Notes to the Financial Statements

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

1 BASIS OF PRESENTATION

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

The Company was established in the People's Republic of China (the "PRC", "China" or the "State") on 25 March 1995 as a joint stock limited company as part of the reorganisation (the "Reorganisation") of the Company's holding company, China Southern Air Holding Company ("CSAHC"). CSAHC is a state-owned enterprise under the supervision of the PRC central government.

The Company's H Shares and American Depositary Shares ("ADS") (each ADS representing 50 H Shares) have been listed on The Stock Exchange of Hong Kong Limited and the New York Stock Exchange, respectively since July 1997. In July 2003, the Company issued 1,000,000,000 A Shares which are listed on the Shanghai Stock Exchange.

The Company acquired the airline operations and certain related assets of China Northern Airlines Company ("CNA") and Xinjiang Airlines Company ("XJA") from its parent company, CSAHC, with effect from 31 December 2004 (the "CNA/XJA Acquisitions" (Note 43)).

2 PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") promulgated by the International Accounting Standards Board (the "IASB"). IFRSs includes International Accounting Standards ("IAS") and interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The IASB has issued a number of new and revised IFRSs that are effective for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised IFRSs for the current and prior accounting periods reflected in these financial statements is provided in Note 3.

(b) Basis of preparation

At 31 December 2005, the Group had net current liabilities of RMB25,907 million (2004: RMB18,855 million). In preparing the financial statements, the directors have considered the future funding of the Group and have determined that adequate funding being available to finance the working capital and capital expenditure requirements of the Group during the twelve months ending 31 December 2006. Accordingly, the financial statements have been prepared on a going concern basis. Further details are set out in Note 44.

The consolidated financial statements for the year ended 31 December 2005 comprise the Company and its subsidiaries and the Group's interest in associates and jointly controlled entities.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that the following assets are stated at their fair value as explained in the accounting policies set out below:

– Certain property, plant and equipment (Note 2(d)); and

– Short term investments (Note 2(h)).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(b) Basis of preparation (cont'd)

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are disclosed in Note 49.

(c) Basis of consolidation

(i) Subsidiaries

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised profits, but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interest and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (Note 2(l)).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(c) Basis of consolidation (cont'd)

(ii) Associates and jointly controlled entities

An associate is an entity in which the Group has significant influence, but not control or joint control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

A jointly controlled entity is an entity over whose activities the Group has joint control, established by contractual agreement. The consolidated financial statements include the Group's share of the total recognised gains and losses of jointly controlled entities on an equity accounted basis, from the date that joint control commences until the date that joint control ceases. When the Group's share of losses exceeds its interest in a jointly controlled entity, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of a jointly controlled entity.

Unrealised profits arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised profits, but only to the extent that there is no evidence of impairment.

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (Note 2(l)).

(iii) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate or a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment test (Note 2(l)). In respect of associates or jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the interest in the associate or jointly controlled entity.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities and contingent liabilities over the cost of a business combination or an investment in an associate or a jointly controlled entity is recognised immediately in profit or loss.

On disposal of a cash generating unit, an associate or a jointly controlled entity during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(d) Property, plant and equipment

(i) Owned assets

An item of property, plant and equipment is initially recorded at cost less accumulated depreciation (see (iv) below) and impairment losses (Note 2(l)). The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to working condition and location for its intended use and the initial estimate, where relevant, of the costs of dismantling and removing the item and restoring the site on which it is located. Subsequent to the revaluation (Note 18), which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluations are performed with sufficient regularity to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair value at the balance sheet date.

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in the income statement on the date of retirement or disposal. Any related revaluation surplus is transferred from the revaluation reserve to retained earnings.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Flight equipment acquired by way of finance lease is stated at an amount equal to lower of its fair value and the present value of minimum lease payments at inception of the lease, less accumulated depreciation (see (iv) below) and impairment losses (Note 2(l)) and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Subsequent to the revaluation (Note 18), which was based on depreciated replacement costs, leased assets are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluations are performed with sufficient regularity to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair value at the balance sheet date.

The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rentals are written off as an expense of the period in which they are incurred.

Gains or losses on aircraft sale and leaseback transactions which result in finance leases are deferred and amortised over the terms of the related leases. Gains or losses on other aircraft sale and leaseback transactions are recognised immediately if the transactions are established at fair value. Any difference between the sales price and the fair value is deferred and amortised over the period the assets are expected to be used.

Where the Group has the use of assets held under operating leases, payments made under operating leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the income statement as an integral part of the aggregate net lease payments. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(d) Property, plant and equipment (cont'd)

(iii) Subsequent costs

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

(iv) Depreciation

Depreciation is calculated to write off the cost or revalued amount of items of property, plant and equipment, less their estimated residual value, if any, using the straight line method over their estimated useful lives as follows:

Buildings	15 to 40 years
Owned and leased aircraft	15 to 20 years
Other flight equipment	
Jet engines	8 to 15 years
Others, including rotable spares	8 to 15 years
Machinery and equipment	5 to 10 years
Vehicles	6 years

Depreciation for assets acquired under finance leases is calculated to write off the cost of the assets in equal annual amounts over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out above.

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

(e) Construction in progress

Construction in progress represents office buildings, various infrastructure projects under construction and equipment pending installation, and is stated at cost less impairment losses (Note 2(l)). Cost comprises direct costs of construction and the initial estimate, where relevant, of the costs of dismantling and removing the item and restoring the site on which it is located as well as interest charges during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use, notwithstanding any delay in the issue of the relevant commissioning certificates by the relevant PRC authorities.

No depreciation is provided in respect of construction in progress.

(f) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's governmental authorities. Land use rights are carried at cost less impairment losses (Note 2(l)) and are charged to the income statement on a straight-line basis over the respective periods of the rights which range from 30 to 50 years.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(g) Deferred expenditure

Custom duties and other direct costs in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised over the terms of the related leases.

Lump sum housing benefits payable to employees of the Group are deferred and amortised on a straight line basis over a period of 10 years, which represents the benefit vesting period of the employees.

Deferred expenditure is carried at cost less impairment losses (Note 2(l)).

(h) Other investments in debt and equity securities

The Group's and the Company's policies for investments in debt and equity securities, other than investments in subsidiaries, associates and jointly controlled entities, are as follows:

Investments in securities held for trading are classified as current assets and are initially stated at fair value. At the balance sheet date the fair value is remeasured, with any resultant gain or loss recognised in the income statement.

Dated debt securities that the Group and/or the Company have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are initially recognised in the balance sheet at fair value plus transaction costs. Subsequently, they are stated in the balance sheet at amortised cost less impairment losses (Note 2(l)).

Other financial instruments are stated at cost less impairment losses (Note 2(l)). Other financial instruments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be measured reliably.

(i) Inventories

Inventories, which consist primarily of expendable spare parts and supplies, are stated at cost less any applicable provision for obsolescence, and are expensed when used in operations. Cost represents the average unit cost. Inventories held for disposal are stated at the lower of cost and net realisable value. Net realisable value represents estimated resale price.

(j) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (Note 2(l)), except where the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (Note 2(l)).

(k) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(l) Impairment of assets

(i) Impairment of investments in debt and equity securities and other receivables

Investments in debt and equity securities and other current and non-current receivables that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

– For unquoted equity securities and current receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for current receivables are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for equity securities are not reversed.

– For financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets).

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

– Property, plant and equipment;

– Construction in progress;

– Lease and equipment deposits;

– Lease prepayments;

– Deferred expenditure; and

– Investments in subsidiaries, associates and jointly controlled entities

If any such indication exists, the asset's recoverable amount is estimated.

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(l) Impairment of assets (cont'd)

(ii) Impairment of other assets (cont'd)

– Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(m) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings using the effective interest method.

(n) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(o) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligations and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(p) Defeasance of long-term liabilities

Where long-term liabilities have been defeased by the placement of security deposits, those liabilities and deposits (and income and charge arising therefrom) are netted off in order to reflect the overall commercial effect of the arrangements. Such netting off has been effected where a right is held by the Group to insist on net settlement of the liability and deposit including in all situations of default and where that right is assured beyond doubt.

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(q) Deferred credits

In connection with the acquisition or operating lease of certain aircraft and engines, the Group receives various credits. Such credits are deferred until the aircraft and engines are delivered, at which time they are either applied as a reduction of the cost of acquiring the aircraft and engines, resulting in a reduction of future depreciation, or amortised as a reduction of rental expense for aircraft and engines under operating leases.

(r) Income tax

Income tax for the year comprises current and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to the recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investment in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the difference will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
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2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(r) Income tax (cont'd)

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

– in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

– in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  - the same taxable entity; or

  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(s) Revenue recognition

(i) Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage. Revenues from airline-related business are recognised when services are rendered. Revenue is stated net of sales tax.

(ii) Interest income is recognised as it accrues using the effective interest method.

(iii) Dividend income is recognised when the Group's right to receive the dividend is established.

(iv) Operating lease income is recognised on a straight line basis over the terms of the respective leases.

(t) Traffic commissions

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

(u) Maintenance and overhaul costs

Routine maintenance, repairs and overhauls are expensed in the income statement as and when incurred. Major overhauls in respect of owned and leased aircraft are capitalised and amortised over the average expected life between major overhauls.

In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of overhauls required to be performed on the related aircraft prior to their return to the lessors.

