Principal Accounting Policies

1. BASIS OF ACCOUNTING

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants ("HKSA") with the exception of the recognition of exchange differences on certain long-term liabilities in Cathay Pacific as explained in accounting policy no. 4 below. In the view of the Directors, this departure is necessary to show a true and fair view. The accounts have been prepared under the historical cost convention as modified by the revaluation of certain investment properties and investments in securities.

In the current year, the group adopted the following Statements of Standard Accounting Practice ("HK SSAPs") issued by the HKSA which affect the group and are effective for accounting periods commencing on or after 1st January 2001:

HK SSAP 9 (revised)	Events after the balance sheet date
HK SSAP 14 (revised)	Leases (effective for periods commencing on or after 1st July 2000)
HK SSAP 26	Segment reporting
HK SSAP 28	Provisions, contingent liabilities and contingent assets
HK SSAP 30	Business combinations
HK SSAP 31	Impairment of assets

The effects of adopting these new standards are set out in the accounting policies below.

2. BASIS OF CONSOLIDATION

The consolidated accounts of the group incorporate the accounts of Swire Pacific Limited and all its subsidiary companies made up to 31st December. Subsidiary companies are those entities in which the group controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

The results of subsidiary companies are included in the consolidated profit and loss account and minority interests therein are deducted from the consolidated profit after taxation. Results attributable to subsidiary company interests acquired or disposed of during the year are included from the date of acquisition or to the date of disposal as applicable.

All significant intercompany transactions and balances within the group are eliminated on consolidation.

The gain or loss on the disposal of a subsidiary, jointly controlled or associated company represents the difference between the proceeds of the sale and the group's share of its net assets together with any goodwill or negative goodwill which was not previously charged to or amortised in the consolidated profit and loss account.

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

In the Company's balance sheet the investments in subsidiary companies are stated at cost less provision, if necessary, for any diminution in value other than temporary in nature. The results of subsidiary companies are accounted for by the Company on the basis of dividends received and receivable.

3. JOINTLY CONTROLLED AND ASSOCIATED COMPANIES

Jointly controlled companies are those companies held for the long term, over which the group is in a position to exercise joint control with other venturers in accordance with contractual arrangements and where none of the participating parties has unilateral control over the economic activity of the joint venture. Associated companies are those companies, not being subsidiary companies, in which the group has a substantial long-term interest in the equity voting rights, and over which the group is in a position to exercise significant influence.

The results of jointly controlled and associated companies are accounted for by the Company on the basis of dividends received and receivable. The consolidated profit and loss account includes the group's share of results of jointly controlled and associated companies for the year. Valuation changes arising on group investment properties held in jointly controlled companies are treated in accordance with principal accounting policy no. 5 - Valuation of investment properties. In the Company's balance sheet, investments in jointly controlled and associated companies are stated at cost less provisions for any diminution in value other than temporary in nature. In the consolidated balance sheet, the investment in jointly controlled and associated companies represents the group's share of net assets and goodwill (net of accumulated amortisation) on acquisition.

4. FOREIGN CURRENCIES

The rates of exchange at which foreign currencies are translated into Hong Kong dollars for accounting purposes are as follows:

(i) In respect of foreign currency denominated assets and liabilities, with the exception of the Perpetual Capital Securities as set out in (iv) below, the balance sheets of subsidiary, jointly controlled and associated companies and forward exchange contracts which do not match commitments: the rates ruling at the balance sheet date; and

(ii) In respect of foreign currency transactions entered into during the year: the market rates or forward exchange contract rates ruling at the relevant transaction dates.

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

4. FOREIGN CURRENCIES (continued)

(iii) Unrealised differences on net investments in foreign subsidiary, jointly controlled and associated companies (including intra-group balances of an equity nature) and related long-term liabilities are taken directly to reserves.

(iv) The group's two issues of Perpetual Capital Securities, which were issued by wholly-owned subsidiary companies (the 'Issuers'), are denominated in US dollars and have no scheduled maturity. They are, however, redeemable at the Company's or the respective Issuer's option either (a) on or after 30th October 2006 and 13th May 2017 respectively or (b) at any time upon amendment or imposition of certain taxes and, in any case, become due in the event of the Company's or the respective Issuer's winding-up. Since it is not the present intention of the group that these Perpetual Capital Securities will be redeemed, they are valued at the historical exchange rates.

