Principal Accounting Policies

1. BASIS OF ACCOUNTING

The accounts have been prepared in accordance with Statements of Standard Accounting Practice ("HK SSAPs") and Interpretations issued by the Hong Kong Society of Accountants ("HKSA") with the exception of the recognition of exchange differences on certain long-term liabilities as explained in accounting policy 4 below.

2. BASIS OF CONSOLIDATION

The consolidated accounts of the Group incorporate the accounts of the Company and its subsidiary companies made up to 31st December, together with the Group's share of the results and net assets of its associated companies.

The results of subsidiary companies are included in the consolidated profit and loss account, and the share attributable to minority interests is deducted from consolidated profit after taxation. Where interests have been bought or sold during the year, only those results relating to the period of ownership are included in the accounts.

Goodwill arising on consolidation represents the excess of the cost of subsidiary and associated companies over the fair value of the Group's share of the net assets at the date of acquisition. In prior years, goodwill was written off to reserves in the year in which it arose. With the introduction of HK SSAP 30 "Business Combinations", the Group now recognises goodwill arising on consolidation as an intangible asset and amortises it on a straight line basis over its estimated useful economic life not exceeding a period of twenty years.

This change in accounting policy has been accounted for retrospectively and the comparative statements for 1999 have been restated. The effect of the change in 1999 is to increase operating expenses and reduce operating profit by HK$11 million. The retained profit brought forward from 1999 has been increased by HK$187 million being the reinstatement of unamortised goodwill. The amortisation of goodwill in 2000 totals HK$14 million.

The carrying amount of goodwill is reviewed annually and is written down if any permanent impairment arises. On disposal of a subsidiary or associated company, the unamortised goodwill is included in the calculation of any gain or loss.

Minority interests in the consolidated balance sheet comprise the outside shareholders' proportion of the net assets of subsidiary companies.

3. ASSOCIATED COMPANIES

Associated companies are those companies, not being subsidiary companies, in which the Group holds a substantial long-term interest in the equity share capital and over which the Group is in a position to exercise significant management influence.

The consolidated profit and loss account includes the Group's share of results of associated companies as reported in their accounts made up to 31st December. In the consolidated balance sheet, investment in associated companies represents the Group's share of net assets.

In the Company's balance sheet, investment in associated companies is stated at cost less any provision for diminution in value, and loans to those companies. A provision for diminution in value recognises a decline, other than temporary, in the value of the investment.

4. FOREIGN CURRENCIES

Foreign currency transactions entered into during the year are translated into Hong Kong dollars at the market rates ruling at the relevant transaction dates whilst the following items are translated at the rates ruling at the balance sheet date:

(i) foreign currency denominated monetary assets and liabilities (including currency derivatives).

(ii) the balance sheets and results of foreign subsidiary and associated companies.

Exchange differences arising on the translation of foreign currencies into Hong Kong dollars are reflected in the profit and loss account except that:

(i) to reduce its exposure to exchange rate fluctuations on future operating cash flows, the Group arranges its borrowings and leasing obligations in foreign currencies such that repayments can be met by anticipated operating cash flows. In addition the Group takes out currency derivatives to hedge anticipated cash flows. Any unrealised exchange differences on these borrowings, leasing obligations, currency derivatives and on related security deposits are recognised directly in equity via the statement of recognised gains and losses. These exchange differences are included in the profit and loss account as an adjustment to revenue in the same period or periods during which the hedged transaction affects the net profit and loss.

Although this method of accounting complies with International Accounting Standards, it does not comply with HK SSAP 11 which requires that all such exchange differences are charged to the profit and loss account immediately. The effect of this departure from HK SSAP 11 is set out in note 22 to the accounts.

(ii) unrealised differences on net investments in foreign subsidiary and associated companies (including intra-Group balances of an equity nature) and related long-term liabilities are taken directly to reserves.

4. FOREIGN CURRENCIES (CONTINUED)

The treatment of exchange differences on foreign currency operating cash flow hedges is supported by that element of International Accounting Standards which deals with accounting for hedge transactions. In the opinion of the Directors, this treatment fairly reflects the effects of the Group's foreign currency cash flow hedge arrangements. The matching of foreign currency cash flows is a key risk management tool for the Group's airline operations. The appropriateness of continuing this treatment is assessed regularly, taking into consideration the latest operating cash flow projections of each currency. The Directors consider that the immediate recognition of all such exchange fluctuations in the profit and loss account could materially distort year on year results and conclude that the adopted treatment gives a true and fair view of the financial position, financial performance and cash flow of the Group.