(v) Borrowing costs

Borrowing costs are expensed in the income statement as and when incurred, except to the extent that they are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(w) Retirement benefits

Contributions to retirement schemes and additional retirement benefits paid to retired employees are accrued in the year in which the associated services are rendered by employees.

(x) Frequent flyer award programmes

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

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

(y) Translation of foreign currencies

Transactions in foreign currencies are translated into Renminbi at the applicable rates of exchange quoted by the People's Bank of China ("PBOC") prevailing on the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Renminbi at the PBOC exchange rates at the balance sheet date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Renminbi at the PBOC exchange rates prevailing on the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Renminbi at the PBOC exchange rates at the dates the fair value was determined.

(z) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that was a related party of the Group.

(aa) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

3 NEW AND REVISED IFRSs

The IASB has issued a number of new and revised IFRSs that are effective for accounting periods beginning on or after 1 January 2005.

The accounting policies of the Group and/or the Company after the adoption of these new and revised IFRSs have been summarised in Note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

3 NEW AND REVISED IFRSs (cont'd)

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (Note 50).

(a) Changes in presentation of shares of associates' and jointly controlled entities' taxation (IAS 1, Presentation of financial statements)

In prior years, the Group's share of taxation of associates and jointly controlled entities accounted for using the equity method was included as part of the Group's income tax in the consolidated income statement. With effect from 1 January 2005, in accordance with the implementation guidance in IAS 1, the Group has changed the presentation and includes the share of taxation of associates and jointly controlled entities accounted for using the equity method in the respective shares of profit or loss reported in the consolidated income statement before arriving at the Group's profit or loss before tax. These changes in presentation have been applied retrospectively with comparatives restated.

As a result of these changes in presentation, the Group's share of losses of associates and jointly controlled entities have decreased by RMB15 million and RMB3 million, respectively, for the year ended 31 December 2005. For the year ended 31 December 2004, the Group's share of profits of associates was decreased by RMB2 million and share of losses of jointly controlled entities was increased by RMB11 million, respectively. The Group's income tax benefit for the year has decreased by RMB18 million (2004: income tax expense decreased by RMB13 million). Accordingly, there is no effect on the net results and net assets of the Group in either period.

(b) Change in presentation of minority interests (IAS 1, Presentation of financial statements and IAS 27, Consolidated and separate financial statements)

In prior years, minority interests at the balance sheet date were presented separately from liabilities and equity in the consolidated balance sheet. Minority interests in the results of the Group for the year were also separately presented in the consolidated income statement as a deduction before arriving at the profit attributable to shareholders (the equity shareholders of the Company).

With effect from 1 January 2005, in order to comply with IAS 1 and IAS 27, the Group has changed its accounting policy relating to presentation of minority interests. Under the new policy, minority interests are presented as part of equity, separately from interests attributable to the equity shareholders of the Company. Further details of the new policy are set out in Note 2(c). These changes in presentation have been applied retrospectively with comparatives restated.

As a result of these changes in presentation, the Group's loss for the year and total equity at 31 December 2005 have decreased by RMB2 million (2004: RMB203 million) and increased by RMB1,936 million (2004: RMB2,055 million), respectively.

(c) Scope of related parties (IAS 24, Related party disclosures)

As a result of the adoption of revised IAS 24, the definition of related parties as disclosed in Note 2(z) has been expanded such that state-controlled entities are included. The revised IAS 24 also requires the compensation of key management personnel to be disclosed. The Group has included these additional disclosures in the financial statements.

Notes to the Financial Statements (Cont'd)

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4 TURNOVER

Turnover comprises revenues from airline and airline-related business and is stated net of sales tax. An analysis of turnover is as follows:

	2005 RMB million	2004 RMB million
Traffic revenue		
Passenger	**34,328**	21,100
Cargo and mail	**3,091**	2,244
	37,419	23,344
Other operating revenue		
Commission income	**237**	203
General aviation income	**77**	55
Ground services income	**195**	146
Air catering income	**25**	53
Rental income	**69**	45
Aircraft lease income	**1**	11
Others	**270**	117
	874	630
	38,293	23,974

Pursuant to various sales tax rules and regulations, the Group is required to pay sales tax to national and local tax authorities at the rate of approximately 3% of the traffic revenue in respect of domestic flights and outbound international/Hong Kong and Macau flights. Sales tax incurred by the Group during the year ended 31 December 2005, netted off against revenue, amounted to RMB1,111 million (2004: RMB716 million).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

5 FLIGHT OPERATIONS EXPENSES

	2005 **RMB million**	2004 RMB million
Jet fuel costs	**11,929**	6,050
Operating lease charges		
– Aircraft and flight equipment	**2,497**	1,665
– Land and buildings	**302**	109
Air catering expenses	**1,196**	705
Aircraft insurance	**105**	185
Flight personnel payroll and welfare	**1,619**	1,026
Training expenses	**373**	183
CAAC Infrastructure Development Fund contributions	**978**	466
Others	**395**	29
	19,394	10,418

Contributions to the CAAC Infrastructure Development Fund are payable based on the traffic capacity deployed by the Group on its routes, except for the period from 1 January 2004 to 31 March 2004 when the Group was exempted from paying any contributions.

6 MAINTENANCE EXPENSES

	2005 **RMB million**	2004 RMB million
Repairing and maintenance charges	**4,153**	3,247
Maintenance materials	**436**	212
	4,589	3,459

7 AIRCRAFT AND TRAFFIC SERVICING EXPENSES

	2005 **RMB million**	2004 RMB million
Landing and navigation fees	**4,891**	3,222
Ground service charges	**868**	281
	5,759	3,503

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

8 PROMOTION AND SALES EXPENSES

	2005	2004
	RMB million	RMB million
Sales commissions	**1,503**	1,062
Ticket office expenses	**659**	555
Computer reservation services	**417**	233
Advertising and promotion	**32**	36
Others	**169**	54
	2,780	1,940

9 GENERAL AND ADMINISTRATIVE EXPENSES

	2005	2004
	RMB million	RMB million
General corporate expenses	**2,408**	1,260
Impairment losses for trade and other receivables	**–**	27
Auditors' remuneration	**12**	11
Other taxes and levies	**37**	25
	2,457	1,323

10 DEPRECIATION AND AMORTISATION

	2005	2004
	RMB million	RMB million
Depreciation		
– Owned assets	**3,292**	1,891
– Assets acquired under finance leases	**1,128**	472
Amortisation of deferred credits	**(20)**	–
Other amortisation	**40**	50
	4,440	2,413

Depreciation of property, plant and equipment leased out under operating leases amounted to RMB35 million (2004: RMB55 million).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

11 STAFF COSTS

	2005 RMB million	2004 RMB million
Salaries, wages and welfare	**3,515**	2,260
Retirement scheme contributions	**472**	168
	3,987	2,428

Staff costs relating to flight operations, maintenance, aircraft and traffic servicing, promotion and sales and general and administrative expenses are also included in the respective total amounts disclosed separately in Notes 5 to 9 above.

12 INTEREST EXPENSE

	2005 RMB million	2004 RMB million
Interest on bank and other loans wholly repayable within five years	**211**	221
Interest on other loans	**877**	156
Finance charges on obligations under finance leases	**626**	348
Less: borrowing costs capitalised	**(98)**	(34)
	1,616	691

The borrowing costs have been capitalised at rates ranging from 4.14% to 5.27% per annum (2004: 1.51% to 3.48% per annum).

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

13 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

(a) Directors' and supervisors' emoluments

Details of directors' and supervisors' emoluments for the year ended 31 December 2005 are set out below:

Name	Note	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive directors						
Liu Shao Yong	(i)	–	299	–	12	311
Liu Ming Qi		–	242	–	10	252
Peng An Fa		–	101	–	6	107
Wang Quan Hua		–	237	–	12	249
Zhao Liu An	(i)	–	237	–	12	249
Zhou Yong Qian		–	237	–	12	249
Si Xian Min		–	281	–	12	293
Zhou Yong Jin		–	127	–	2	129
Xu Jie Bo		–	226	–	12	238
Wu Rong Nan		–	368	162	7	537
Supervisors						
Sun Xiao Yi		–	237	–	12	249
Yang Guang Hua		–	225	–	12	237
Yang Yi Hua		–	48	70	11	129
Independent non-executive directors						
Simon To	(ii)	–	–	–	–	–
Peter Lok		58	–	–	–	58
Wei Ming Hai		58	–	–	–	58
Wang Zhi		58	–	–	–	58
Sui Guang Jun		58	–	–	–	58
		232	2,865	232	132	3,461

Notes to the Financial Statements (Cont'd)

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(Expressed in Renminbi)

13 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT (cont'd)

(a) Directors' and supervisors' emoluments (cont'd)

Details of directors' and supervisors' emoluments for the year ended 31 December 2004 are set out below:

Name	Note	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive directors						
Liu Shao Yong	(i)	–	213	–	2	215
Liu Ming Qi		–	401	–	9	410
Wang Quan Hua		–	335	–	9	344
Peng An Fa		–	335	–	9	344
Zhao Liu An	(i)	–	364	–	3	367
Zhou Yong Qian		–	364	–	3	367
Si Xian Min		–	169	114	10	293
Zhou Yong Jin		–	180	110	3	293
Xu Jie Bo		–	173	110	10	293
Wu Rong Nan		–	264	152	6	422
Wang Chang Shun		–	34	45	4	83
Yan Zhi Qing		–	39	55	4	98
Supervisors						
Sun Xiao Yi		–	335	–	9	344
Yang Guang Hua		–	173	110	10	293
Yang Yi Hua		–	44	108	9	161
Gan Yu Hua		–	16	3	10	29
Li Qi Hong		–	26	16	2	44
Liang Hua Fu		–	33	45	4	82
Independent non-executive directors						
Simon To	(ii)	–	–	–	–	–
Peter Lok		52	–	–	–	52
Wei Ming Hai		50	–	–	–	50
Wang Zhi		50	–	–	–	50
Sui Guang Jun		50	–	–	–	50
		202	3,498	868	116	4,684

Notes:

(i) The above amounts included the salaries paid to these directors as pilots of the Company.

