

# Report of the Independent International Auditors

China Eastern Airlines Corporation Limited



**To the shareholders of China Eastern Airlines Corporation Limited**  
*(established in the People's Republic of China with limited liability)*

We have audited the accompanying consolidated balance sheet of China Eastern Airlines Corporation Limited (the "Company") and its subsidiaries (the "Group") as at 31 December 2003, and the related consolidated income statement, consolidated cashflow statement and consolidated statement of changes in shareholders' equity for the year then ended, and the balance sheet of the Company as at 31 December 2003. These financial statements set out on pages 57 to 120 are the responsibility of the Company's management. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Group and the Company as at 31 December 2003, and of the results of the Group's operations and cashflows for the year then ended in accordance with International Financial Reporting Standards, and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**PricewaterhouseCoopers**  
*Certified Public Accountants*  
Hong Kong, 5 April 2004



# Consolidated Income Statement

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
Traffic revenues			
Passenger		10,261,027	10,037,830
Cargo and mail		3,186,984	2,444,667
Other operating revenues		829,147	596,492
Turnover	3	14,277,158	13,078,989
Other operating income, net	4	2,442	226,373
Operating expenses			
Wages, salaries and benefits	5	(1,449,054)	(1,035,853)
Take-off and landing charges		(2,254,456)	(1,987,835)
Aircraft fuel		(3,044,956)	(2,563,701)
Food and beverages		(541,669)	(605,894)
Aircraft depreciation and operating leases		(2,851,047)	(2,455,403)
Other depreciation, amortisation and operating leases		(495,079)	(400,291)
Aircraft maintenance		(1,329,304)	(1,077,764)
Commissions		(465,147)	(379,674)
Office and administration		(1,057,500)	(1,044,113)
Revaluation deficit of fixed assets		–	(171,753)
Other		(569,925)	(519,614)
Total operating expenses		(14,058,137)	(12,241,895)
Operating profit		221,463	1,063,467
Finance costs, net	6	(712,458)	(731,389)
Exchange loss, net		(70,325)	(37,518)
Share of results before taxation of associates	16	(28,511)	(31,666)
(Loss)/profit before taxation	7	(589,831)	262,894
Taxation	9(a)	(247,554)	(54,438)
(Loss)/profit after taxation		(837,385)	208,456
Minority interests	33	(112,431)	(122,087)
(Loss)/profit attributable to shareholders		(949,816)	86,369
(Loss)/earnings per share	10	(RMB0.195)	RMB0.018



# Consolidated Balance Sheet

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
As at 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
<b>Non-current assets</b>			
Fixed assets	12	26,838,903	20,465,950
Construction in progress	13	219,788	413,812
Lease prepayments	14	847,319	867,368
Investments in associates	16	626,084	331,570
Goodwill and negative goodwill	17	38,505	40,707
Advances on aircraft and flight equipment	18	2,239,893	3,227,720
Other long-term receivables and investments	19	1,962,362	2,223,768
Deferred tax assets	31	399,771	569,997
Derivative assets	41	2,814	9,891
		<b>33,175,439</b>	<b>28,150,783</b>
<b>Current assets</b>			
Flight equipment spare parts less allowance for obsolescence (2003: RMB400,534,000; 2002: RMB347,198,000)		552,172	556,376
Trade receivables less allowance for doubtful accounts (2003: RMB83,663,000 ; 2002: RMB69,141,000)	20	1,325,677	965,226
Prepayments and other receivables	21	1,262,173	815,049
Short-term investments	22	–	290,000
Short-term deposits with an associate	39(a)(iii)	214,241	94,502
Cash and bank balances		1,477,409	1,889,647
		<b>4,831,672</b>	<b>4,610,800</b>
<b>Current liabilities</b>			
Trade payables	23	109,242	64,523
Sales in advance of carriage		926,453	700,714
Other payables and accrued expenses	24	4,299,989	2,791,033
Current portion of obligations under finance leases	26	1,692,084	2,247,059
Current portion of long-term bank loans	27	2,250,734	1,261,902
Notes payables		756,490	411,250
Tax payable		106,113	44,560
Short-term bank loans	28	4,631,918	4,526,509
		<b>14,773,023</b>	<b>12,047,550</b>
<b>Net current liabilities</b>		<b>(9,941,351)</b>	<b>(7,436,750)</b>
<b>Total assets less current liabilities</b>		<b>23,234,088</b>	<b>20,714,033</b>



# Consolidated Balance Sheet

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
As at 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
<b>Share capital</b>	29	<b>4,866,950</b>	4,866,950
<b>Reserves</b>	30	<b>1,515,201</b>	2,512,153
<b>Total capital and reserves</b>		<b>6,382,151</b>	7,379,103
<b>Minority interests</b>	33	<b>522,713</b>	404,517
<b>Non-current liabilities</b>			
Obligations under finance leases	26	<b>5,408,802</b>	5,936,907
Long-term bank loans	27	<b>8,972,189</b>	5,232,729
Deferred tax liabilities	31	<b>740,112</b>	802,822
Accrued aircraft overhaul expenses	25	<b>191,384</b>	243,684
Long-term portion of other payable	32	<b>121,860</b>	142,250
Post-retirement benefit obligations	34(b)	<b>545,771</b>	528,924
Long-term portion of staff housing allowances	35(b)	<b>254,669</b>	–
Derivative liabilities	41	<b>94,437</b>	43,097
		<b>16,329,224</b>	12,930,413
		<b>23,234,088</b>	20,714,033

These financial statements have been approved for issue by the Board of Directors on 5 April 2004.

**Ye Yigan**  
Director

**Wan Mingwu**  
Director



# Balance Sheet

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
As at 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
<b>Non-current assets</b>			
Fixed assets	12	22,383,760	18,581,914
Construction in progress	13	92,520	109,785
Lease prepayments	14	405,204	415,479
Investments in subsidiaries	15	3,808,615	2,020,558
Investments in associates	16	590,601	361,020
Goodwill and negative goodwill	17	38,505	40,707
Advances on aircraft and flight equipment	18	2,239,893	3,227,720
Other long-term receivables and investments	19	1,925,548	2,185,990
Deferred tax assets	31	349,318	531,520
Derivative assets	41	2,814	9,891
		<b>31,836,778</b>	<b>27,484,584</b>
<b>Current assets</b>			
Flight equipment spare parts less allowance for obsolescence (2003: RMB 393,105,000; 2002: RMB339,289,000)		517,802	507,170
Trade receivables less allowance for doubtful accounts (2003: RMB 77,967,000; 2002: RMB65,088,000)	20	845,504	515,634
Prepayments and other receivables	21	1,115,070	616,194
Short-term deposits with an associate	39(a)(iii)	88,124	72,826
Cash and bank balances		565,302	797,035
		<b>3,131,802</b>	<b>2,508,859</b>
<b>Current liabilities</b>			
Trade payables	23	65,420	50,370
Sales in advance of carriage		773,309	558,626
Other payables and accrued expenses	24	3,605,920	2,238,369
Current portion of obligations under finance leases	26	1,692,084	2,247,059
Current portion of long-term bank loans	27	2,250,734	1,261,902
Notes payables		658,901	319,740
Short-term bank loans	28	3,971,918	3,501,509
		<b>13,018,286</b>	<b>10,177,575</b>
<b>Net current liabilities</b>		<b>(9,886,484)</b>	<b>(7,668,716)</b>
<b>Total assets less current liabilities</b>		<b>21,950,294</b>	<b>19,815,868</b>



(Prepared in accordance with International Financial Reporting Standards)  
As at 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
<b>Share capital</b>	29	<b>4,866,950</b>	4,866,950
<b>Reserves</b>	30	<b>970,963</b>	2,255,962
<b>Total capital and reserves</b>		<b>5,837,913</b>	7,122,912
<b>Non-current liabilities</b>			
Obligations under finance leases	26	<b>5,408,802</b>	5,936,907
Long-term bank loans	27	<b>8,972,189</b>	5,232,729
Deferred tax liabilities	31	<b>663,954</b>	749,461
Accrued aircraft overhaul expenses	25	<b>138,310</b>	137,734
Long-term portion of other payable	32	<b>121,860</b>	142,250
Post-retirement benefit obligations	34(b)	<b>470,429</b>	450,778
Long-term portion of staff housing allowances	35(b)	<b>242,400</b>	–
Derivative liabilities	41	<b>94,437</b>	43,097
		<b>16,112,381</b>	12,692,956
		<b>21,950,294</b>	19,815,868

These financial statements have been approved for issue by the Board of Directors on 5 April 2004.

