNACAL renewed the management services agreement with the same terms under the management services agreement dated 25th March 2002 for a period of three years from 25th March 2005 to 24th March 2008 at a monthly fee of HK$300,000.

(vi) The airport related charges paid to ADA-Administrative Airport Limited ("ADA") were at terms pursuant to the tariff published by the Macau Government in the government gazette.

(vii) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.

(viii) The technical and ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Dragonair.

(ix) The inflight meal services rendered were charged at terms pursuant to agreements entered into by the Group with Macau Catering Services Company Limited, a 34.5% owned associate held by a minority shareholder of Air Macau.

(x) The Group entered into a lease agreement with Easy Advance Limited and Wise Advice Limited, fellow subsidiaries, pursuant to which Easy Advance Limited and Wise Advice Limited lease office premises and certain car parks to the Group at a monthly rental of MOP141,800 (equivalent to approximately HK$138,000).

Notes to the Financial Statements (Cont'd)

38 RELATED PARTY TRANSACTIONS (Cont'd)

(a) Revenue and expenses (Cont'd)

(xi) The above transactions with other state-owned enterprises and banks were entered into in accordance with the terms as set out in the agreements governing the transactions or as mutually agreed between the parties.

(xii) On 4th November 2005, BACL entered into a project management services agreement with Air China Beijing Construction Base Command Centre ("Air China Command Centre"), a division of CNAH, for services relating to the phase 3 construction work in respect to the expansion of the ancillary facilities in the Beijing Capital International Airport ("Capital Airport") during its commencement, construction and post-completion stages.

Pursuant to the project management services agreement, total management fee is equivalent to 2.5% of the approved budget of the construction work for the project. The estimated construction cost as set out in the "Feasibility Study Report regarding the construction work of ancillary facilities of Air China in Capital Airport" of RMB310,850,000 (equivalent to approximately HK$300,000,000) is used as the base figure for determining the management fee as the construction budget is yet to approve. The amount represented 30% project management fee paid to Air China Command Centre upon signing of the project management services agreement.

(b) On 25th August 2004, CNACG entered into two license agreements with the Company pursuant to which CNACG has agreed to grant licenses to the Company, free of royalty, for the rights to use those trademarks in Hong Kong and Macau, respectively, so long as the Company is a direct or indirect subsidiary of China National Aviation Holding Company ("License Agreements").

No royalty charge was levied under the License Agreements in respect of the use of these trademarks during the period.

(c) Key management compensation

	2005	2004
	HK$'000	HK$'000
Directors' fees	**3,480**	3,355
Salaries and other short-term employee benefits	**7,457**	7,066
	10,937	10,421

38 RELATED PARTY TRANSACTIONS (Cont'd)

(d) Year-end balances arising from sales/purchases of goods/services with related parties comprised:

	2005 HK$'000	2004 HK$'000
Receivables from related parties (note)		
Immediate holding company	**29,412**	36,245
An associate	**1,088**	1,017
A fellow subsidiary	**240**	–
Related companies	**1,994**	3,934
Other state-owned enterprises	**6,145**	9,910
	38,879	51,106
Bank deposits		
Other state-owned banks	**823,737**	597,703
Payables to related parties (note)		
An associate	**14,075**	14,698
Fellow subsidiary	**17,359**	15,720
Related companies	**4,583**	62
Other state-owned enterprises	**26,887**	23,410
	62,904	53,890
Short-term bank loans		
Other state-owned banks	**25,371**	69,217

Note: Repayment terms of these balances with the above related parties have been disclosed in notes 25 and 31.

39 EVENT AFTER THE BALANCE SHEET DATE

On 24th January 2006, the Group entered into agreements with Shun Tak Air Transport Limited and its subsidiaries respectively, to establish Macau Asia Express Limited ("Macau Asia Express") to engage in the business activities of operating low cost model air transport services based in Macau. The Group will hold 43.7% effective equity interest (including indirect interest) in Macau Asia Express. The aggregate initial investment to Macau Asia Express is up to approximately HK$234,000,000 and the Group's attributable share of the investment cost will be funded by the Group's internal resources. The completion of the establishment is subject to certain conditions to be fulfilled.

Macau Asia Express is a subsidiary of the Group, as defined by the laws of Macau, but the Group does not have unilateral control over the entity. Accordingly, it will be accounted for as a jointly controlled entity in accordance with Hong Kong Accounting Standard 31 "Investments in joint ventures".

40 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 24th March 2006.