(ii) Simon To received director's fee of RMB1 during the year ended 31 December 2005 (2004: RMB1).

Notes to the Financial Statements (Cont'd)

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13 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT (cont'd)

(b) Individuals with highest emoluments

Of the five individuals with the highest emoluments, one (2004: Nil) is director of the Company during the year whose emolument is disclosed in Note 13(a) above. The aggregate of the emoluments in respect of the other four (2004: five) individuals during the year are as follows:

	2005 RMB'000	2004 RMB'000
Salaries, allowances and benefits in kind	**1,931**	2,045
Retirement scheme contributions	**39**	29
	1,970	2,074

The emoluments of the four individuals (2004: five) with the highest emoluments are within the following band:

	2005 Number of individuals	2004 Number of individuals
Nil to HK$1,000,000 (RMB1,052,000 equivalent)	**4**	5

14 INCOME TAX (BENEFIT)/EXPENSE

(a) Income tax (benefit)/expense in the consolidated income statement

	2005 RMB million	2004 RMB million (restated, Note 3)
PRC income tax	**12**	176
Deferred tax (Note 24)	**(19)**	(111)
Income tax (benefit)/expense	**(7)**	65

The statutory income tax rate in the PRC is 33%. Except for certain branches and subsidiaries, the Company and its subsidiaries are entitled to enjoy a preferential tax rate of 15% pursuant to approval documents issued by the relevant tax authorities.

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

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

14 INCOME TAX (BENEFIT)/EXPENSE (cont'd)

(b) Reconciliation between tax (benefit)/expense and accounting (loss)/profit at applicable tax rates

	2005 **RMB million**	2004 RMB million (restated, Note 3)
(Loss)/profit before tax	**(1,853)**	220
Expected tax on (loss)/profit before tax calculated at 15% (2004:15%)	**(278)**	33
Adjustments:		
Tax effect of non-deductible expenses	**82**	29
Tax effect of non-taxable income	**(8)**	–
Tax effect of share of results of associates and jointly controlled entities	**37**	(1)
Tax effect of unused tax losses not recognised	**135**	–
Others	**25**	4
Actual tax (benefit)/expense	**(7)**	65

15 LOSS ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The loss attributable to equity shareholders of the Company for the year ended 31 December 2005 includes a loss of RMB1,675 million (2004: RMB169 million) which has been dealt with in the financial statements of the Company.

16 DIVIDENDS

No interim dividend was paid during both the current and prior years.

The board of directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December 2005. No final dividend was paid in respect of the year ended 31 December 2004.

17 BASIC LOSS PER SHARE

The calculation of basic loss per share for the year ended 31 December 2005 is based on the loss attributable to equity shareholders of the Company of RMB1,848 million (2004: RMB48 million) and the weighted average number of shares in issue during the year of 4,374 million (2004: 4,374 million).

The amount of diluted loss per share is not presented as there were no dilutive potential ordinary shares in existence for both the current and prior years.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

18 PROPERTY, PLANT AND EQUIPMENT, NET

(a) The Group

	Buildings	Aircraft: Owned	Aircraft: Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Cost or valuation:						
At 1 January 2004	3,288	17,222	10,463	6,842	1,930	39,745
Exchange adjustments	5	–	–	–	12	17
Reclassification on exercise of purchase options	–	550	(550)	–	–	–
Additions	336	4,156	–	525	5	5,022
Transfer from construction in progress	2,472	–	–	–	235	2,707
Through the CNA/XJA Acquisitions	915	5,206	4,616	1,753	490	12,980
Disposals	(28)	–	–	(76)	(73)	(177)
At 31 December 2004	6,988	27,134	14,529	9,044	2,599	60,294
Representing:						
Cost	6,633	20,905	10,189	6,870	2,115	46,712
Valuation – 1996 (Note (d))	355	6,229	4,340	2,174	484	13,582
	6,988	27,134	14,529	9,044	2,599	60,294
At 1 January 2005	6,988	27,134	14,529	9,044	2,599	60,294
Exchange adjustments	(6)	–	–	–	(14)	(20)
Additions	64	1,827	8,146	1,336	307	11,680
Transfer from construction in progress	513	–	–	–	56	569
Transfer to inventories	–	–	–	(126)	–	(126)
Disposals	(256)	–	–	(207)	(81)	(544)
At 31 December 2005	**7,303**	**28,961**	**22,675**	**10,047**	**2,867**	**71,853**
Representing:						
Cost	6,948	22,732	18,335	7,873	2,383	58,271
Valuation – 1996 (Note (d))	355	6,229	4,340	2,174	484	13,582
	7,303	**28,961**	**22,675**	**10,047**	**2,867**	**71,853**

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

18 PROPERTY, PLANT AND EQUIPMENT, NET (cont'd)

(a) The Group (cont'd)

	Buildings	Aircraft: Owned	Aircraft: Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Accumulated depreciation:						
At 1 January 2004	594	3,192	2,605	3,644	1,174	11,209
Exchange adjustments	1	–	–	–	9	10
Reclassification on exercise of purchase options	–	183	(183)	–	–	–
Charge for the year	179	956	472	544	212	2,363
Disposals	(17)	–	–	(51)	(61)	(129)
At 31 December 2004	757	4,331	2,894	4,137	1,334	13,453
At 1 January 2005	757	4,331	2,894	4,137	1,334	13,453
Exchange adjustments	(1)	–	–	–	(11)	(12)
Charge for the year	227	1,546	1,108	1,121	418	4,420
Disposals	(74)	–	–	(145)	(55)	(274)
At 31 December 2005	**909**	**5,877**	**4,002**	**5,113**	**1,686**	**17,587**
Net book value:						
At 31 December 2005	**6,394**	**23,084**	**18,673**	**4,934**	**1,181**	**54,266**
At 31 December 2004	6,231	22,803	11,635	4,907	1,265	46,841

Notes to the Financial Statements (Cont'd)

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18 PROPERTY, PLANT AND EQUIPMENT, NET (cont'd)

(b) The Company

	Buildings	Aircraft Owned	Aircraft Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Cost or valuation:						
At 1 January 2004	1,644	12,868	10,463	5,396	1,189	31,560
Reclassification on exercise of purchase options	–	550	(550)	–	–	–
Additions through transfer of property, plant and equipment upon dissolution of a subsidiary	3	–	–	134	13	150
Additions	12	3,509	–	192	38	3,751
Transfer from construction in progress	1,663	–	–	–	235	1,898
Through the CNA/XJA Acquisitions	727	5,206	4,616	1,745	441	12,735
Disposals	(23)	–	–	–	(40)	(63)
At 31 December 2004	4,026	22,133	14,529	7,467	1,876	50,031
Representing:						
Cost	3,832	17,520	10,189	5,642	1,612	38,795
Valuation – 1996 (Note (d))	194	4,613	4,340	1,825	264	11,236
	4,026	22,133	14,529	7,467	1,876	50,031
At 1 January 2005	4,026	22,133	14,529	7,467	1,876	50,031
Additions	29	128	8,146	1,181	65	9,549
Transfer from construction in progress	77	–	–	–	56	133
Transfer to inventories	–	–	–	(126)	–	(126)
Disposals	(78)	–	–	(202)	(29)	(309)
At 31 December 2005	**4,054**	**22,261**	**22,675**	**8,320**	**1,968**	**59,278**
Representing:						
Cost	3,860	17,648	18,335	6,495	1,704	48,042
Valuation – 1996 (Note (d))	194	4,613	4,340	1,825	264	11,236
	4,054	**22,261**	**22,675**	**8,320**	**1,968**	**59,278**

Notes to the Financial Statements (Cont'd)

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18 PROPERTY, PLANT AND EQUIPMENT, NET (cont'd)

(b) The Company (cont'd)

	Buildings	Aircraft: Owned	Aircraft: Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Accumulated depreciation:						
At 1 January 2004	324	2,231	2,605	3,073	717	8,950
Reclassification on exercise of purchase options	–	183	(183)	–	–	–
Additions through transfer of property, plant and equipment upon dissolution of a subsidiary	1	–	–	72	10	83
Charge for the year	110	744	472	346	117	1,789
Disposals	(10)	–	–	–	(35)	(45)
At 31 December 2004	425	3,158	2,894	3,491	809	10,777
At 1 January 2005	425	3,158	2,894	3,491	809	10,777
Charge for the year	138	1,255	1,108	786	336	3,623
Disposals	(61)	–	–	(100)	(15)	(176)
At 31 December 2005	**502**	**4,413**	**4,002**	**4,177**	**1,130**	**14,224**
Net book value:						
At 31 December 2005	**3,552**	**17,848**	**18,673**	**4,143**	**838**	**45,054**
At 31 December 2004	3,601	18,975	11,635	3,976	1,067	39,254

(c) Substantially all of the Group's buildings are located in the PRC. The Group was formally granted the rights to use the twenty one parcels of land in Guangzhou, Shenzhen, Zhuhai, Beihai, Changsha, Shantou, Haikou, Zhengzhou, Guiyang and Wuhan by the relevant PRC authorities for periods of 30 to 70 years, which expire between 2020 and 2068. For other land in the PRC on which the Group's buildings are erected, the Group was formally granted the rights to use such land for periods of one to five years pursuant to various lease agreements between the Company and CSAHC. In this connection, rental payments totalling RMB24 million were paid to CSAHC during 2005 (2004: RMB2 million) in respect of these leases (Note 39(a)(vi)).