**Ye Yigan**  
Director

**Wan Mingwu**  
Director



# Consolidated Cash Flow Statement

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

	2003 RMB'000	2002 RMB'000
<b>Cash flows from operating activities</b>		
(Loss)/profit attributable to shareholders	(949,816)	86,369
<b>Adjustments to reconcile (loss)/profit attributable to shareholders to net cash from operating activities:</b>		
Depreciation of fixed assets	1,974,462	1,710,811
Losses/(gains) on disposals of aircraft and flight equipment	28,767	(115,904)
Losses on disposals of other fixed assets	4,811	27,129
Gains on disposals of short-term investments	(21,920)	–
Amortisation of lease prepayments	20,049	20,128
Amortisation of bond discount	(43,603)	(40,358)
Amortisation of value added tax capitalised	12,245	16,017
Provision for post-retirement benefits	20,844	23,614
Amortisation of goodwill and negative goodwill	2,202	2,202
Revaluation deficit of fixed assets	–	171,753
Foreign exchange losses	77,850	52,207
Share of results after tax of associates	32,738	32,613
Minority interests	112,431	122,087
<b>Movements in:</b>		
Flight equipment spare parts	4,204	(91,543)
Trade receivables	(360,451)	(179,392)
Prepayments and other receivables	184,761	(176,609)
Trade payables	44,719	16,406
Sales in advance of carriage	225,739	55,088
Other payables and accrued expenses	1,759,628	346,336
Interest accrued on a long-term payable	9,610	10,802
Tax payable	61,553	37,611
Deferred taxation	118,797	(17,570)
Long-term portion of accrued aircraft overhaul expenses	(52,300)	50,681
	<b>4,217,136</b>	<b>2,074,109</b>
<b>Net cash inflow from operating activities</b>	<b>3,267,320</b>	<b>2,160,478</b>



# Consolidated Cash Flow Statement

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

	Note	2003 RMB'000	2002 RMB'000
<b>Cash flows from investing activities:</b>			
Additions of aircraft and flight equipment		(5,560,406)	(1,004,136)
Instalment payment for acquisition of a passenger carriage business		(30,000)	(30,000)
Proceeds on disposals of aircraft, flight equipment, other fixed assets and equipment		91,940	149,818
Additions of buildings, other fixed assets and equipment		(216,211)	(206,595)
Additions of construction in progress		(249,737)	(287,179)
Additions of lease prepayments		–	(30,680)
Investments in associates		(327,252)	(254,656)
Advances on aircraft and flight equipment		(1,295,656)	(2,599,610)
Repayments of advances on aircraft and flight equipment		–	20,722
Increase in long-term bank deposits		(64,255)	(20,992)
Purchase of short-term investments		–	(290,000)
Proceeds from disposals of short-term investments		311,920	–
Net (increase)/decrease in short-term deposits with original maturities over three months		(69,246)	10,388
<b>Net cash used in investing activities</b>		<b>(7,408,903)</b>	<b>(4,542,920)</b>
<b>Cash flows from financing activities:</b>			
Short-term bank loans		10,920,917	6,349,141
Repayments of short-term bank loans		(10,815,508)	(3,110,274)
Long-term bank loans		5,606,107	2,855,152
Repayments of long-term bank loans		(898,022)	(1,661,088)
Principal repayments of finance lease obligations		(1,400,749)	(1,958,143)
Loans from an associate		–	15,000
Repayments of loans from an associate		–	(15,000)
Increase in notes payables		345,240	411,250
Dividend paid		–	(97,339)
Capital injection from a minority shareholder		5,765	–
Advances from minority shareholders		–	167,730
<b>Net cash inflow from financing activities</b>		<b>3,763,750</b>	<b>2,956,429</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(377,833)</b>	<b>573,987</b>
<b>Cash and cash equivalents at 1 January</b>		<b>1,944,525</b>	<b>1,330,980</b>
<b>Exchange adjustment</b>		<b>16,088</b>	<b>39,558</b>
<b>Cash and cash equivalents at 31 December</b>	36(a)	<b>1,582,780</b>	<b>1,944,525</b>





# Consolidated Statement of Changes in Shareholders' Equity

China Eastern Airlines Corporation Limited

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

	Share capital (note 29) RMB'000	Other reserves (note 30) RMB'000	Retained profits (note 30) RMB'000	Total RMB'000
<b>Balance at 1 January 2002</b>	4,866,950	913,499	1,539,859	7,320,308
Net gains/(losses) not recognised in the income statement				
Revaluation surplus of fixed assets, net of tax	–	418,006	–	418,006
Revaluation surplus after tax shared by minority shareholders	–	(12,981)	–	(12,981)
Revaluation deficit offset against previous revaluation surplus of fixed assets, net of tax	–	(301,639)	–	(301,639)
Unrealised losses on cashflow hedges	–	(33,621)	–	(33,621)
	–	69,765	–	69,765
Dividends relating to 2001	–	–	(97,339)	(97,339)
Profit attributable to shareholders	–	–	86,369	86,369
Transfer from retained profits to other reserves	–	21,391	(21,391)	–
<b>Balance at 31 December 2002 and 1 January 2003</b>	<b>4,866,950</b>	<b>1,004,655</b>	<b>1,507,498</b>	<b>7,379,103</b>
Net gains/(losses) not recognised in the income statement				
Unrealised losses on cashflow hedges	–	(49,654)	–	(49,654)
Release of reserves upon disposals of aircraft	–	(14,269)	16,787	2,518
	–	(63,923)	16,787	(47,136)
Loss attributable to shareholders	–	–	(949,816)	(949,816)
Transfer from retained profits to other reserves	–	72,510	(72,510)	–
<b>Balance at 31 December 2003</b>	<b>4,866,950</b>	<b>1,013,242</b>	<b>501,959</b>	<b>6,382,151</b>

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 1. Corporate Information

China Eastern Airlines Corporation Limited (the "Company") was established in the People's Republic of China ("PRC") as a joint stock company limited by shares on 14 April 1995. The Company is majority owned by China Eastern Air Holding Company ("CEA Holding"), a state-owned enterprise. The Company and its subsidiaries (the "Group") are principally engaged in the operation of civil aviation, air cargo, postal delivery and other extended transportation services.

## 2. Principal Accounting Policies

### (a) Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and the disclosure requirements of the Hong Kong Companies Ordinance. This basis of accounting differs in certain material respects from that used in the preparation of the Group's statutory accounts in the PRC. The statutory accounts of the Group have been prepared in accordance with the accounting principles and the relevant regulations applicable to PRC joint stock limited companies ("PRC Accounting Regulations"). In preparing these financial statements, appropriate restatements have been made to the Group's statutory accounts to conform with IFRS.

The consolidated financial statements have been prepared under historical cost convention as modified by the revaluation of fixed assets, short-term investments and derivative financial instruments.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current event and actions, actual results ultimately may differ from those estimates.

### (b) Group accounting

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



*(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003*

### 2. Principal Accounting Policies (Cont'd)

#### **(b) Group accounting (Cont'd)**

##### **(i) Subsidiaries**

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies, are consolidated.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. See note 2(m) for the accounting policy on goodwill. Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless it cannot be recovered. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interests represent the interests of outside members in the operating results and net assets of subsidiaries.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses.

##### **(ii) Associates**

Investments in associates are accounted for by the equity method of accounting. Under this method the Company's share of the post-acquisition profits or losses of associates is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. Associates are entities over which the Group generally has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control.



(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 2. Principal Accounting Policies (Cont'd)

### (b) Group accounting (Cont'd)

#### (ii) Associates (Cont'd)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investment in associates includes goodwill (net of accumulated amortisation) on acquisition. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group has incurred obligations or made payments on behalf of the associates.

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

### (c) Foreign currency translation

The Group maintains its books and records in Renminbi ("RMB") which is the measurement currency of the Group. Transactions in foreign currencies are translated at the applicable rates of exchange prevailing at the dates of the transactions, quoted by the People's Bank of China. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the rates prevailing at the balance sheet date as quoted by the People's Bank of China. Exchange differences are included in the income statement, except when deferred in equity as qualifying cashflow hedges.

### (d) Revenue recognition and sales in advance of carriage

Passenger, cargo and mail revenues are recognised as traffic revenues when the transportation services are provided. The value of sold but unused tickets is included in the current liabilities as sales in advance of carriage.

Revenues from other operating businesses, including income derived from the provision of ground services and commission income are recognised when services are rendered. Commission income includes amounts earned from other carriers in respect of sales made by the Group's agents. The related commission payable to such agents are included as commission expenses in the income statement. Rental income from leasing office premises and cargo warehouses is recognised on a straight-line basis over the lease term.



(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 2. Principal Accounting Policies (Cont'd)

### (d) Revenue recognition and sales in advance of carriage (Cont'd)

Revenues are presented net of business tax and civil aviation infrastructure levies.

Interest income is recognised on a time-proportion basis.

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

### (e) Segmental 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 as the secondary reporting format.

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

- (i) Traffic revenue from domestic services within the PRC (excluding Hong Kong Special Administrative Region ("Hong Kong")) is attributed to the domestic operation. Traffic revenue from inbound and outbound services between the PRC and Hong Kong or overseas markets is attributed to the geographical area in which the relevant overseas origin or destination lies.
- (ii) Other operating revenues from ticket handling services, airport ground services and other miscellaneous services are attributed on the basis of where the services are performed.

### (f) Retirement benefits

The Group participates in defined contribution retirement schemes regarding pension and medical benefit for employees organised by the municipal governments of respective provinces. The contributions to the schemes are charged to the income statement as and when incurred.

In addition, the Group provides retirees with post-retirement benefits including retirement subsidies, transportation subsidies, social function activity subsidies as well as other welfare. The cost of providing the aforementioned post-retirement benefits under the Group's defined benefit plan is actuarially determined and recognised over the employees' service period by using the projected unit credit method. Post-retirement benefit expenses recognised in the income statement include, if applicable, current service cost, interest cost, amortised actuarial gains and losses, the effect of any curtailment or settlement and past service cost.

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 2. Principal Accounting Policies (Cont'd)

### (g) Maintenance and overhaul costs

In respect of aircraft and engines under operating leases, the Group has the responsibility to fulfill certain return conditions under relevant leases. In order to fulfill these return conditions, major overhauls are required to be conducted on a regular basis. Accordingly, estimated costs of major overhauls for aircraft and engines under operating leases are accrued and charged to the income statement over the estimated period between overhauls using the ratios of actual flying hours/cycles and estimated flying hours/cycles between overhauls. The costs of major overhaul comprise mainly labour and materials. Differences between the estimated cost and the actual cost of the overhaul are included in the income statement in the period of overhaul.

In respect of aircraft and engines owned by the Group or held under finance leases, costs of major overhauls are charged to the income statement as and when incurred.

All other routine repairs and maintenance costs incurred in restoring such fixed assets to their normal working condition are charged to the income statement as and when incurred.

Improvements are capitalised and depreciated over their expected useful lives to the Group.

### (h) Government grant

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs they are intended to compensate.

Government grants relating to the fixed assets are included in non-current liabilities as other liabilities and are credited to the income statement on a straight-line basis over the expected lives of the related assets.