5. FIXED ASSETS AND DEPRECIATION

Fixed assets are stated at cost less accumulated depreciation.

Depreciation of fixed assets is calculated on a straight line basis to write down their cost over their anticipated useful lives to estimated residual values as follows:

Aircraft and related equipment	over 15 to 20 years to residual value of between 0% to 15% of cost
Other equipment	over 3 to 7 years to nil residual value
Leasehold land and buildings	over the period of the lease to nil residual value

Major modifications to aircraft and reconfiguration costs are capitalised as part of aircraft cost and are depreciated over periods of up to ten years.

The Group's depreciation policy and carrying amount of fixed assets is reviewed regularly, taking into consideration factors such as changes in fleet composition, current and forecast market prices, and technical factors which affect the life expectancy of the assets. Any impairment in value is recognised by writing down carrying value to estimated net recoverable amount.

6. LEASED ASSETS

Fixed assets held under lease agreements that give rights equivalent to ownership are treated as if they had been purchased outright at fair market value, and the corresponding liabilities to the lessor, net of interest charges, are included as obligations under finance leases.

Amounts payable in respect of finance leases are apportioned between interest charges and reductions of obligations based on the interest rates implicit in the leases.

Operating lease payments and income are charged and credited respectively to the profit and loss account on a straight line basis over the life of the related lease.

7. INTANGIBLE ASSETS

Intangible assets comprise goodwill and expenditure on computer system development. The accounting policy for goodwill is outlined in accounting policy 2 on page 33.

In prior years, expenditure on computer system development which gives rise to economic benefits was capitalised as part of fixed assets. This expenditure has been re-classified as an intangible asset in accordance with the new HK SSAP 29 “Intangible Assets” and is being amortised on a straight line basis over its useful life not exceeding a period of four years. This change has no impact on the profit and loss account of the Group.

8. INVESTMENTS

Long-term investments are stated at fair value and any change in fair value is recognised in the investment revaluation reserve. On disposal or if there is evidence that the investment is impaired, the relevant cumulative gain or loss on the investment is transferred from the investment revaluation reserve to the profit and loss account.

9. STOCK

Stock held for consumption is valued at weighted average cost, less any applicable allowance for obsolescence. Stock held for disposal is stated at the lower of cost and net realisable value. Net realisable value represents estimated resale price.

10. FUNDS WITH INVESTMENT MANAGERS AND OTHER LIQUID INVESTMENTS

Funds with investment managers and other liquid investments are marked to market and any gain or loss arising from their revaluation is taken to the profit and loss account.

Cash deposits and notes placed in respect of certain leasing and financing arrangements are stated at cost while other investments purchased to meet future leasing obligation repayments are stated at amortised cost.

11. FUEL PRICE DERIVATIVES

The Group uses fuel derivatives to reduce its exposure to fluctuating fuel costs. Gains and losses on these instruments are recognised as a component of fuel expense during the period the related fuel is used.

12. DEFERRED TAXATION

Provision is made for deferred taxation using the liability method for all material timing differences except where it is considered probable that no liability will arise in the foreseeable future.

In addition, where initial cash benefits have been received in respect of certain lease arrangements, provision is made for the future obligation to make taxation payments on behalf of the lessors.

13. MAINTENANCE AND OVERHAUL COSTS

Replacement spares and labour costs for maintenance and overhaul of aircraft are charged to the profit and loss account on consumption and as incurred respectively.

14. REVENUE RECOGNITION

Passenger and cargo ticket sales are recognised as revenue when the transportation service is provided. The value of unflown passenger and cargo sales is recorded as unearned transportation revenue. Income from catering and other services is recognised when the services are rendered.

15. RETIREMENT BENEFITS

Arrangements for staff retirement benefits vary from country to country and are made in accordance with local regulations and customs. The significant plans are defined benefit retirement plans and are valued every year using a prospective actuarial valuation method. The Group profit and loss account is charged each year with actuarially determined contributions based on such valuation.

16. FREQUENT-FLYER PROGRAMME

The Group operates a frequent-flyer programme called Asia Miles through a wholly-owned subsidiary. The incremental cost of providing travel in exchange for redemption of miles earned by members is accrued in the accounts as an operating cost and a future liability after allowing for miles which are not expected to be redeemed. As members redeem awards, the incremental liability is reduced to reflect the release of the outstanding obligations.

17. RELATED PARTIES

For the purposes of these accounts, 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 or entities.