(d) In compliance with the PRC rules and regulations governing initial public offering of shares by PRC joint stock limited companies, the property, plant and equipment of the Group as at 31 December 1996 were revalued. This revaluation was conducted by Guangzhou Assets Appraisal Corp. ("GAAC"), a firm of independent valuers registered in the PRC, on a depreciated replacement cost basis, and approved by the China State-owned Assets Administration Bureau.

Notes to the Financial Statements (Cont'd)

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18 PROPERTY, PLANT AND EQUIPMENT, NET (cont'd)

(d) (cont'd)

Subsequent to the 1996 revaluation, the property, plant and equipment of the Group are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Based on a revaluation performed as of 30 September 2005, by Savills Valuation & Professional Services Limited, a firm of independent valuers, on a depreciated replacement cost basis, the carrying value of property, plant and equipment did not differ materially from their fair value. Consequently, no additional fair value adjustment was recorded during the year ended 31 December 2005.

At 31 December 2005, the carrying amount of such revalued property, plant and equipment approximated the historical carrying value of such assets had they been stated at cost less accumulated depreciation and impairment losses.

(e) As at 31 December 2005, certain aircraft of the Group and the Company with an aggregate carrying value of approximately RMB30,408 million and RMB26,506 million, respectively (2004: RMB23,562 million and RMB21,814 million, respectively) were mortgaged under certain loan and lease agreements (Notes 30 and 31).

(f) In 2002, the Company entered into operating lease arrangements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi Aviation Technology Company Limited ("Zhuhai Xiang Yi"), a jointly controlled entity of the Company. The leases with initial one-year term are automatically renewable for additional subsequent one year terms unless either party gives appropriate notice of termination. In this connection, rental income totalling RMB31 million (2004: RMB31 million) was received by the Company during the year in respect of the leases (Note 39(a)(xi)). As at 31 December 2005, the cost and accumulated depreciation of the relevant property, plant and equipment leased out under the operating leases amounted to RMB862 million and RMB664 million, respectively (2004: RMB787 million and RMB514 million, respectively). Depreciation of the relevant property, plant and equipment recognised during the year totalled RMB35 million (2004: RMB55 million). As at 31 December 2005, the Company's total future minimum lease payments under non-cancellable operating leases were receivable within one year and amounted to RMB31 million (2004: RMB31 million).

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

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18 PROPERTY, PLANT AND EQUIPMENT, NET (cont'd)

(h) As at 31 December 2005 and up to the date of approval of these financial statements, the Group is in the process of applying for the land use right certificates and property title certificates in respect of the properties located in Guangzhou Baiyun International Airport, in which the Group has interests and for which such certificates have not been granted. As at 31 December 2005, carrying value of such properties of the Group and the Company amounted to RMB2,316 million and RMB1,527 million, respectively (2004: RMB2,319 million and RMB1,513 million, respectively). The directors of the Company are of the opinion that the use of and the conduct of operating activities at the properties referred to above are not affected by the fact that the Group has not yet obtained the relevant land use right certificates and property title certificates.

19 CONSTRUCTION IN PROGRESS

	The Group		**The Company**	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
At 1 January	**565**	1,630	**232**	1,532
Additions	**678**	1,616	**470**	576
Through the CNA/XJA Acquisitions	**–**	26	**–**	22
Transfer to property, plant and equipment	**(569)**	(2,707)	**(133)**	(1,898)
At 31 December	**674**	565	**569**	232

The construction in progress as at 31 December 2005 mainly related to projects at the Guangzhou, Jilin and Fuzhou airports, Shenzhen cargo centre and Beijing branch.

20 INTEREST IN SUBSIDIARIES

	The Company	
	2005	2004
	RMB million	RMB million
Unlisted shares/capital contributions, at cost	**1,482**	1,232
Amounts due from subsidiaries	**609**	917
	2,091	2,149

Details of the Group's principal subsidiaries are set out in Note 51.

Notes to the Financial Statements (Cont'd)

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21 INTEREST IN ASSOCIATES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Share of net assets	**142**	429	**–**	–
Unlisted capital contributions, at cost	**–**	–	**354**	357
Less: impairment loss	**–**	–	**(214)**	(61)
	142	429	**140**	296

Details of the Group's principal associates are set out in Note 52, all of which are unlisted corporate entities.

Summary financial information on associates:

	100 Percent		Group's effective interest	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Non-current assets	**5,334**	4,254	**2,081**	1,672
Current assets	**2,275**	2,165	**455**	1,049
Non-current liabilities	**(3,897)**	(2,918)	**(1,520)**	(1,290)
Current liabilities	**(3,318)**	(2,568)	**(874)**	(1,002)
Net assets	**394**	933	**142**	429
Revenues	**3,314**	2,676	**1,318**	1,042
Expenses	**(3,798)**	(2,633)	**(1,618)**	(1,030)
Taxation	**(39)**	(5)	**15**	(2)
(Loss)/profit for the year	**(523)**	38	**(285)**	10

22 INTEREST IN JOINTLY CONTROLLED ENTITIES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Share of net assets	**805**	782	**–**	–
Unlisted capital contributions, at cost	**–**	–	**666**	636
	805	782	**666**	636

Details of the Group's principal jointly controlled entities are set out in Note 52, all of which are unlisted corporate entities.

Notes to the Financial Statements (Cont'd)

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22 INTEREST IN JOINTLY CONTROLLED ENTITIES (cont'd)

Summary financial information on jointly controlled entities:

	Group's effective interest	
	2005	2004
	RMB million	RMB million
Non-current assets	**920**	845
Current assets	**877**	794
Non-current liabilities	**(524)**	(389)
Current liabilities	**(468)**	(468)
Net assets	**805**	782
Revenues	**1,115**	762
Expenses	**(1,082)**	(767)
Taxation	**3**	(11)
Profit/(loss) for the year	**36**	(16)

23 OTHER INVESTMENTS

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Non-current investments				
Unlisted equity securities available for sale, at cost	**320**	272	**170**	167
Current investments				
Listed equity securities held for trading	**–**	523	**–**	502
Listed debt securities held-to-maturity	**–**	160	**–**	–
	–	683	**–**	502
Market value of listed securities	**–**	683	**–**	502

The current investments at 31 December 2004 were listed outside Hong Kong.

Net realised and unrealised gain on trading securities of the Group amounted to RMB6 million during the year (2004: RMB15 million).

Dividend income from unlisted securities of the Group amounted to RMB4 million during the year (2004: RMB14 million).

Notes to the Financial Statements (Cont'd)

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24 DEFERRED TAX ASSETS/LIABILITIES

Movements of net deferred tax (liabilities)/assets are as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
At 1 January	**(287)**	(398)	**51**	(90)
Credited to income statement (Note 14(a))	**19**	111	**23**	141
At 31 December	**(268)**	(287)	**74**	51

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

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Deferred tax assets:				
Tax losses	**159**	39	**159**	39
Repair charges capitalised	**275**	254	**220**	195
Accrued expenses	**175**	275	**175**	271
Others	**29**	21	**28**	20
Total deferred tax assets	**638**	589	**582**	525
Deferred tax liabilities:				
Accrued expenses	**(58)**	(75)	**–**	–
Depreciation allowances in excess of the related depreciation	**(832)**	(752)	**(508)**	(459)
Others	**(16)**	(49)	**–**	(15)
Total deferred tax liabilities	**(906)**	(876)	**(508)**	(474)
	(268)	(287)	**74**	51
Net deferred tax asset recognised on the balance sheet	**74**	51	**74**	51
Net deferred tax liability recognised on the balance sheet	**(342)**	(338)	**–**	–
	(268)	(287)	**74**	51

The Group had tax losses for PRC income tax purposes totalling approximately RMB1,601 million as at 31 December 2005 (2004: RMB260 million). Such tax losses are available for carry forward to set off against future PRC assessable income for a maximum period of five years and will expire in 2011. In accordance with accounting policy set out in Note 2(r), the Group has not recognised deferred tax asset in respect of tax losses to the extent of approximately RMB710 million (2004: Nil) as it was determined by management that it is not probable that future taxable profits against which the losses can be utilised will be available before they expire.

Notes to the Financial Statements (Cont'd)

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24 DEFERRED TAX ASSETS/LIABILITIES (cont'd)

The Group has also not recognised deferred tax assets in respect of cumulative tax losses from operations in Hong Kong of approximately RMB303 million (2004: RMB303 million) as it is not probable that future taxable profits against which the losses can be utilised will be available. The tax losses do not expire under current tax legislation.

25 OTHER ASSETS

Other assets of the Group and the Company include lump sum housing benefits of RMB171 million (2004: RMB197 million). Further details are set out in Note 40.