### (i) Taxation

The Group provides for taxation on the basis of the results for the year as adjusted for items which are not assessable or deductible for income tax purposes. Taxation of the Group is determined in accordance with the relevant tax rules and regulations applicable in the jurisdictions where the Group operates.



(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 2. Principal Accounting Policies (Cont'd)

### (i) Taxation (Cont'd)

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax.

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

### (j) Fixed assets

(i) Fixed assets are recognised initially at cost which comprises purchase price, costs transferred from construction in progress and any directly attributable costs of bringing the assets to the condition for their intended use.

Subsequent to the initial recognition, fixed assets are stated at revalued amount less accumulated depreciation and accumulated impairment losses. Independent valuations are performed at least every five years or sooner if considered necessary by the directors. In the intervening years, the directors review the carrying values of the fixed assets and adjustment is made where these are materially different from fair value. Increases in the carrying amount arising on revaluation are credited to the revaluation reserve. Decreases in valuation of fixed assets are first offset against increases from earlier valuations of the same asset and are thereafter charged to the income statement. All other decreases in valuation are charged to the income statement. Any subsequent increases are credited to the income statement up to the amount previously charged.

(ii) Depreciation of fixed assets is calculated on the straight-line method to write off the cost or revalued amount of each asset to their residual value over their estimated useful lives. The annual depreciation charges are calculated as follows:–

Aircraft	– over 20 years to residual value of 5% of cost or revalued amount
Flight equipment	
– Engines	– over 20 years to nil residual value
– Other flight equipment	– over the expected useful lives to residual value of 5% of cost or revalued amount
Buildings	– over the expected useful lives of 15 to 35 years to residual value of 3% of cost or revalued amount
Other fixed assets and equipment	– over 5 to 20 years to residual value of 3% of cost or revalued amount

(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 2. Principal Accounting Policies (Cont'd)

### (j) Fixed assets (Cont'd)

- (iii) Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in operating profit. When revalued assets are sold, the amounts included in revaluation reserves are transferred to retained earnings.
- (iv) The carrying amounts of assets are reviewed regularly to assess whether their recoverable amounts have declined below their carrying amounts. The recoverable amount is the greater of the net selling price and value in use. In determining the value in use, expected future cashflows generated by the assets including its residual value on disposals are discounted to their present value. When an impairment has occurred, their carrying amount is reduced immediately to their recoverable amount. The amount of reduction to recoverable amount is charged to the income statement.

### (k) Construction in progress

Construction in progress represents office buildings, various infrastructure projects under construction and plant and equipment pending installation. This includes the costs of construction and acquisition and interest capitalised. No depreciation is provided on construction in progress until the asset is completed and put into use.

### (l) Lease prepayments

Lease prepayments represent acquisition costs of land use rights less accumulated amortisation. Amortisation is provided over the lease period of land use rights on a straight-line basis.

Beginning 2002, land use rights are presented as operating leases and stated at historical cost less accumulated amortisation. The land use rights, which were revalued as part of the Company's restructuring in 1996 and recorded at valuation as a non-monetary assets in exchange for share capital of the Company, are now stated at historical cost which is nil. Retrospective adjustments have been made in prior year to reflect the change in accounting for land use rights.





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## 2. Principal Accounting Policies (Cont'd)

### (m) *Goodwill and negative goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary or associate at the date of acquisition. Goodwill is recognised as an asset and amortised by equal annual instalments over its estimated useful economic life up to a maximum of 20 years.

Negative goodwill represents the excess of the fair value of the Group's share of the net assets of the acquired subsidiary or associate over the cost of acquisition. Negative goodwill is presented in the same balance sheet classifications as goodwill. To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the Group's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities, that portion of negative goodwill is recognised in the income statement when the future losses and expenses are recognised. Any remaining negative goodwill, not exceeding the fair values of the non-monetary assets acquired, is recognised in the income statement over the remaining weighted average useful life of those assets up to a maximum of 20 years; negative goodwill in excess of the fair values of those assets is recognised in the income statement immediately.

At each balance sheet date the Group assesses whether there is any indication of impairment. If such indications exist, an analysis is performed to assess whether the carrying amount of goodwill is fully recoverable. A write down is made if the carrying amount exceeds the recoverable amount.

The gain or loss on disposals of an entity includes the carrying amount of goodwill relating to the entity sold.

### (n) *Advances on aircraft and flight equipment*

Advance contract payments to aircraft manufacturers to secure deliveries of aircraft and flight equipment in future years are capitalised along with attributable interests, and transferred to fixed assets upon delivery of the aircraft.

### (o) *Borrowing costs*

Interest attributable to funds used to finance the acquisition of new aircraft and construction of major ground facilities is capitalised as an additional cost of the related asset. Interest is capitalised at the Group's weighted average interest rate on borrowings or, where applicable, the interest rate related to specific borrowings during the period of time that is required to complete and prepare the asset for its intended use.

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

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## 2. Principal Accounting Policies (Cont'd)

### (p) Long-term bank deposits

Long-term bank deposits placed to secure future lease obligations are stated at cost and are classified as held-to-maturity financial assets.

### (q) Zero coupon bonds

Zero coupon bonds purchased to secure and to settle future lease obligations are stated at acquisition cost plus discount amortised to date and are classified as held-to-maturity securities. The discount thereon is amortised over the period to maturity under the effective interest method and included as interest income in the income statement.

### (r) Impairment of long lived assets

Fixed assets and other non-current assets, including goodwill are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cashflows.

### (s) Flight equipment spare parts

Flight equipment spare parts are carried at weighted average cost less allowance for obsolescence and are expensed when used in operations. Allowance for obsolescence is provided for expendable spare parts at rates which depreciate costs, less an estimated residual value, over the estimated useful lives of the related aircraft.

### (t) Trade receivables

Trade receivables are carried at original invoice amount less provision made for impairment of these receivables. A provision for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cashflows, discounted at the market rate of interest for similar borrowers.

### (u) Short-term investments

Short-term investments are carried at fair value. Realised and unrealised gains or losses arising from the changes in fair value of these investments are recognised in the income statement in the period in which they arise.



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## 2. Principal Accounting Policies (Cont'd)

### (v) *Cash and cash equivalents*

Cash and short-term highly liquid investments, which are readily convertible into cash and have original maturities of three months or less at the date of acquisition, are classified as cash and cash equivalents.

### (w) *Frequent flyer programme*

The Group estimates the present value of the incremental cost of providing free travel awards entitled by members under a frequent flyer programme when free travel award levels are achieved based on accumulated mileage. The estimated incremental cost is recognised as an expense in the income statement and accrued as a liability in the balance sheet.

As members redeem awards or their entitlements expire, the incremental cost liability is reduced accordingly to reflect the acquittal of the outstanding obligations.

### (x) *Provisions*

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

### (y) *Leases*

#### (i) A Group company is the lessee

Leases of fixed assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Leased assets are depreciated using the straight-line method over their expected useful lives to residual values.



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## 2. Principal Accounting Policies (Cont'd)

### (y) Leases (Cont'd)

#### (i) A Group company is the lessee (Cont'd)

Leases of assets under which a significant portion of the lease risks and rewards of ownership are retained by the lessor are classified as operating leases. Lease payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

#### (ii) A Group company is the lessor

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

Assets leased out under operating leases are included in fixed assets in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar fixed assets. Rental income is recognised on a straight-line basis over the lease term.

### (z) Derivative financial instruments

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are remeasured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. The Group designates certain derivatives as either (1) a hedge of the fair value of a recognised asset or liability (i.e. fair value hedge), or (2) a hedge of a forecasted transaction or of a firm commitment (i.e. cashflow hedge).

Derivative financial instrument that does not qualify for hedge accounting is accounted for as trading instrument and any unrealised gain or loss, being changes in fair value of the derivative, is recognised in the income statement immediately.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective, are recorded in the income statement, along with any changes in the fair value of the hedged assets or liabilities that are attributable to the hedged risk.



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## 2. Principal Accounting Policies (Cont'd)

### (z) Derivative financial instruments (Cont'd)

Derivative financial instrument that qualifies for hedge accounting and is designated as a specific hedge of the variability in cashflows of a highly probable forecast transaction, is accounted for as follows:-

- (i) the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. The cumulative gain or loss on the derivative financial instrument is removed from equity and recognised in the income statement in the same period during which the hedged forecast transaction affects net profit or loss.
- (ii) the ineffective part of any gain or loss is recognised in the income statement immediately.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the committed or forecasted transaction ultimately occurs. When a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was recorded in equity is immediately transferred to the income statement.

### (aa) Comparatives

Where necessary, comparative figures have been reclassified to conform with changes in presentation in the current year.

## 3. Revenues and Turnover

The Group is principally engaged in the provision of domestic, Hong Kong and international passenger, cargo and mail airline services. Turnover comprises revenues from airline and related services net of business tax and civil aviation infrastructure levies.

	Group	
	2003 RMB'000	2002 RMB'000
Gross turnover	14,575,443	13,814,709
Less: Business tax (note (a))	(168,639)	(304,558)
Civil aviation infrastructure levies (note (b))	(129,646)	(431,162)
Turnover	14,277,158	13,078,989
Rental income from operating subleases of aircraft (note 4)	31,209	110,469
Interests income (note 6)	147,846	115,824
<b>Total revenues</b>	<b>14,456,213</b>	<b>13,305,282</b>

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### 3. Revenues and Turnover (Cont'd)

- (a) Pursuant to various PRC sales tax rules and regulations, the Group is required to pay PRC business tax. Except for traffic revenues derived from inbound international and regional flights which are not subject to PRC business tax, the Group's traffic revenues, commission income and ground service income are subject to PRC business tax levied at rates ranging from 3% to 5%.