(v) To reduce exposure to exchange rate fluctuations on future operating cash flows, the Cathay Pacific Group arranges borrowings and leasing obligations in foreign currencies such that repayments can be met by anticipated operating cash flows. In addition the Cathay Pacific 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 Consolidated 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 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 25 to the accounts.

The treatment of exchange differences on foreign currency operating cash flow hedges adopted by the Company 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 Cathay Pacific Group's foreign currency cash flow hedge arrangements. The matching of foreign currency cash flows is a key risk management tool for the Cathay Pacific 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 Cathay Pacific Group.

5. VALUATION OF INVESTMENT PROPERTIES

Investment properties, whether complete or in the course of development, are valued at intervals of not more than three years by independent valuers; in each of the intervening years valuations are undertaken by professionally qualified executives of the group. The valuations are on an open market basis, related to individual properties, and separate values are not attributed to land and buildings. The valuations are incorporated in the annual accounts. Increases in valuations are credited to the property valuation reserve; decreases are first set off against increases on earlier valuations on a portfolio basis and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited. Upon sale of a revalued investment property the revaluation surplus is transferred to operating profit.

6. FIXED ASSETS AND DEPRECIATION

Fixed assets, other than investment properties, are carried at cost less depreciation. Changes in the value of investment properties reflecting market conditions, depreciation and other factors are incorporated in the annual accounts on the basis set out in principal accounting policy no. 5. With the exception of land included in investment properties and freehold land, all other leasehold land is depreciated over the remaining period of the relevant lease. Other fixed assets are depreciated at rates sufficient to write off their original cost to estimated residual values over their anticipated useful lives in the following manner:

Other properties	2% to 5% per annum
Plant and machinery	7% to 34% per annum
Vessels	4% to 7% per annum

The expected useful lives and residual values of all fixed assets are regularly reviewed to take into account operational experience and changing circumstances.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

7. GOODWILL

Goodwill arising on consolidation represents the excess of cost of acquisition of subsidiary, jointly controlled and associated companies over the group's share of the fair value ascribed to the separable net assets at the date of acquisition. In previous years, goodwill was written off against the revenue reserve in the year in which it arose. With the introduction of HK SSAP 30 "Business combinations",

7. GOODWILL (continued)

goodwill arising on or after 1st January 2001 is capitalised in the balance sheet and is amortised to the profit and loss account on a straight-line basis over its estimated useful economic life. The group has taken advantage of the transitional provisions in HK SSAP 30 whereby all goodwill arising from earlier acquisitions before 1st January 2001, previously written off against revenue reserve, has not been restated. Any subsequent impairment of such goodwill is recognised in the profit and loss account, in accordance with HK SSAP 31 "Impairment of assets". Following the transitional provisions of HK SSAP 30, where an impairment loss has arisen since the date of acquisition on goodwill previously written off against reserves, this change in accounting policy for recognition of goodwill impairment has been applied retrospectively and the impairment losses have been recognised as a prior year adjustment in accordance with HK SSAP 2 "Net profit or loss for the period, fundamental errors and changes in accounting policies". Impairment losses of HK$307 million on goodwill previously written off against the revenue reserve have been recognised in the profit and loss account prior to 2000. This change has no effect on the opening revenue reserve at 1st January 2001 and 2000.

The group's opening revenue reserve at 1st January 2001 and 2000 has been increased by HK$90 million following the reclassification to fixed assets of previously overstated goodwill arising from the acquisition of a subsidiary company in 1997. Comparatives have been restated.

8. INVESTMENTS IN SECURITIES

(i) Held-to-maturity securities

Held-to-maturity securities are stated in the balance sheet at cost adjusted for any discount or premium amortised to date. The discount or premium is amortised over the period to maturity and included as interest income or expense in the profit and loss account. Provision is made when there is a diminution in value.

The carrying amounts of held-to-maturity securities are reviewed at the balance sheet date in order to assess the credit risk and whether the carrying amounts are expected to be recovered. Provisions are made when carrying amounts are not expected to be recovered and are recognised in the profit and loss account.

(ii) Investment securities

Investment securities 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 value of 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.

Transfers from the investment revaluation reserve to the profit and loss account as a result of impairments are written back in the profit and loss account when the circumstances and events leading to the impairment cease to exist.