Movements of lump sum housing benefits are as follows:

	The Group and the Company	
	2005	2004
	RMB million	RMB million
At 1 January	**197**	223
Amortisation for the year	**(26)**	(26)
At 31 December	**171**	197

26 INVENTORIES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Expendable spare parts and maintenance materials	**1,241**	1,175	**990**	904
Other supplies	**141**	127	**106**	95
	1,382	1,302	**1,096**	999

The analysis of the amount of inventories recognised as an expense is as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Consumption	**720**	596	**383**	275
Write-down of inventories	**209**	–	**209**	–
	929	596	**592**	275

As a result of fleet adjustment, inventories have been written down by RMB209 million at 31 December 2005.

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27 TRADE RECEIVABLES

Credit terms granted by the Group to sales agents and other customers generally range from one to three months. An ageing analysis of trade receivables, net of impairment losses for bad and doubtful debts, is set out below:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Within 1 month	**1,366**	998	**1,076**	863
More than 1 month but less than 3 months	**137**	163	**73**	133
More than 3 months but less than 12 months	**14**	42	**7**	39
More than 12 months	**1**	–	**–**	–
	1,518	1,203	**1,156**	1,035

As at 31 December 2005, the Group and the Company had amounts due from a fellow subsidiary of RMB42 million (2004: RMB52 million) which were included in trade receivables.

All of the trade receivables are expected to be recovered within one year.

Included in trade receivables are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD15**	USD11	**USD14**	USD10

28 OTHER RECEIVABLES

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

29 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash at bank and in hand and deposits with China Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associate of the Group. In accordance with the financial agreement dated 22 May 1997 and subsequently revised on 31 December 2004 between the Company and SA Finance, all the Group's deposits accepted by SA Finance were simultaneously placed with several designated major PRC banks by SA Finance. As at 31 December 2005, the Group's and the Company's deposits with SA Finance amounted to RMB544 million and RMB480 million, respectively (2004: RMB406 million and RMB362 million, respectively).

Notes to the Financial Statements (Cont'd)

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29 CASH AND CASH EQUIVALENTS (cont'd)

Included in cash and cash equivalents are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD24**	USD37	**USD23**	USD42
Japanese Yen	**JPY1,161**	JPY1,272	**JPY1,093**	JPY1,243

30 BANK AND OTHER LOANS

(a) At 31 December 2005, bank and other loans are analysed as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Bank loans	**28,960**	23,450	**25,128**	20,701
Other loans	**3**	3	**–**	–
	28,963	23,453	**25,128**	20,701

(b) At 31 December 2005, bank and other loans were repayable as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Within 1 year or on demand	**16,223**	11,518	**14,664**	10,161
After 1 year but within 2 years	**4,316**	1,626	**3,475**	1,476
After 2 years but within 5 years	**4,251**	6,422	**3,079**	5,283
After 5 years	**4,173**	3,887	**3,910**	3,781
	28,963	23,453	**25,128**	20,701
Less: loans due within one year classified as current liabilities	**(16,223)**	(11,518)	**(14,664)**	(10,161)
	12,740	11,935	**10,464**	10,540

Notes to the Financial Statements (Cont'd)

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30 BANK AND OTHER LOANS (cont'd)

(c) Details of bank and other loans with original maturity over one year are as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Renminbi denominated loans				
Non-interest bearing loan from a municipal government authority repayable on demand	**3**	3	**–**	–
Floating interest rates ranging from 5.02% to 5.51% per annum as at 31 December 2005, with maturities through 2011	**877**	1,217	**550**	1,217
United States Dollars denominated loans				
Fixed interest rates ranging from 4.43% to 7.73% per annum as at 31 December 2005, with maturities through 2015	**2,414**	2,676	**1,835**	2,326
Floating interest rates ranging from 3-month LIBOR + 0.70% to 0.90% per annum as at 31 December 2005, with maturities through 2012	**3,610**	1,426	**1,946**	1,426
Floating interest rates ranging from 6-month LIBOR + 0.30% to 1.20% per annum as at 31 December 2005, with maturities through 2013	**7,713**	8,206	**7,511**	6,713
	14,617	13,528	**11,842**	11,682
Less: loans due within one year classified as current liabilities	**(1,877)**	(1,593)	**(1,378)**	(1,142)
	12,740	11,935	**10,464**	10,540

(d) As at 31 December 2005, bank loans of the Group and the Company included short-term bank loans totalling RMB14,346 million and RMB13,286 million, respectively (2004: RMB9,925 million and RMB9,019 million, respectively). On such date, the Group's and the Company's weighted average interest rates on short-term borrowings were both 4.83% per annum (2004: 1.60% and 1.56% per annum, respectively).

(e) As at 31 December 2005, bank and other loans of the Group and the Company totalling RMB8,116 million and RMB5,954 million, respectively (2004: RMB8,620 million and RMB7,783 million, respectively) were secured by mortgages over certain of the Group's and the Company's aircraft with carrying amount of RMB11,735 million and RMB7,833 million, respectively (2004: RMB11,927 million and RMB10,179 million, respectively).

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30 BANK AND OTHER LOANS (cont'd)

(f) At 31 December 2005, certain bank and other loans were guaranteed by the following parties:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Guarantors				
Industrial Commercial Bank of China	**111**	149	**111**	149
Export-Import Bank of the United States	**1,171**	1,732	**593**	969
Bank of China	**155**	291	**155**	53
CSAHC	**1,908**	2,452	**1,474**	1,812
Shenzhen Yingshun Investment Development Company Limited	**22**	–	**–**	–
SA Finance	**7**	9	**–**	–
	3,374	4,633	**2,333**	2,983

(g) At 31 December 2005, loans to the Group and the Company from SA Finance amounted to RMB300 million and Nil, respectively (2004: RMB256 million and RMB76 million, respectively) (Note 39(b)).

(h) At 31 December 2005, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an approximate RMB39,294 million (2004: RMB35,750 million), of which approximately RMB28,242 million (2004: RMB11,525 million) was utilised.

(i) Included in bank and other loans are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD3,208**	USD1,969	**USD2,834**	USD1,926
Hong Kong Dollars	**HKD1,821**	HKD2,678	**HKD1,640**	HKD2,678

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31 OBLIGATIONS UNDER FINANCE LEASES

The Group and the Company have commitments under finance lease agreements in respect of aircraft and related equipment. The majority of these leases have terms of 10 to 15 years expiring during the years 2006 to 2017. At 31 December 2005, future payments under these finance leases are as follows:

	The Group and the Company					
	2005			2004		
	Obligations RMB million	**Payments RMB million**	**Interest RMB million**	Obligations RMB million	Payments RMB million	Interest RMB million
Within 1 year	**3,373**	**4,030**	**657**	2,144	2,580	436
After 1 year but within 2 years	**2,930**	**3,423**	**493**	2,863	3,213	350
After 2 years but within 5 years	**4,797**	**5,750**	**953**	6,044	6,540	496
After 5 years	**4,732**	**5,412**	**679**	692	722	30
	15,832	**18,615**	**2,782**	11,743	13,055	1,312
Less: balance due within one year classified as current liabilities	**(3,373)**			(2,144)		
	12,459			9,599		

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

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

Security, including charges over the assets concerned and relevant insurance policies, is provided to the lessors. At 31 December 2005, certain of the Group's and the Company's aircraft with carrying amount of RMB18,673 million (2004: RMB11,635 million) were mortgaged to secure finance lease obligations RMB15,832 million (2004: RMB11,743 million).

Included in obligations under finance leases are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group and the Company	
	2005 million	2004 million
United States Dollars	**USD1,556**	USD958
Japanese Yen	**JPY47,795**	JPY47,840

Notes to the Financial Statements (Cont'd)

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32 TRADE AND BILLS PAYABLES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Trade payables	**3,033**	1,554	**2,576**	1,320
Bills payable	**896**	136	**896**	136
	3,929	1,690	**3,472**	1,456

The following is the ageing analysis of trade and bills payables:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Within 1 month	**2,000**	735	**1,797**	642
More than 1 month but less than 3 months	**1,225**	431	**1,043**	369
More than 3 months but less than 6 months	**704**	524	**632**	445
	3,929	1,690	**3,472**	1,456

At 31 December 2005, the Group and the Company had an amount due to a fellow subsidiary of RMB859 million (2004: RMB838 million) which was included in trade and bills payables.

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

Included in trade and bills payables are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2005	2004	**2005**	2004
	million	million	**million**	million
United States Dollars	**USD147**	USD108	**USD129**	USD104

33 AMOUNTS DUE FROM/TO RELATED COMPANIES

(a) Amounts due from related companies

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Jointly controlled entities	**84**	–	**84**	–

The amounts due from related companies were unsecured, interest free and have no fixed terms of repayment.

33 AMOUNTS DUE FROM/TO RELATED COMPANIES (cont'd)

(b) Amounts due to related companies

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
CSAHC and its subsidiaries	**12**	2,094	**12**	2,094
An associate	**5**	–	**–**	–
Jointly controlled entities	**99**	340	**52**	288
	116	2,434	**64**	2,382

The amounts due to related companies were unsecured, interest free and have no fixed terms of repayment.