From 1 May 2003 to 31 December 2003, PRC business tax for all domestic, international and regional passenger traffic revenues of the Group are waived by the PRC Government, to subsidise for the airlines' losses on revenue due to the outbreak of Severe Acute Respiratory Syndrome ("SARS").

- (b) The civil aviation infrastructure levies are paid to Civil Aviation Administration of China ("CAAC"), at rates of 5% and 2% respectively for domestic and international or regional traffic revenues.

From 1 May 2003 to 31 December 2003, civil aviation infrastructure levies for all domestic, international and regional traffic revenues of the Group are waived by the PRC Government, to subsidise for the airlines' losses on revenue due to the outbreak of SARS.

### 4. Other Operating Income

	Group	
	2003 RMB'000	2002 RMB'000
(Loss)/gain on disposals of aircraft and engines (note (a))	(28,767)	115,904
Rental income from operating subleases of aircraft	31,209	110,469
	<b>2,442</b>	<b>226,373</b>

- (a) During the year, the Group disposed of three B737-200 aircraft (2002: two A310 aircraft) to an unrelated third party.



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## 5. Wages, Salaries and Benefits

	Group	
	2003 RMB'000	2002 RMB'000
Wages, salaries and allowances	989,092	897,843
Contribution under defined contribution retirement schemes (note 34 (a))	159,200	98,876
Post-retirement benefits (note 34 (b) (iii))	40,299	39,134
Staff housing allowances (note 35 (b))	260,463	–
	<b>1,449,054</b>	<b>1,035,853</b>
Average number of employees for the year ended	<b>16,435</b>	<b>15,719</b>

## 6. Finance Costs, Net

	Group	
	2003 RMB'000	2002 RMB'000
Interest charged on obligations under finance leases	490,456	509,889
Interest on bank loans		
– wholly repayable within five years	270,965	174,395
– not wholly repayable within five years	180,291	222,702
	451,256	397,097
Interest accrued on a long-term payable (note 32)	9,610	10,802
Interest on loans from an associate	6,396	1,373
Less: amounts capitalised into fixed assets and advances on aircraft and flight equipment (note 18)	(97,414)	(71,948)
	<b>860,304</b>	<b>847,213</b>
Interest income	(147,846)	(115,824)
	<b>712,458</b>	<b>731,389</b>

The capitalisation rates used for the year ended 31 December 2003 range between 3 months LIBOR+0.25% and 5.76% per annum (2002: range between 4.00% and 6.50% per annum).

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## 7. (Loss)/Profit before Taxation

	Group	
	2003 RMB'000	2002 RMB'000
(Loss)/profit before taxation is stated after charging:–		
Depreciation of fixed assets		
– owned assets	1,396,739	1,070,074
– assets held under finance leases and for own use	577,723	603,311
– assets held under finance leases and subleased out under operating leases	–	37,426
Operating lease rentals		
– aircraft	1,238,012	1,025,800
– land and buildings	116,279	98,955
Amortisation of lease prepayments	20,049	20,128
Losses on disposals of other fixed assets	4,811	27,129
Amortisation of goodwill and negative goodwill	2,202	2,202
Allowances for obsolescence of flight equipment spare parts	53,336	33,024
Allowances for doubtful accounts	19,229	41,529
Auditors' remuneration	7,380	6,360
and after crediting:–		
Government grants received	(58,448)	(54,810)
Gain on disposals of short-term investments	(21,920)	–

## 8. Emoluments of Directors, Supervisors and Senior Management

(a) Directors' and supervisors' emoluments comprise the following:–

	Group	
	2003 RMB'000	2002 RMB'000
Emoluments for executive directors		
– salaries, allowances and benefits in kind	425	375
– bonuses	124	82
Emoluments for supervisors		
– salaries, allowances and benefits in kind	46	42
– bonuses	18	13
	<b>613</b>	<b>512</b>

During the year ended 31 December 2003, no directors and supervisors waived their emoluments (2002: nil).





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## 8. Emoluments of Directors, Supervisors and Senior Management (Cont'd)

(b) The five highest paid individuals of the Group are as follows:-

	Number of individuals	
	2003	2002
Directors	2	2
Non-directors and non-supervisors	3	3
	<b>5</b>	<b>5</b>

(c) The emoluments of the five highest paid individuals:-

Two (2002: two) of the Group's five highest paid individuals in 2003 are executive directors whose remunerations are included in the directors' emoluments above. Details of the remuneration of the remaining three (2002: three) highest paid individuals are as follows:-

	Group	
	2003 RMB'000	2002 RMB'000
Salaries, allowances and benefits in kind	705	629
Bonuses	138	100
	<b>843</b>	<b>729</b>

During the year ended 31 December 2003, no emoluments were paid by the Group to the directors, supervisors or the five highest paid individuals as an inducement to join or upon joining the Group, or as a compensation for loss of office (2002: nil).

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## 9. Taxation

(a) Taxation is (charged)/credited to the consolidated income statement as follows:-

	Group	
	2003 RMB'000	2002 RMB'000
Provision for PRC income tax – current year	(124,530)	(71,061)
Deferred taxation (note 31)	(118,797)	17,570
	<b>(243,327)</b>	(53,491)
Share of tax attributable to associates (note 16)	(4,227)	(947)
	<b>(247,554)</b>	(54,438)

- (i) Pursuant to a preferential tax policy in Pudong, Shanghai, the Company is entitled to a reduced income tax rate of 15%.
- (ii) Two major subsidiaries of the Company, namely China Cargo Airlines Co., Ltd. and China Eastern Airlines Jiangsu Co., Ltd. are subject to a reduced income tax rate of 15% and the standard PRC income tax rate of 33% respectively.
- (iii) The difference between the actual taxation charge in the consolidated income statement and the amounts which would result from applying the enacted tax rate to (loss)/profit before taxation can be reconciled as follows:-

	Group	
	2003 RMB'000	2002 RMB'000
(Loss)/profit before taxation	(589,831)	262,894
Tax calculated at enacted tax rate of 15 %	88,475	(39,434)
Effect attributable to subsidiaries and associates charged at tax rate of 33%	(4,117)	(11,101)
Adjustments:-		
Expenses not deductible for tax purposes	(62,421)	(15,799)
Unrecognised tax losses of the Company	(258,515)	-
Unrecognised tax losses of associates	(14,821)	(11,347)
Utilisation of previously unrecognised tax losses of subsidiaries	-	36,953
Expired tax losses not deductible for tax purposes	-	(15,185)
Others	3,845	1,475
Tax charge	<b>(247,554)</b>	(54,438)

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### 9. Taxation (Cont'd)

- (b) The Group operates international flights to certain overseas destinations. There was no material overseas taxation for the year as there exists double tax relief between PRC and the corresponding jurisdictions (including Hong Kong).
- (c) In accordance with the relevant PRC tax regulations, the operating lease rentals and the interest element of finance leases and bank loans paid or payable to foreign enterprises by the Group is subject to Foreign Enterprise Income Tax of PRC. This tax should be withheld by the Group at the time of payment and paid on behalf of the lessors or lenders. Pursuant to the Circular (2000) No. 2551 issued by the State Tax Bureau, lease payments made by aviation companies to foreign enterprises in respect of lease arrangements entered into prior to 1 September 1999 are exempted from the payment of any withholding tax. Withholding tax payable in respect of the leases arrangements entered into on or after 1 September 1999 are charged to the income statement as incurred.

### 10. (Loss)/Earnings per Share

The calculation of (loss)/earnings per share is based on the loss attributable to shareholders of RMB949,816,000 (2002: profit of RMB86,369,000) and 4,866,950,000 (2002: 4,866,950,000) shares in issue during the year. The Company has no potential dilutive ordinary shares.

### 11. Dividends

The Board of Directors of the Company does not recommend the payment of a dividend for the year ended 31 December 2003 (2002: nil).

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## 12. Fixed Assets

	Group				
	Aircraft and flight equipment		Buildings	Other fixed assets and equipment	Total
	Owned	Held under finance leases			
RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
<b>Valuation</b>					
At 1 January 2003	14,140,941	11,318,748	1,774,876	2,050,936	29,285,501
Reclassification upon completion of finance lease terms	438,967	(438,967)	–	–	–
Transfer from construction in progress (note 13)	–	–	389,612	54,149	443,761
Additions	7,728,025	76,645	63,940	161,727	8,030,337
Disposals	(144,715)	–	(3,908)	(228,631)	(377,254)
At 31 December 2003	22,163,218	10,956,426	2,224,520	2,038,181	37,382,345
<b>Accumulated depreciation</b>					
At 1 January 2003	4,614,292	3,078,861	248,720	877,678	8,819,551
Reclassification upon completion of finance lease terms	43,275	(43,275)	–	–	–
Charge for the year	1,035,312	577,723	86,595	274,832	1,974,462
Disposals	(35,286)	–	(364)	(214,921)	(250,571)
At 31 December 2003	5,657,593	3,613,309	334,951	937,589	10,543,442
<b>Net book value at 31 December 2003</b>	<b>16,505,625</b>	<b>7,343,117</b>	<b>1,889,569</b>	<b>1,100,592</b>	<b>26,838,903</b>
Net book value at 31 December 2002	9,526,649	8,239,887	1,526,156	1,173,258	20,465,950
<b>Company</b>					
<b>Valuation</b>					
At 1 January 2003	12,402,632	11,318,748	1,274,323	1,352,752	26,348,455
Reclassification upon completion of finance lease terms	438,967	(438,967)	–	–	–
Transfer from construction in progress (note 13)	–	–	26,877	42,827	69,704
Transfer to a subsidiary	(2,464,474)	–	–	–	(2,464,474)
Additions	7,690,584	76,645	49,718	91,098	7,908,045
Disposals	(144,715)	–	(3,493)	(94,249)	(242,457)
At 31 December 2003	17,922,994	10,956,426	1,347,425	1,392,428	31,619,273
<b>Accumulated depreciation</b>					
At 1 January 2003	3,933,330	3,078,861	178,261	576,089	7,766,541
Reclassification upon completion of finance lease terms	43,275	(43,275)	–	–	–
Transfer to a subsidiary	(130,081)	–	–	–	(130,081)
Charge for the year	876,727	577,723	57,461	207,708	1,719,619
Disposals	(35,286)	–	(205)	(85,075)	(120,566)
At 31 December 2003	4,687,965	3,613,309	235,517	698,722	9,235,513
<b>Net book value at 31 December 2003</b>	<b>13,235,029</b>	<b>7,343,117</b>	<b>1,111,908</b>	<b>693,706</b>	<b>22,383,760</b>
Net book value at 31 December 2002	8,469,302	8,239,887	1,096,062	776,663	18,581,914

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## 12. Fixed Assets (Cont'd)

(a) On 31 December 2002, the Group's fixed assets were revalued by the directors of the Company on a market value or replacement cost basis. The difference between the valuation and the carrying amount of the fixed assets as at 31 December 2002 was recognised. On 31 December 2003, the directors of the Company reviewed the carrying value of the Group's fixed assets as at 31 December 2003 and are of the opinion that the carrying amount is not materially different from the fair value.