9. DEFERRED EXPENDITURE

Deferred expenditure is amortised over periods of up to ten years.

10. STOCKS AND WORK IN PROGRESS

Stocks are stated at the lower of cost and net realisable value. Cost represents average unit cost and net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses. Work in progress comprises direct material and labour costs and an appropriate proportion of overhead expenses less provisions for foreseeable losses.

11. PROPERTIES UNDER DEVELOPMENT FOR SALE

Properties under development for sale are included under current assets and comprise land at cost, construction costs, interest charges and profit taken to date, less sales instalments received and receivable and provisions for possible losses.

When a development property in Hong Kong is sold in advance of completion, profit is recognised over the course of the development and is computed each year as a proportion of the total estimated profit to completion; the proportion used being the lower of the proportion of construction costs incurred at the balance sheet date to estimated total construction costs and the proportion of sales proceeds received and receivable at the balance sheet date to total sales proceeds. Sales proceeds due on completion are accounted for as receivables if the occupation permit has been issued and the development is substantially complete.

Where purchasers fail to pay the balance of the purchase price on completion and the company exercises its entitlement to resell the property, sales deposits received in advance of completion which are forfeited are credited to operating profit; any profits recognised up to the date of completion are written back.

12. ACCOUNTS RECEIVABLE

Provision is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the balance sheet are stated net of such provision.

13. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, amounts repayable on demand from banks and financial institutions and short-term liquid investments which were within three months of maturity when acquired, less advances from banks and financial institutions repayable within three months from the date of the advance.

14. BORROWING COSTS

Interest charges incurred are charged to the profit and loss account except that those interest charges directly attributable to the acquisition, construction or production of qualifying assets (i.e. assets that necessarily take a substantial period of time to prepare for their intended use or sale) are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

15. OPERATING LEASES

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease term.

16. DEFERRED TAXATION

Provision is made for deferred taxation at current rates of taxation in respect of material timing differences except where it is considered that no liability will arise in the foreseeable future.

17. REVENUE RECOGNITION

Sales are recognised as revenue upon delivery of goods and provision of services. Revenue for properties under development for sale is recognised as set out in principal accounting policy no. 11. Rental income and interest income are recognised on an accruals basis.

18. RELATED PARTIES

Related parties are individuals and companies, including subsidiary, jointly controlled and associated companies, where the individual, company or group has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions.

19. RETIREMENT BENEFITS

Swire Pacific Limited and its subsidiary companies provide retirement benefit schemes for their employees, the majority of which are of a defined benefit nature and are all held in separate trustee administered funds. With only a few minor exceptions, employees are not required to contribute to the cost of these Schemes.

All Schemes are actuarially valued as required on a regular basis using a prospective actuarial valuation method. The group profit and loss account is charged each year with actuarially determined contributions based on such valuations.

20. PROVISIONS

With the introduction of HK SSAP 28 "Provisions, contingent liabilities and contingent assets", the group's previous practice of providing for future dry-docking costs is no longer allowed as it does not meet the recognition and measurement criteria prescribed therein. Therefore, any dry-docking costs incurred are now capitalised and amortised to the profit and loss account over the period until the next dry-docking takes place. This change in accounting policy has been applied retrospectively and the comparatives for 2000 have been restated to conform to the changed policy. The group's opening revenue reserve at 1st January 2001 has been increased by HK$90 million (1st January 2000: HK$86 million), being the reinstatement of unamortised dry-docking costs at 31st December 2000 of HK$23 million (31st December 1999: HK$28 million) in fixed assets and the reversal of provisions for dry-docking costs at 31st December 2000 of HK$67 million (31st December 1999: HK$58 million).

21. DIVIDENDS

In accordance with the revised HK SSAP 9 "Events after the balance sheet date", the group no longer recognises dividends proposed or declared after the balance sheet date as a liability at the balance sheet date. This change in accounting policy has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

As detailed in note 25 to the accounts, this change has resulted in an increase in the opening revenue reserve at 1st January 2001 of HK$1,179 million (1st January 2000: HK$1,179 million) which is the reversal of the provision for 2000 (1999) proposed final dividend previously recorded as a liability as at 31st December 2000 (31st December 1999) although not declared until after the balance sheet date.

22. SEGMENT REPORTING

In accordance with the group's internal financial reporting the group has determined that business segments be presented as the primary reporting format and geographical segments as the secondary reporting format.