34 ACCRUED EXPENSES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Jet fuel costs	**686**	743	**493**	560
Operating lease charges	**86**	29	**86**	29
Air catering expenses	**132**	192	**131**	164
Salaries and welfare	**193**	349	**114**	137
Lump sum housing benefits payable	**92**	108	**92**	108
Repairs and maintenance	**996**	976	**960**	976
Provision for major overhauls (Note 36)	**151**	75	**123**	62
Landing and navigation fees	**1,129**	1,331	**890**	1,041
Computer reservation services	**190**	195	**105**	187
Interest expense	**338**	240	**312**	218
Duties and levies	**12**	71	**12**	45
Property management fee	**37**	–	**37**	–
Others	**208**	242	**162**	206
	4,250	4,551	**3,517**	3,733

Notes to the Financial Statements (Cont'd)

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35 OTHER LIABILITIES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
CAAC Infrastructure Development fund	**177**	161	**125**	108
Airport construction surcharge	**542**	316	**482**	267
Airport tax	**198**	112	**198**	110
Construction cost payable	**793**	864	**531**	668
Advance payments on charter flights	**104**	119	**92**	94
Sales agent deposits	**198**	182	**155**	147
Other tax payable	**441**	332	**228**	206
Others	**1,343**	888	**1,082**	867
	3,796	2,974	**2,893**	2,467

36 PROVISION FOR MAJOR OVERHAULS

Details of provision for major overhauls in respect of aircraft held under operating leases are as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
At 1 January	**359**	200	**248**	131
Provision for the year	**129**	89	**86**	47
Through the CNA/XJA Acquisitions	**–**	70	**–**	70
Less: Provision utilised during the year	**(36)**	–	**(25)**	–
At 31 December	**452**	359	**309**	248
Less: current portion included in accrued expenses (Note 34)	**(151)**	(75)	**(123)**	(62)
	301	284	**186**	186

37 SHARE CAPITAL

	2005	2004
	RMB million	RMB million
Registered, issued and paid up capital:		
2,200,000,000 domestic state-owned shares of RMB 1.00 each	**2,200**	2,200
1,174,178,000 H shares of RMB 1.00 each	**1,174**	1,174
1,000,000,000 A shares of RMB 1.00 each	**1,000**	1,000
	4,374	4,374

All the domestic state-owned, H and A shares rank pari passu in all material respects.

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38 RESERVES

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Share premium				
At 1 January and 31 December	**5,325**	5,325	**5,325**	5,325
Statutory surplus reserve (Note a)				
At 1 January	**402**	361	**349**	339
Transfer from retained earnings	**8**	41	**–**	10
At 31 December	**410**	402	**349**	349
Statutory public welfare fund (Note b)				
At 1 January	**193**	173	**177**	172
Transfer from retained earnings	**5**	20	**–**	5
At 31 December	**198**	193	**177**	177
Discretionary surplus reserve (Note c)				
At 1 January	**77**	77	**77**	77
Transfer from retained earnings	**6**	–	**–**	–
At 31 December	**83**	77	**77**	77
Retained earnings/(accumulated losses)				
At 1 January	**1,477**	1,586	**(322)**	(138)
Loss for the year	**(1,848)**	(48)	**(1,675)**	(169)
Appropriations to reserves	**(19)**	(61)	**–**	(15)
At 31 December	**(390)**	1,477	**(1,997)**	(322)
Total	**5,626**	7,474	**3,931**	5,606

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

No appropriation of reserves has been made by the Company for the year ended 31 December 2005 as the Company sustained a loss during the year.

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

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38 RESERVES (cont'd)

(b) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer between 5% and 10% of their annual net profits after taxation, as determined under the PRC accounting rules and regulations, to the statutory public welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's and the relevant subsidiaries' employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than in liquidation. The transfer to this reserve must be made before distribution of a dividend to shareholders and is subject to respective shareholders' approval.

No appropriation of reserves has been made by the Company for the year ended 31 December 2005 as the Company sustained a loss during the year.

(c) The appropriation to this reserve is subject to shareholders' approval. The usage of this reserve is similar to that of statutory surplus reserve.

(d) Dividend distributions may be proposed at the discretion of the Company's board of directors, after consideration of the transfers referred to above and making up cumulative prior years' losses. Pursuant to the Articles of Association of the Company, the net profit of the Company for the purpose of profit distribution is deemed to be the lesser of (i) the net profit determined in accordance with the PRC accounting rules and regulations, and (ii) the net profit determined in accordance with IFRSs; or if the financial statements of the Company are not prepared in accordance with IFRSs, the accounting standards of one of the countries in which its shares are listed. As at 31 December 2005, the Company did not have any distributable reserves (2004: Nil).

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39 RELATED PARTY TRANSACTIONS

In addition to the balances disclosed in Notes 27, 29, 30, 32 and 33 to these financial statements, the Group entered into the following material related party transactions.

(a) Significant transactions with related companies

The Group obtained various operational and financial services provided by CSAHC and its affiliates, and the Group's associates and jointly controlled entities during the normal course of its business.

Details of the significant transactions carried out are as follows:

	Note	**2005 RMB million**	2004 RMB million
Expenses paid to CSAHC and its affiliates			
Handling charges	(i)	**32**	33
Air catering supplies	(ii)	**173**	170
Commission expense	(iii)	**26**	2
Sundry aviation supplies	(iv)	**88**	66
Lease charges for aircraft	(v)	**10**	–
Lease charges for land and buildings	(vi)	**90**	18
Property management fee	(vii)	**28**	–
Housing benefits	(viii)	**–**	85
Expenses paid to associates and jointly controlled entities			
Ground service expenses	(ix)	**32**	–
Repairing charges	(x)	**1,118**	1,159
Flight simulation service charges	(xi)	**126**	100
Interest expense	(xii)	**37**	3
Income received from associates and jointly controlled entities			
Rental income	(xi)	**31**	31
Interest income	(xii)	**3**	4
Others			
CNA/XJA Acquisitions	(xiii)	**–**	15,522
Operating expenses recharged to related companies	(xiv)	**–**	65

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39 RELATED PARTY TRANSACTIONS (cont'd)

(a) Significant transactions with related companies (cont'd)

(i) The Group acquires aircraft, flight equipment and other airline-related facilities through Southern Airlines (Group) Import and Export Trading Company ("SAIETC"), a wholly-owned subsidiary of CSAHC.

(ii) The Group purchases certain inflight meals and related services from Shenzhen Air Catering Company Limited, a co-operative joint venture established in the PRC, in respect of which CSAHC is entitled to 33% of its income after tax, and Southern Airlines (Group) Catering Co., Ltd, a wholly owned subsidiary of CSAHC.

(iii) Commission is earned by certain subsidiaries of CSAHC in connection with the air tickets sold by them on behalf of the Group. Commission is calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value.

(iv) Certain sundry aviation supplies are purchased from Southern Airlines (Group) Economic Development Company ("SAGEDC"), a subsidiary of CSAHC.

(v) The Group leases an aircraft from China Southern Airlines (Group) Hainan Co., Ltd, a subsidiary of CSAHC.

(vi) The Group leases certain land and buildings in the PRC from CSAHC. Rental payments for land and buildings amounted to RMB24 million (Note 18(c)) and RMB66 million, respectively (2004: RMB2 million and RMB16 million, respectively) were paid to CSAHC in 2005.

(vii) China Southern Airlines (Group) Property Management Co., Ltd, a subsidiary of CSAHC, provides property management services to the Group.

(viii) The Group paid a fixed annual fee of RMB85 million to CSAHC from 1995 to 2004 in respect of the provision of quarters to the eligible employees of the Group (Note 40). No such payment was made in 2005.

(ix) Airport ground service was provided by Beijing Southern Airlines Ground Services Company Limited, a jointly controlled entity of the Company.

(x) The Group has a 50% equity interest in both Guangzhou Aircraft Maintenance Engineering Company Limited ("GAMECO") and MTU Maintenance Zhuhai Co., Ltd ("MTU Zhuhai"), which provide comprehensive maintenance services to the Group.

(xi) The Group has a 51% equity interest in Zhuhai Xiang Yi, which provides flight simulation services to the Group. In addition, the Group entered into operating lease agreements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi (Note 18(f)).

(xii) Interest income was received from deposits with SA Finance. The applicable interest rates are determined in accordance with the deposit rates published by the PBOC (Note 29).

The Group obtained loans from SA Finance. The interest rates ranged from 3.30% to 5.02% per annum during the year ended 31 December 2005.

(xiii) On 31 December 2004, the Group acquired the airline operations and certain related assets of CNA and XJA at a total consideration of RMB15,522 million, which was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,563 million outstanding as of that date. The remaining consideration of RMB1,959 million was fully paid in cash during 2005.

(xiv) In 2004, the Group provided administrative services to CNA and XJA. Operating expenses amounted to RMB65 million were recharged to CNA and XJA on a cost basis.

In addition to the above, certain subsidiaries of CSAHC also provided hotel and other services to the Group during the year. The total amount involved is not material to the results of the Group for the year.

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business and in accordance with the agreements governing such transactions.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

39 RELATED PARTY TRANSACTIONS (cont'd)

(b) Loans from SA Finance

Loans from SA Finance are unsecured and have the following terms:

Interest rate	Guarantee	The Group 2005 RMB million	The Group 2004 RMB million
Floating interest rates at 90% of interest rates as published by the PBOC, repayable within 1 year	No guarantee	**–**	76
Floating interest rates at 90% of interest rates as published by the PBOC, repayable within 1 year	Guaranteed by CSAHC	**300**	180
		300	256

(c) Key management personnel remuneration

Remuneration for key management personnel is as follows:

	2005 RMB'000	2004 RMB'000
Short-term employees benefits	**5,926**	6,748
Post-employment benefits	**221**	182
	6,147	6,930
Directors and supervisors (Note 13)	**3,461**	4,684
Senior management	**2,686**	2,246
	6,147	6,930

Total remuneration is included in "staff costs" (Note 11).