Had the Group's fixed assets been stated at cost less accumulated depreciation and impairment losses as at 31 December 2003, the carrying amounts of aircraft and flight equipment would have been RMB26,618,747,000 (2002: RMB20,194,500,000).

(b) Certain aircraft of the Group and the Company with an aggregate carrying value of approximately RMB9,735,106,000 as at 31 December 2003 (2002: RMB3,272,123,000) were pledged as collateral under certain loan agreements (see note 27).

(c) Included in the additions of fixed assets of the Group and the Company were interest capitalised of RMB152,591,000 (2002: RMB33,377,000), RMB62,149,000 (2002: RMB13,362,000) of which were capitalised during the year ended 31 December 2003.

## 13. Construction in Progress

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
At 1 January	413,812	347,406	109,785	190,394
Additions	249,737	287,179	52,439	43,698
Transfer to fixed assets (note 12)	(443,761)	(220,773)	(69,704)	(124,307)
At 31 December	219,788	413,812	92,520	109,785

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#### 14. Lease Prepayments

Lease prepayments represent unamortised prepayments for land use rights.

The Group's land use rights are located in the PRC and majority of these land use rights have terms of 50 years from the date of grant. As at 31 December 2003, majority of these land use rights had remaining terms ranging from 43 to 49 years (2002: from 44 to 50 years).

Certificates of certain land use rights with nil carrying value (2002: nil) of the Group are currently registered under the name of CEA Holding. The procedures to change the registration of the land use rights certificates with the relevant municipal land bureaus are currently being addressed by CEA Holding. Until the completion of these transfer procedures, the Group is unable to assign or pledge these land use rights. However, the Group currently has no need to assign and no intention to pledge these land use rights. In addition, the Group is entitled to lawfully and validly occupy and use these lands for its daily operations in spite of the fact that the procedures of changing the registration of these land use rights have not been fully completed. Accordingly, the directors of the Company do not believe the lack of certificates of certain land use rights has any material impact on the financial position of the Group.

#### 15. Investments in Subsidiaries

	Company	
	2003 RMB'000	2002 RMB'000
Unlisted shares, at cost	1,600,156	1,378,420
Amounts due from subsidiaries	2,208,459	642,138
	<b>3,808,615</b>	<b>2,020,558</b>



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### 15. Investments in Subsidiaries (Cont'd)

Particulars of the principal subsidiaries, all of which are limited companies established and operating in the PRC, are as follows:–

Company	Place and date of establishment	Paid-up capital		Attributable equity interest		Principal activities
		2003 RMB'000	2002 RMB'000	2003	2002	
China Cargo Airlines Co., Ltd.	PRC 22 July 1998	500,000	500,000	70%	70%	Provision of cargo carriage services
China Eastern Airlines Jiangsu Co., Ltd.	PRC 3 May 1993	236,579	236,579	55%	55%	Provision of airline services
Eastern Airlines Hotel Co., Ltd.	PRC 18 March 1998	70,000	70,000	86%	86%	Provision of hotel services to crew members
Shanghai Eastern Flight Training Co., Ltd.	PRC 18 December 1995	473,000	358,800	95%	95%	Provision of flight training services
Shanghai Eastern Airlines Investment Co., Ltd.	PRC 8 May 2002	412,500	300,000	99%	98%	Investment holding

### 16. Investments in Associates

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Unlisted investment, at cost	–	–	590,601	361,020
Share of net assets	572,818	272,098	–	–
Goodwill	53,266	59,472	–	–
	<b>626,084</b>	<b>331,570</b>	<b>590,601</b>	<b>361,020</b>



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## 16. Investments in Associates (Cont'd)

	Group	
	2003 RMB'000	2002 RMB'000
Movement in investments in associates are as follows:–		
At 1 January	331,570	109,527
Cost of investment	327,252	254,656
Share of results before taxation	(28,511)	(31,666)
Share of taxation	(4,227)	(947)
At 31 December	626,084	331,570

The share of results before taxation includes an amortisation of RMB6,206,000 (2002: RMB2,586,000) for the goodwill in respect of acquisition of associates.

Particular of the principal associates, all of which are limited companies established and operating in the PRC, are as follows:–

Company	Place and date of establishment	Paid-up capital RMB'000	Attributable equity interest		Principal activities
			2003	2002	
China Eastern Airlines Wuhan Co., Ltd.	PRC 16 August 2002	600,000	40%	40%	Provision of air transportation services
Eastern Air Group Finance Co., Ltd.	PRC 6 December 1995	400,000	25%	25%	Provision of financial services to companies comprising CEA Holding
Eastern Aviation Advertising Services Co., Ltd.	PRC 4 March 1986	10,000	45%	45%	Provision of aviation advertising agency services
China Eastern Air Catering Investment Co., Ltd.	PRC 17 November 2003	350,000	45%	–	Provision of air catering services





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## 16. Investments in Associates (Cont'd)

Company	Place and date of establishment	Paid-up capital RMB'000	Attributable equity interest		Principal activities
			2003	2002	
Eastern Aviation Import & Export Co., Ltd.	PRC 9 June 1993	80,000	45%	–	Provision of aviation equipment, spare parts and tools trading
Shanghai Dongmei Aviation Travel Co., Ltd.	PRC 17 October 2003	31,000	45%	–	Provision of travelling and accommodation agency services
Qingdao Liuting International Airport Co., Ltd	PRC 1 December 2000	450,000	25%	–	Provision of airport operation services

## 17. Goodwill and Negative Goodwill

	Goodwill RMB'000	Group and Company Negative Goodwill RMB'000	Total RMB'000
Cost			
At 1 January 2003 and 31 December 2003	113,105	(55,245)	57,860
Accumulated amortisation			
At 1 January 2003	22,621	(5,468)	17,153
Charge for the year	5,654	(3,452)	2,202
At 31 December 2003	28,275	(8,920)	19,355
Net book value at 31 December 2003	84,830	(46,325)	38,505
Net book value at 31 December 2002	90,484	(49,777)	40,707

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## 18. Advances on Aircraft and Flight Equipment

	Group and Company	
	2003 RMB'000	2002 RMB'000
At 1 January	3,227,720	1,141,576
Additions	1,198,242	2,527,662
Interest capitalised during the year (note 6)	97,414	71,948
Transfer to fixed assets	(2,283,483)	(513,466)
At 31 December	2,239,893	3,227,720

Included in the balance as at 31 December 2003 is interest capitalised of RMB130,965,000 (2002: RMB95,701,000).

## 19. Other Long-term Receivables and Investments

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Long-term bank deposits (note 26)	1,743,924	1,463,044	1,743,924	1,463,044
US Treasury zero coupon bonds (note (a) and 21)	–	542,124	–	542,124
Deposits for aircraft under operating leases	110,812	89,273	90,339	69,170
Prepaid custom duty and value added tax	37,410	52,501	37,410	52,501
Prepayments and other long-term receivables	70,216	76,826	53,875	59,151
	1,962,362	2,223,768	1,925,548	2,185,990

- (a) US Treasury zero coupon bonds will mature in February 2004 and are classified as current assets as at 31 December 2003 (note 21).

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## 20. Trade Receivables Less Allowance for Doubtful Accounts

The credit terms given to trade customers are determined on individual basis, with the credit period ranging from half to three months.

As at 31 December 2003, the aging analysis of the trade receivables were as follows:–

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Less than 31 days	853,303	555,787	564,870	317,705
31 to 60 days	348,159	200,702	221,498	50,191
61 to 90 days	28,094	70,333	968	39,297
Over 90 days	96,121	138,404	58,168	108,441
	<b>1,325,677</b>	<b>965,226</b>	<b>845,504</b>	<b>515,634</b>

## 21. Prepayments and Other Receivables

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Amounts due from related companies				
(note 39(a)(i))	45,389	46,159	35,785	42,632
Discounts on aircraft acquisitions receivable	29,814	78,822	29,814	78,822
Receivables from provision of ground services	111,129	125,418	111,129	68,813
Prepaid aircraft operating lease rentals	95,959	111,908	79,340	92,881
US Treasury zero coupon bonds (note 26)	585,736	–	585,736	–
Receivable on aircraft operating lease rentals	–	8,034	–	8,034
Advance payment for equity interests	–	112,500	–	112,500
Other	394,146	332,208	273,266	212,512
	<b>1,262,173</b>	<b>815,049</b>	<b>1,115,070</b>	<b>616,194</b>

## 22. Short-term Investments

Short-term investments are valued at market value at 31 December by reference to stock exchange quoted bid prices.

Short-term investments are classified as current assets because they are expected to be realised within twelve months of the balance sheet date.

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### 23. Trade Payables

As at 31 December 2003 and 2002, all trade payables were current balances and aged within 30 days.

### 24. Other Payables and Accrued Expenses

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Amounts due to related companies				
(note 39(a)(i))	<b>771,643</b>	339,133	<b>739,427</b>	313,961
Accrued operating expenses	<b>2,004,906</b>	1,241,948	<b>1,635,974</b>	967,536
Payable for land use rights	–	3,093	–	–
Current portion of accrued aircraft				
overhaul expenses (note 25)	<b>385,168</b>	304,129	<b>377,224</b>	304,129
Duties and levies payable	<b>10,049</b>	55,279	–	47,970
Current portion of a long-term payable				
(note 32)	<b>30,000</b>	30,000	<b>30,000</b>	30,000
Current portion of post-retirement				
benefits obligation (note 34(b)(i))	<b>19,750</b>	15,753	<b>18,635</b>	15,290
Current portion of provision for staff				
housing allowances (note 35 (b))	<b>85,973</b>	80,179	<b>78,771</b>	78,198
Accrued salaries, wages and benefits	<b>138,954</b>	125,462	<b>119,117</b>	114,236
Flight equipment purchase payable	<b>511,347</b>	167,390	<b>498,299</b>	164,710
Amounts due to minority shareholders	<b>156,308</b>	155,486	–	–
Other	<b>185,891</b>	273,181	<b>108,473</b>	202,339
	<b>4,299,989</b>	2,791,033	<b>3,605,920</b>	2,238,369

### 25. Accrued Aircraft Overhaul Expenses

	Group RMB'000	Company RMB'000
At 1 January 2003	<b>547,813</b>	<b>441,863</b>
Additional provisions	<b>123,213</b>	<b>121,839</b>
Utilised during the year	<b>(94,474)</b>	<b>(48,168)</b>
At 31 December 2003	<b>576,552</b>	<b>515,534</b>



(Prepared in accordance with International Financial Reporting Standards)  
Year ended 31 December 2003

## 25. Accrued Aircraft Overhaul Expenses (Cont'd)

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Total accrued aircraft overhaul expenses	576,552	547,813	515,534	441,863
Less: current portion (note 24)	(385,168)	(304,129)	(377,224)	(304,129)
Long-term portion	191,384	243,684	138,310	137,734

## 26. Obligations under Finance Leases

At 31 December 2003, the Group and the Company had 18 aircraft (2002: 19 aircraft) under finance leases. Under the terms of the leases, the Group and the Company has the option to purchase, at or near the end of the lease term, certain aircraft at fair market value and others at either fair market value or a percentage of the respective lessor's defined cost of the aircraft.

The future minimum lease payments, interest and present value of minimum lease payments which are principally denominated in foreign currencies, under these finance leases as at 31 December 2003 were as follows:-

	Group and Company					
	2003		2002		Present value of minimum lease payments	
	Minimum lease payments RMB'000	Interest RMB'000	Minimum lease payments RMB'000	Minimum lease payments RMB'000	Interest RMB'000	Present value of minimum lease payments RMB'000
Within one year	2,049,079	356,995	1,692,084	2,733,720	486,661	2,247,059
In the second year	1,242,950	256,355	986,595	1,142,846	307,758	835,088
In the third to fifth year inclusive	4,361,682	322,316	4,039,366	4,524,438	519,489	4,004,949
After the fifth year	408,853	26,012	382,841	1,162,325	65,455	1,096,870
Total	8,062,564	961,678	7,100,886	9,563,329	1,379,363	8,183,966
Less: amount repayable within						
one year	(2,049,079)	(356,995)	(1,692,084)	(2,733,720)	(486,661)	(2,247,059)
Long-term portion	6,013,485	604,683	5,408,802	6,829,609	892,702	5,936,907

At 31 December 2003, the Group and the Company had long-term bank deposits and U.S. Treasury zero coupon bonds totalling RMB2,329,660,000 (2002: RMB2,005,168,000) pledged as securities under certain finance lease arrangements (see notes 19 and 21). All of these bank deposits and the U.S. Treasury zero coupon bonds will be used to meet future lease obligations as they fall due.

In addition, the Group's finance lease obligations are secured by the related aircraft, the relevant insurance policies and bank guarantees.

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## 27. Long-term Bank Loans

	Group and Company	
	2003 RMB'000	2002 RMB'000
Bank loans		
– secured	6,495,507	2,589,504
– unsecured	4,727,416	3,905,127
<b>Total</b>	<b>11,222,923</b>	<b>6,494,631</b>
Less: amount repayable within one year	(2,250,734)	(1,261,902)
<b>Long-term portion</b>	<b>8,972,189</b>	<b>5,232,729</b>

The bank loans are repayable as follows:–

Within one year	2,250,734	1,261,902
In the second year	2,438,574	1,709,114
In the third to fifth year inclusive	4,163,578	2,367,721
After the fifth year	2,370,037	1,155,894
<b>Total</b>	<b>11,222,923</b>	<b>6,494,631</b>

The terms of long-term bank loans can be summarised as follows:–

	Interest rate and final maturities	Group and Company	
		2003 RMB'000	2002 RMB'000
RMB denominated bank loans:–			
Loans for construction projects	Fixed interest rate of 6.21% per annum as at 31 December 2003; 7 to 10-year loans with final maturities through to 2007	637,500	800,000
Loans for the purchases of aircraft	Fixed interest rates ranging from 4.12% to 4.94% per annum as at 31 December 2003; 3-year loans with final maturity through to 2006	1,306,700	250,000
		<b>1,944,200</b>	<b>1,050,000</b>
U.S. dollar denominated bank loans:–			
Loans for the purchases of aircraft	Fixed interest rates ranging from 5.65% to 6.86% per annum and floating interest rates ranging from 3 months LIBOR +0.25% to 6 months LIBOR +0.3% as at 31 December 2003; 10 to 12-year loans with final maturities through to 2008	9,278,723	5,444,631
<b>Total long-term bank loans</b>		<b>11,222,923</b>	<b>6,494,631</b>



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## 27. Long-term Bank Loans (Cont'd)

Bank loans totaling RMB6,495,508,000 at 31 December 2003 (2002: RMB2,589,504,000) of the Group and the Company for the purchases of aircraft were secured by the related aircraft (note 12(b)).

Bank loans were guaranteed by the following parties:-

	Group and Company	
	2003	2002
	RMB'000	RMB'000
RMB denominated bank loans guaranteed by CEA Holding	1,944,200	1,050,000
U.S. dollar denominated bank loans guaranteed by third parties:-		
– Export-Import Bank of the United States	1,276,352	1,488,745
– China Industrial and Commercial Bank	94,089	144,645
– China Construction Bank	85,879	100,399
	<b>3,400,520</b>	<b>2,783,789</b>

## 28. Short-term Bank Loans

Short-term bank loans of the Group and the Company are repayable within one year with interest charged at the prevailing market rates based on the rates quoted by the People's Bank of China. The interest rates related to such loans were between 2.06% and 5.04% per annum (2002: 2.06% and 5.31% per annum). During the year ended 31 December 2003, the weighted average interest rate on short-term bank loans was 3.34% per annum (2002: 4.39% per annum).

## 29. Share Capital

	2003	2002
	RMB'000	RMB'000
Registered, issued and fully paid of RMB1.00 each A shares		
State-owned shares held by CEA Holding	3,000,000	3,000,000
Shares held by public	300,000	300,000
	<b>3,300,000</b>	<b>3,300,000</b>
Overseas listed foreign H shares	1,566,950	1,566,950
	<b>4,866,950</b>	<b>4,866,950</b>

Pursuant to articles 49 and 50 of the Company's Articles of Association, the A shares held by CEA Holding, employees, the public and H shares are all registered ordinary shares, carrying equal rights.

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### 30. Reserves

	Share premium RMB'000	Statutory common reserve fund (note (a)) RMB'000	Statutory common welfare fund (note (b)) RMB'000	Discretionary common reserve fund (note (c)) RMB'000	Revaluation reserve RMB'000	Capital reserve RMB'000	Hedging reserve (note 41) RMB'000	Retained profits RMB'000	Total RMB'000
<b>Group</b>									
At 1 January 2003	1,006,455	106,809	106,727	27,989	504,957	(720,057)	(28,225)	1,507,498	2,512,153
Unrealised losses on cashflow hedges (note 41)									
- gross	-	-	-	-	-	-	(58,417)	-	(58,417)
- tax	-	-	-	-	-	-	8,763	-	8,763
Release of reserves upon disposals of aircraft									
- gross	-	-	-	-	(16,787)	-	-	16,787	-
- tax	-	-	-	-	2,518	-	-	-	2,518
Loss attributable to shareholders	-	-	-	-	-	-	-	(949,816)	(949,816)
Transfer from retained profits to reserves (note (d))									
	-	36,689	35,821	-	-	-	-	(72,510)	-
At 31 December 2003	1,006,455	143,498	142,548	27,989	490,688	(720,057)	(77,879)	501,959	1,515,201
<b>Company</b>									
At 1 January 2003	1,006,455	77,214	77,214	27,908	517,549	(720,057)	(28,225)	1,297,904	2,255,962
Unrealised losses on cashflow hedges (note 41)									
- gross	-	-	-	-	-	-	(58,417)	-	(58,417)
- tax	-	-	-	-	-	-	8,763	-	8,763
Release of reserves upon disposals of aircraft									
- gross	-	-	-	-	(80,812)	-	-	80,812	-
- tax	-	-	-	-	12,122	-	-	-	12,122
Loss for the year	-	-	-	-	-	-	-	(1,247,467)	(1,247,467)
At 31 December 2003	1,006,455	77,214	77,214	27,908	448,859	(720,057)	(77,879)	131,249	970,963





## Notes to the Financial Statements

China Eastern Airlines Corporation Limited

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### 30. Reserves (Cont'd)