(d) The Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its staff. Details of the Group's employee benefits plan are disclosed in Note 40.

Notes to the Financial Statements (Cont'd)

(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

39 RELATED PARTY TRANSACTIONS (cont'd)

(e) Transactions with other state-owned enterprises

The Group is a state-owned entity and operates in an economic regime currently predominated by state-owned entities. Apart from transactions with CSAHC and its affiliates, the Group conducts a majority of its business activities with entities directly or indirectly owned or controlled by the PRC government and numerous government authorities and agencies (collectively referred to as "state-owned entities") in the ordinary course of business. These transactions, which include sales and purchase of goods and ancillary materials, rendering and receiving services, lease of assets, purchase of property, plant and equipment and obtaining finance, are carried out at terms similar to those that would be entered into with non-state-owned entities and have been reflected in the financial statements. The management believes that it has provided meaningful disclosure of related party transactions as summarised above.

40 RETIREMENT AND HOUSING BENEFITS

Employees of the Group participate in several defined contribution retirement schemes organised separately by PRC municipal governments in regions where the major operations of the Group are located. The Group is required to contribute to these schemes at the rates ranging from 9% to 20% (2004: 14% to 20%) of salary costs including certain allowances. A member of the retirement schemes is entitled to pension benefits equal to a fixed proportion of the salary at the retirement date. The retirement benefit obligations of all existing and future retired staff of the Group are assumed by these schemes.

In addition, the Group was selected as one of the pilot enterprises to establish a supplementary defined contribution retirement scheme for the benefit of employees. In this connection, employees of the Group participate in a supplementary defined contribution retirement scheme whereby the Group is required to make defined contributions at rates ranging from 3% to 5% of total salaries. The Group has no obligation for the payment of pension benefits beyond the contributions described above.

Furthermore, pursuant to the comprehensive services agreement (the "Services Agreement") dated 22 May 1997 between the Company and CSAHC, CSAHC provided quarters to eligible employees of the Group. In return, the Group paid a fixed annual fee of RMB85 million to CSAHC for a ten-year period from 1995 to 2004. The agreement expired by 31 December 2004 and no further payment was made in 2005.

Pursuant to an additional staff housing benefit scheme effective September 2002, the Group agreed to pay lump sum housing allowances to certain employees who have not received quarters from CSAHC or the Group according to the relevant PRC housing reform policy, for subsidising their purchases of houses. An employee who quits prior to the end of the vesting benefit period is required to pay back a portion of the lump sum housing benefits determined on a pro-rata basis of the vesting benefit period. The Group has the right to effect a charge on the employee's house and to enforce repayment through selling the house in the event of default in repayment. Any shortfall in repayment would be charged against income statement. As at 31 December 2005, the Company and the Group had made payments totalling RMB168 million (2004: RMB152 million) under the scheme and recorded its remaining contractual liabilities totalling RMB92 million (2004: RMB108 million) as accrued expenses on the balance sheets. Housing allowances are payable when applications are received from eligible employees.

Notes to the Financial Statements (Cont'd)

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41 SEGMENTAL INFORMATION

The Group operates principally as a single business segment for the provision of air transportation services. The analysis of turnover and operating profit/(loss) by geographical segment is based on the following criteria:

(i) Traffic revenue from domestic services within the PRC (excluding Hong Kong and Macau) is attributed to the domestic operation. Traffic revenue from inbound/outbound services between the PRC and Hong Kong/Macau, and the PRC and overseas destinations is attributed to the Hong Kong and Macau operation and international operation respectively.

(ii) Other revenue from ticket selling, general aviation and ground services, air catering and other miscellaneous services is attributed on the basis of where the services are performed.

	Domestic RMB million	Hong Kong and Macau RMB million	*International RMB million	Total RMB million
2005				
Traffic revenue	**29,533**	**1,298**	**6,588**	**37,419**
Other operating revenue	**874**	**–**	**–**	**874**
Turnover	**30,407**	**1,298**	**6,588**	**38,293**
Operating loss	**(282)**	**(97)**	**(926)**	**(1,305)**
2004				
Traffic revenue	17,742	1,180	4,422	23,344
Other operating revenue	630	–	–	630
Turnover	18,372	1,180	4,422	23,974
Operating profit	650	67	192	909

* Asian market accounted for approximately 74% (2004: 67%) of the Group's total international traffic revenue for the year ended 31 December 2005. The remaining portion was mainly derived from the Group's flights to/from European, North American and Australian regions.

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

42 MATERIAL NON-CASH TRANSACTIONS

During 2004, the Group acquired the airline operation and related assets of CNA and XJA at a total consideration of RMB15,522 million, which was partially satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,563 million outstanding as of 31 December 2004. Details are set out in Note 43.

During 2005, aircraft acquired under finance leases amounted to RMB6,938 million.

Notes to the Financial Statements (Cont'd)

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43 EFFECT OF THE CNA/XJA ACQUISITIONS

(a) Supplementary information for cash flow statement

	2004 RMB million
Assets acquired:	
Property, plant and equipment, net	12,980
Inventories	729
Trade receivables	314
Cash and cash equivalents	398
Other assets	1,101
	15,522
Liabilities assumed:	
Bank and other loans	4,587
Obligations under finance leases	6,125
Trade payables	343
Accrued expenses	1,475
Other liabilities	1,033
	13,563
Net identifiable assets and liabilities	1,959
Cash consideration payable and not yet settled at 31 December 2004	1,959
Net cash inflow from acquisitions - cash and cash equivalents acquired	398

(b) Had the CNA/XJA Acquisitions been effected on 1 January 2004, results of operations of the Group for the year ended 31 December 2004 are as follows:

	The Group (without effects of CNA/XJA Acquisitions) RMB million	**Results of airline operations of CNA/XJA** RMB million	**Combined** RMB million
Turnover	23,974	10,057	34,031
Profit for the year	155	170	325

44 FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, other investments, trade receivables, other receivables, other current assets and amounts due from related companies. Financial liabilities of the Group include bank and other loans, obligations under finance leases, trade and bills payables, amounts due to related companies, taxes payable and other liabilities.

Liquidity risk

As at 31 December 2005, the Group's net current liabilities amounted to RMB25,907 million (2004: RMB18,855 million). For the year ended 31 December 2005, the Group recorded a net cash inflow from operating activities of RMB3,835 million (2004: RMB3,596 million), a net cash outflow from investing activities and financing activities of RMB4,017 million (2004: RMB2,593 million) and a decrease in cash and cash equivalents of RMB182 million (2004: an increase of RMB1,003 million).

In 2006 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and on its ability to obtain adequate external finance to meet its committed future capital expenditures. The Group has obtained firm commitments from its principal bankers to renew its short-term bank loans outstanding at 31 December 2005 when they fall due during 2006. In relation to its future capital commitments and other financing requirements, the Group has already entered into loan financing agreements with several PRC banks up to an approximate amount of RMB44,704 million under which the banks would provide loan finance during 2006 and thereafter. The directors of the Company believe that such financing will be available to the Group.

The directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the twelve months ending 31 December 2006. Based on such forecast, the directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during that period. In preparing the cash flow forecast, the directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loan finance which may impact the operations of the Group during the next twelve-month period. The directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, as with all assumptions in regard to future events, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

Interest rate risk

The interest rates and maturity information of the Group's bank loans, and maturity information of the Group's finance lease obligations are disclosed in Notes 30 and 31 respectively.

Foreign currency risk

The Group has significant exposure to foreign currency as substantially all of the Group's lease obligations and bank loans are denominated in foreign currencies, principally US dollars, and to a lesser extent, Japanese Yen. Depreciation or appreciation of the Renminbi against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange, or subject to certain restrictive conditions, entering into forward foreign exchange contracts with authorised PRC banks.

On 21 July 2005, the PBOC announced that the PRC government reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of foreign currencies. In particular, the exchange rate of US dollar against Renminbi was adjusted upward to 8.11 yuan per US dollar with effect from the close of business on 21 July 2005.

Notes to the Financial Statements (Cont'd)

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44 FINANCIAL INSTRUMENTS (cont'd)

Credit risks

Substantially all of the Group's cash and cash equivalents are deposited with PRC financial institutions, which management believes are of high credit quality.

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlement Plan ("BSP"), a clearing scheme between airlines and sales agents organised by International Air Transportation Association which has insignificant credit risk to the Group. As of 31 December 2005, the balance due from BSP agents amounted to RMB782 million (2004: RMB411 million). The credit risk exposure to BSP and the remaining trade receivables balance has been monitored by the Group on an ongoing basis and the impairment losses on bad and doubtful debts have been within management's expectations.