	Share premium RMB'000	Statutory common reserve fund (note (a)) RMB'000	Statutory common welfare fund (note (b)) RMB'000	Discretionary common reserve fund (note (c)) RMB'000	Revaluation reserve RMB'000	Capital reserve RMB'000	Hedging reserve (note 41) RMB'000	Retained profits RMB'000	Total RMB'000
Group									
At 1 January 2002	1,006,455	96,113	96,113	27,908	-	(318,486)	5,396	1,539,859	2,453,358
Reclassification of revaluation reserve (note (e))	-	-	-	-	401,571	(401,571)	-	-	-
Revaluation surplus of fixed assets									
- gross	-	-	-	-	491,772	-	-	-	491,772
- tax	-	-	-	-	(73,766)	-	-	-	(73,766)
Revaluation surplus after tax shared by minority shareholders	-	-	-	-	(12,981)	-	-	-	(12,981)
Revaluation deficit offset against previous revaluation surplus of fixed assets									
- gross	-	-	-	-	(354,870)	-	-	-	(354,870)
- tax	-	-	-	-	53,231	-	-	-	53,231
Unrealised losses on cashflow hedges (note 41)									
- gross	-	-	-	-	-	-	(38,602)	-	(38,602)
- tax	-	-	-	-	-	-	4,981	-	4,981
Dividends relating to 2001	-	-	-	-	-	-	-	(97,339)	(97,339)
Profit attributable to shareholders	-	-	-	-	-	-	-	86,369	86,369
Transfer from retained profits									
to reserves (note (d))	-	10,696	10,614	81	-	-	-	(21,391)	-
At 31 December 2002	1,006,455	106,809	106,727	27,989	504,957	(720,057)	(28,225)	1,507,498	2,512,153



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## 30. Reserves (Cont'd)

	Share premium RMB'000	Statutory common reserve fund (note (a)) RMB'000	Statutory common welfare fund (note (b)) RMB'000	Discretionary common reserve fund (note (c)) RMB'000	Revaluation reserve RMB'000	Capital reserve RMB'000	Hedging reserve (note 41) RMB'000	Retained profits RMB'000	Total RMB'000
Company									
At 1 January 2002	1,006,455	77,214	77,214	27,908	42,881	(318,486)	5,396	1,526,580	2,445,162
Reclassification of revaluation									
reserve (note (e))	-	-	-	-	401,571	(401,571)	-	-	-
Revaluation surplus of fixed assets									
- gross	-	-	-	-	440,866	-	-	-	440,866
- tax	-	-	-	-	(66,130)	-	-	-	(66,130)
Revaluation deficit offset against									
previous revaluation surplus of									
fixed assets									
- gross	-	-	-	-	(354,870)	-	-	-	(354,870)
- tax	-	-	-	-	53,231	-	-	-	53,231
Unrealised losses on cashflow hedges									
(note 41)									
- gross	-	-	-	-	-	-	(38,602)	-	(38,602)
- tax	-	-	-	-	-	-	4,981	-	4,981
Dividends relating to 2001	-	-	-	-	-	-	-	(97,339)	(97,339)
Loss for the year	-	-	-	-	-	-	-	(131,337)	(131,337)
At 31 December 2002	1,006,455	77,214	77,214	27,908	517,549	(720,057)	(28,225)	1,297,904	2,255,962



*(Prepared in accordance with International Financial Reporting Standards)  
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### 30. Reserves (Cont'd)

- (a) Pursuant to PRC regulations and the Company's Articles of Association, the Company is required to transfer 10% of its profit for the year, as determined under the PRC Accounting Regulations, to statutory common reserve fund until the fund aggregates to 50% of the Company's registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory common reserve fund can be used to make good previous years' losses, if any, and to issue new shares to shareholders in proportion to their existing shareholdings or to increase 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.

- (b) Pursuant to PRC regulations and the Company's Articles of Association, the Company is required to transfer 5% to 10% of its profit for the year, as determined under the PRC Accounting Regulations, to the statutory common welfare fund. This fund can only be used to provide staff welfare facilities and other collective benefits to the Company's employees. This fund is non-distributable other than in liquidation.
- (c) The Company is allowed to transfer 5% of the profit for the year as determined under the PRC Accounting Regulations, to discretionary common reserve. The transfer to this reserve is subject to the approval by shareholder's meetings.
- (d) For the year ended 31 December 2003, under the PRC Accounting Regulations, the Company recorded a loss for the year. Accordingly, no profit appropriation of the Company has been made for the year ended 31 December 2003 (2002: nil). Transfer from retained profits to reserves for the year represents the profit appropriation to reserves of certain subsidiaries of the Company.
- (e) Fixed assets of the Group as at 30 June 1996 were revalued as part of the restructuring of the Group, which resulted in a revaluation surplus that formed part of the Company's share capital. The reclassification of the revaluation reserve out of capital reserve has been made in 2002 by reducing "capital reserve" and increasing "revaluation reserve". This change has been done to better present the total amount of revaluation reserve that the Company has since its formation. The revaluation surplus recognised during the restructuring was partially utilised to offset against the revaluation deficit of the same assets arising in 2002 (note 12(a)). Additional valuation surplus arising in 2002 was credited to the revaluation reserve.

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### 31. Deferred Taxation

As at 31 December 2003, the deferred tax assets and liabilities (prior to offsetting of balances within the same tax jurisdiction) were made up of taxation effects of the followings:-

	2003			2002		
	Current RMB'000	Non-current RMB'000	Total RMB'000	Current RMB'000	Non-current RMB'000	Total RMB'000
<b>Group</b>						
Deferred tax assets:-						
Tax losses carried forward	-	312,916	312,916	-	174,472	174,472
Provision for obsolete flight equipment and spare parts	-	41,960	41,960	-	32,608	32,608
Repair cost on flight equipment	-	160,541	160,541	-	203,265	203,265
Provision for post-retirement benefits	2,999	86,734	89,733	2,363	82,417	84,780
Other accrued expenses	108,518	13,744	122,262	69,891	4,981	74,872
	111,517	615,895	727,412	72,254	497,743	569,997
Less: unrecognised assets	-	(258,515)	(258,515)	-	-	-
	111,517	357,380	468,897	72,254	497,743	569,997
Deferred tax liabilities:-						
Provision for overhaul	-	(103,853)	(103,853)	-	(125,887)	(125,887)
Depreciation and amortisation	-	(705,385)	(705,385)	-	(665,083)	(665,083)
Others	-	-	-	-	(11,852)	(11,852)
	-	(809,238)	(809,238)	-	(802,822)	(802,822)
Deferred tax assets/(liabilities), net	111,517	(451,858)	(340,341)	72,254	(305,079)	(232,825)
<b>Company</b>						
Deferred tax assets:-						
Tax losses carried forward	-	312,916	312,916	-	174,472	174,472
Provision for obsolete flight equipment and spare parts	-	43,660	43,660	-	35,588	35,588
Repair cost on flight equipment	-	161,573	161,573	-	204,297	204,297
Provision for post-retirement benefits	2,795	77,900	80,695	2,294	74,952	77,246
Other accrued expenses	64,371	13,744	78,115	34,936	4,981	39,917
	67,166	609,793	676,959	37,230	494,290	531,520
Less: unrecognised assets	-	(258,515)	(258,515)	-	-	-
	67,166	351,278	418,444	37,230	494,290	531,520
Deferred tax liabilities:-						
Provision for overhaul	-	(60,441)	(60,441)	-	(90,735)	(90,735)
Depreciation and amortisation	-	(672,639)	(672,639)	-	(646,874)	(646,874)
Others	-	-	-	-	(11,852)	(11,852)
	-	(733,080)	(733,080)	-	(749,461)	(749,461)
Deferred tax assets/(liabilities), net	67,166	(381,802)	(314,636)	37,230	(255,171)	(217,941)

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### 31. Deferred Taxation (Cont'd)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current liabilities and when the deferred income taxes relate to the same authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheets:

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Deferred tax assets	399,771	569,997	349,318	531,520
Deferred tax liabilities	(740,112)	(802,822)	(663,954)	(749,461)
	<b>(340,341)</b>	<b>(232,825)</b>	<b>(314,636)</b>	<b>(217,941)</b>

In accordance with PRC tax law, tax losses may be carried forward against future taxable income for a period of five years. As at 31 December 2003, the Company had tax losses carried forward approximately RMB2,086 million (2002: RMB1,163 million) which will expire between 2006 and 2008, available to set off against the Company's future taxable income. For the year ended 31 December 2003, the Company did not recognise RMB258,515,000 (2002: nil) of deferred tax asset arising from the tax losses available as management believe it was more likely than not that such tax losses would not be realised before they expire.

Movement in net deferred taxation liability is as follows:-

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
At 1 January	232,825	234,841	217,941	238,663
Charged/(credited) to income statement	118,797	(17,570)	117,580	(28,640)
Charged/(credited) to equity				
– revaluation reserves	(2,518)	20,535	(12,122)	12,899
– unrecognised losses on cashflow hedges	(8,763)	(4,981)	(8,763)	(4,981)
At 31 December	<b>340,341</b>	<b>232,825</b>	<b>314,636</b>	<b>217,941</b>



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### 32. Long-term Payable

	Group and Company	
	2003 RMB'000	2002 RMB'000
At 1 January	172,250	191,448
Less: instalments paid during the year	(30,000)	(30,000)
	142,250	161,448
Interest accrued during the year (note 6)	9,610	10,802
At 31 December	151,860	172,250
Less: Current portion (note 24)	(30,000)	(30,000)
Long-term portion	121,860	142,250

### 33. Minority Interests

	Group	
	2003 RMB'000	2002 RMB'000
At January	404,517	257,205
Contributions from minority shareholders	5,765	12,244
Share of profits of subsidiaries	112,431	122,087
Share of revaluation surplus	–	12,981
At 31 December	522,713	404,517

### 34. Retirement Benefit Plans and Post-Retirement Benefits

#### (a) Defined contribution retirement schemes

##### (i) Pension

Substantially all of the Group employees are eligible to participate in the Group's retirement schemes. The Group participates in defined contribution retirement schemes organised by the municipal governments of the various provinces in which the Group operates. The Group is required to make annual contributions to the schemes at rates ranging from 20% to 22.5% of salary costs including certain allowances calculated in the prior year. Employees contribute at rates ranging from 7% to 8% of their basic salaries. The Group has no other material obligation for the payment of retirement benefits beyond the annual contributions under these schemes. For the year ended 31 December 2003, the Group's pension cost charged to the income statement amounted to RMB121,200,000 (2002: RMB82,876,000).