Fair value

(a) All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2005 and 2004 except the following:

	2005		2004	
	Carrying amount RMB million	**Fair value RMB million**	Carrying amount RMB million	Fair value RMB million
The Group:				
Bank and other loans	**28,963**	**28,989**	23,453	23,665
The Company:				
Bank and other loans	**25,128**	**25,132**	20,701	20,862

The following methods and assumptions were used to estimate the fair value for each class of financial instrument:

(i) *Cash and cash equivalents, short-term investments, trade receivables, other receivables and other current assets, obligations under finance leases, trade and bills payables, taxes payable and other liabilities*

The carrying values approximate their fair values because of the short maturities of these instruments.

(ii) *Bank and other loans*

The fair value has been estimated by applying a discounted cash flow approach using interest rates available to the Group for similar indebtedness.

(iii) Fair value estimates are made at a specific point in time and are based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(b) The economic characteristics of the Group's finance leases vary from lease to lease. It is impractical to compare such leases with those prevailing in the market within the constraints of timeliness and cost for the purpose of estimating the fair value of such leases.

44 FINANCIAL INSTRUMENTS (cont'd)

Fair value (cont'd)

(c) Other non-current investments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be measured reliably.

(d) Amounts due from/to related companies are unsecured, interest-free and have no fixed terms of repayment. Given these terms, it is not meaningful to disclose fair values of these balances.

45 COMMITMENTS

(a) Capital commitments

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

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Commitments in respect of aircraft and flight equipment				
– authorised and contracted for	**45,628**	11,776	**33,955**	10,121
– authorised but not contracted for	**–**	13,571	**–**	13,571
	45,628	25,347	**33,955**	23,692
Commitments in respect of investments in the Guangzhou new airport				
– authorised and contracted for	**79**	110	**79**	110
– authorised but not contracted for	**761**	714	**761**	714
	840	824	**840**	824
Other commitments				
– authorised and contracted for	**11**	132	**11**	117
– authorised but not contracted for	**1,324**	568	**1,241**	200
	1,335	700	**1,252**	317
	47,803	26,871	**36,047**	24,833

Notes to the Financial Statements (Cont'd)

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45 COMMITMENTS (cont'd)

(a) Capital commitments (cont'd)

At 31 December 2005, the Group had on order 82 aircraft and certain flight equipment, scheduled for deliveries in 2006 to 2010. Deposits of RMB6,351 million have been made towards the purchase of these aircraft and related equipment. As at 31 December 2005, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and flight equipment are as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
2005	**–**	8,748	**–**	7,093
2006	**7,341**	2,996	**5,914**	2,996
2007	**8,945**	32	**7,240**	32
2008	**14,354**	–	**13,046**	–
2009	**5,300**	–	**3,511**	–
2010	**9,688**	–	**4,244**	–
	45,628	11,776	**33,955**	10,121

At 31 December 2005, the Group's and the Company's attributable share of the capital commitments of jointly controlled entities was as follows:

	2005	2004
	RMB million	RMB million
Authorised and contracted for	**–**	–
Authorised but not contracted for	**74**	156
	74	156

(b) Operating lease commitments

At 31 December 2005, the total future minimum lease payments under non-cancellable aircraft and flight equipment operating leases were payable as follows:

	The Group		The Company	
	2005	2004	**2005**	2004
	RMB million	RMB million	**RMB million**	RMB million
Payments due				
Within 1 year	**3,340**	1,761	**3,113**	1,488
After 1 year but within 5 years	**10,798**	9,207	**10,309**	8,602
After 5 years	**10,456**	1,782	**10,444**	1,761
	24,594	12,750	**23,866**	11,851

45 COMMITMENTS (cont'd)

(c) Investing commitments

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

	2005 **RMB million**	2004 RMB million
Subsidiaries	**–**	181
Jointly controlled entities	**83**	83
	83	264

46 CONTINGENT LIABILITIES

(a) Pursuant to the Reorganisation of CSAHC effected in 1995 (Note 1), the Company assumed the airline and airline-related businesses together with the relevant assets and liabilities from CSAHC. The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the businesses assumed by the Company in the Reorganisation, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by CSAHC prior to the Reorganisation. There are not, however, any definitive PRC regulations or other pronouncements confirming such conclusion.

(b) The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan and Haikou. The Group has a significant investment in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan and Haikou lack adequate documentation evidencing CSAHC's rights thereto.

The Group cannot predict the magnitude of the effect on its financial condition or results of operations to the extent that their uses of one or more of above parcels of land or the related facilities were successfully challenged. Pursuant to an indemnification agreement dated 22 May 1997 entered into between the Company and CSAHC, CSAHC has agreed to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of its land and buildings.

47 COMPARATIVE FIGURES

Certain comparative figures have been adjusted or re-classified as a result of the changes in accounting policies. Further details are disclosed in Note 3.

48 PARENT AND ULTIMATE HOLDING COMPANY

As at 31 December 2005, the directors of the Company consider the immediate parent and ultimate holding company of the Group to be CSAHC, a state-owned enterprise established in the PRC. CSAHC does not produce financial statements available for public use.

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49 ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group's financial position and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in condition and assumptions are factors to be considered when reviewing the financial statements. The principal accounting policies are set forth in Note 2. The Group believes the following critical accounting policies involve the most significant judgements and estimates used in the preparation of the financial statements.

Impairments

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, this asset may be considered "impaired", and an impairment loss may be recognised in accordance with IAS 36 "Impairment of Assets". The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to the level of traffic revenue and the amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on a reasonable and supportable assumptions and projections of traffic revenue and amount of operating costs.

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Impairment loss for doubtful accounts

The Group maintains an impairment loss for doubtful accounts for estimated losses resulting from the inability of the debtors to make required payments. The Group bases the estimates of future cash flows on the ageing of the trade receivables balance, debtors' credit-worthiness, and historical write-off experience. If the financial condition of the debtors were to deteriorate, actual write-offs would be higher than estimated.

Notes to the Financial Statements (Cont'd)

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50 RECENTLY ISSUED ACCOUNTING STANDARDS

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting periods beginning on or after
IFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
IFRS 7, Financial instruments: disclosures	1 January 2007
IFRIC 4, Determining whether an arrangement contains a lease	1 January 2006
IFRIC 5, Rights to interests arising from decommissioning, restoration environmental rehabilitation funds	1 January 2006
IFRIC 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 December 2005
IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies	1 March 2006
IFRIC 8, Scope of IFRS 2	1 May 2006
IFRIC 9, Reassessment of embedded derivatives	1 June 2006
Amendments to IAS 1, Presentation of financial statements - capital disclosures	1 January 2007
Amendments to IAS 19, Employee benefits - actuarial gains and losses, group plans and disclosures	1 January 2006
Amendments to IAS 39, Financial instruments: recognition and measurement – Cash flow hedge accounting of forecast intragroup transactions – The fair value option	1 January 2006
Amendments to IAS 39, Financial instruments: recognition and measurement, and IFRS 4, Insurance contracts – Financial guarantee contracts	1 January 2006
Amendment to IAS 21, The effects of changes in foreign exchange rates – Net investment in a foreign operation	1 January 2006
Amendments to IFRS 1, First-time adoption	1 January 2006

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of these amendments and new standards and new interpretations in future periods is unlikely to have a significant impact on the Group's results of operations and financial position.

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51 SUBSIDIARIES

The particulars of the Group's principal subsidiaries at 31 December 2005 are as follows:

Name of company	Place of establishment/ operation	Registered capital	Proportion of ownership interest held by the Company	Principal activities
Guangxi Airlines Company Limited (a)	PRC	RMB170,900,000	95%	Airline
Southern Airlines (Group) Shantou Airlines Company Limited (a)	PRC	RMB280,000,000	60%	Airline
Zhuhai Airlines Company Limited (a)	PRC	RMB250,000,000	60%	Airline
Xiamen Airlines Company Limited (a)	PRC	RMB700,000,000	60%	Airline
Guizhou Airlines Company Limited (a)	PRC	RMB80,000,000	60%	Airline
Guangzhou Air Cargo Company Limited (a)	PRC	RMB238,000,000	70%	Cargo services
Guangzhou Baiyun International Logistic Company Limited (a)	PRC	RMB50,000,000	61%	Logistics operations
Guangzhou Nanland Air Catering Company Limited (b)	PRC	RMB120,000,000	75%	Air catering
China Southern West Australian Flying College Pty Limited	Australia	AUD100,000	65%	Pilot training services
Xinjiang Civil Aviation Property Management Limited (a)	PRC	RMB251,332,832	51.8%	Property management

(a) These subsidiaries are PRC limited liabilities companies.

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

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52 ASSOCIATES AND JOINTLY CONTROLLED ENTITIES

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

		Proportion of ownership interest held by			
Name of company	Place of establishment/ operation	Group's effective interest	The Company	subsidiaries	Principal activities
Guangzhou Aircraft Maintenance Engineering Company Limited (a)	PRC	50%	50%	–	Provision of aircraft repair and maintenance services
China Southern Airlines Group Finance Company Limited	PRC	49.3%	32%	26%	Provision of financial services
Sichuan Airlines Corporation Limited	PRC	39%	39%	–	Airline
MTU Maintenance Zhuhai Co., Ltd (a)	PRC	50%	50%	–	Provision of engine repair and maintenance services
China Postal Airlines Limited (a)	PRC	49%	49%	–	Airline
Zhuhai Xiang Yi Aviation Technology Company Limited (a)	PRC	51%	51%	–	Provision of flight simulation services
Beijing Southern Airlines Ground Services Company Limited (a)	PRC	50%	50%	–	Provision of airport ground services

(a) These are jointly controlled entities.