##### (ii) Medical insurance

In 1998, the State Council announced that each municipal government should introduce a medical insurance scheme for employees and retirees of all enterprises, of which the detailed policies and regulations were to be set out by individual municipal government.



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### 34. Retirement Benefit Plans and Post-Retirement Benefits (Cont'd)

#### (a) Defined contribution retirement schemes (Cont'd)

##### (ii) Medical insurance (Cont'd)

In the end of 2000, the Shanghai Municipal Government promulgated the detailed policies and regulations of its medical insurance scheme. In January 2001, the Group joined this scheme under which the Group and its employees contribute approximately 12% and 2% of the employee's basic salaries to the scheme respectively. The Group has no other obligation for the payment of medical expense beyond the annual contributions. For the year ended 31 December 2003, the Group's medical insurance contribution charged to the income statement amounted to approximately RMB38,000,000 (2002: RMB16,000,000).

#### (b) Post retirement benefits

In addition to the above retirement schemes, the Group provides retirees with post-retirement benefits including transportation subsidies, social function activities subsidies as well as other welfare. The expected cost of providing these post-retirement benefits is actuarially determined and recognised by using the projected unit credit method, which involves a number of assumptions and estimates including the rate of inflation, discount rate, employees' turnover ratio as well as mortality rate.

(i) As at 31 December 2003, the post-retirement benefit obligations recognised in the balance sheets of the Group and the Company were as follows:-

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Present value of unfunded				
post-retirement benefit obligations	533,806	538,794	459,074	462,272
Unrecognised actuarial gains	51,170	21,403	48,702	18,462
	<b>584,976</b>	560,197	<b>507,776</b>	480,734
Payments made in the year	(19,455)	(15,520)	(18,712)	(14,666)
Post-retirement benefit obligations	565,521	544,677	489,064	466,068
Less: current portion (note 24)	(19,750)	(15,753)	(18,635)	(15,290)
Post-retirement benefit obligations				
– long-term portion	545,771	528,924	470,429	450,778

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### 34. Retirement Benefit Plans and Post-Retirement Benefits (Cont'd)

#### (b) Post retirement benefits (Cont'd)

(ii) Changes in post-retirement benefit obligations are as follows:-

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
At 1 January	544,677	521,063	466,068	449,468
Current service cost	13,064	13,081	11,262	11,148
Interest on obligation	27,235	26,053	23,474	22,204
Payment made in the year	(19,455)	(15,520)	(18,712)	(14,666)
Transfer to subsidiaries	-	-	6,972	(2,086)
At 31 December	565,521	544,677	489,064	466,068

(iii) The costs of post-retirement benefits were recognised under wages, salaries and benefits in the consolidated income statement for the year as follows:-

	Group	
	2003 RMB'000	2002 RMB'000
Current service cost	13,064	13,081
Interest on obligation	27,235	26,053
Total (note 5)	40,299	39,134

(iv) Principal actuarial assumptions at the balance sheet date are as follows:-

	2003	2002
Discount rate	5.00%	5.00%
Annual rate of increase of per capita benefit payment	1.50%	1.50%
Employees turnover rate	3.00%	3.00%

### 35. Staff Housing Benefits

#### (a) Staff housing fund

In accordance with the PRC housing reform regulations, the Group is required to make contribution to the State-sponsored housing fund at a range from 1% to 15% (2002: 1% to 15%) of the specified salary amount of its PRC employees. At the same time, the employees are required to make contribution equal to the Group's contribution out of their salaries. The employees are entitled to claim the entire sum of the fund contribution under certain specified withdrawal circumstances. For the year ended 31 December 2003, the Group's contributions to the housing funds amounted to RMB65,300,000 (2002: RMB61,179,000) which is charged to the income statement.



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### 35. Staff Housing Benefits (Cont'd)

#### **(b) Staff housing allowances**

In 2000, the State Council of the PRC issued circulars stipulating that distribution of staff quarters to employees at discounted prices should be withdrawn and cash allowance should be made to employees thereafter. Eligible staff who joined in enterprises prior to 1998 have not been allocated with any quarters or who have not been allocated with a quarter up to the minimum area are entitled to an one-off cash allowance. However, the specific timetable and procedures of implementation of these policies are to be determined by individual provincial or municipal government based on the particular situation of the province or municipality. Certain provincial governments have already set out the implementation procedures while Shanghai Municipal Government is yet to announce such details. Upon the issuance of the government circulars in 2000, the Company's directors estimated a provision of approximately RMB 80,179,000 for staff housing allowance payable to eligible employees who joined in the Group prior to 1998 with reference to staff housing policies already set out by certain provincial governments then. Such provision for staff housing benefits is included in other payables in the Group's consolidated balance sheet as at 31 December 2002 (note 24).

In October 2003, the Board of directors approved a new staff housing policy (the "New Staff Housing Policy") which is extended to cover all existing staff who have not been allocated sufficient housing quarters. The benefit level given to the staff under the New Staff Housing Policy is generally higher as compared to the policies to which the Company's directors made reference in 2000.

Under the New Staff Housing Policy, staff who have not been allocated with any housing quarters or who have not been allocated with a quarter up to the minimum area as set out in the New Staff Housing Policy are entitled to a cash allowance. An eligible staff's entitlement is calculated based on area of quarter entitled and the unit price as set out in the New Staff Housing Policy. The total entitlement is principally vested over a period of 20 years. Upon an employee's resignation, his or her entitlement will cease and any unpaid entitlement related to past services will be paid. Upon the establishment of the New Staff Housing Policy, employees are entitled to a portion of the total entitlement already accrued based on his or her past service period. Such entitlement will be paid over a period of 4 to 5 years. The Group recognised a provision of RMB 340,642,000 as related to its present obligation for its employee's staff housing entitlements, RMB 85,973,000 of which is to be payable in 2004 and is classified as current portion in other payables in the Group's consolidated balance sheet as at 31 December 2003 (note 24). The incremental obligation of RMB 260,463,000 for staff housing benefits as a result of the New Staff Housing Policy was charged to the current year's income statement.

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### 36. Notes to the Consolidated Cashflow Statement

#### (a) Analysis of the balances of cash and cash equivalents

	2003 RMB'000	2002 RMB'000
Cash and bank balances	1,477,409	1,889,647
Short-term deposits with an associate	214,241	94,502
Less: short-term deposits with original maturities over three months	(108,870)	(39,624)
	<b>1,582,780</b>	<b>1,944,525</b>

#### (b) Supplementary information

	2003 RMB'000	2002 RMB'000
Interest received, net of amortisation of bond discount	104,243	75,466
Interest paid, net of amount capitalised	860,304	847,213
Income tax paid	60,845	33,683
Investing activities not affecting cash:–		
Discounts on aircraft acquisition used for purchases of flight equipment and spare parts	50,220	125,728

### 37. Commitments and Contingent Liabilities

#### (a) Capital commitments

As at 31 December 2003, the Group and the Company had the following capital commitments:–

	Group		Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Authorised and contracted for:–				
– Aircraft and related equipment	7,668,801	14,543,622	7,668,801	14,543,622
– Additional investment in subsidiaries	–	–	–	517,183
– Other	358,415	176,810	358,415	57,380
	<b>8,027,216</b>	<b>14,720,432</b>	<b>8,027,216</b>	<b>15,118,185</b>
Authorised but not contracted for:–				
– Aircraft and related equipment	723,000	830,000	–	–
– Additional investment in subsidiaries	–	–	992,183	–
– Other	1,122,526	2,984,270	1,054,650	2,984,050
	<b>1,845,526</b>	<b>3,814,270</b>	<b>2,046,833</b>	<b>2,984,050</b>
	<b>9,872,742</b>	<b>18,534,702</b>	<b>10,074,049</b>	<b>18,102,235</b>

The above commitments mainly include amounts for acquisition of ten A-320, two A340, four A321 aircraft and two A340 engines (2002: twenty A-320 and five A-340 aircraft) for delivery between 2004 and 2005 (2002: between 2003 and 2005).



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### 37. Commitments and Contingent Liabilities (Cont'd)

#### (a) Capital commitments (Cont'd)

Contracted expenditures for the above aircraft and related equipment, including deposits prior to delivery, subject to an inflation increase built in the contracts and any discounts available upon delivery of the aircraft, were expected to be paid as follows:-

	Group and Company 2003 RMB'000
2004	5,129,692
2005	2,539,109
	<b>7,668,801</b>

#### (b) Operating lease commitments

As at 31 December 2003, the Group and the Company had commitments under operating leases to pay future minimum lease rentals as follows:-

	2003		2002	
	Aircraft and flight equipment RMB'000	Land and buildings RMB'000	Aircraft and flight equipment RMB'000	Land and buildings RMB'000
<b>Group</b>				
Within one year	1,063,619	49,532	1,048,361	46,366
In the second year	1,134,669	12,284	837,456	15,272
In the third to fifth year inclusive	2,735,477	24,413	2,144,350	19,915
After the fifth year	1,145,355	11,206	1,938,362	10,436
	<b>6,079,120</b>	<b>97,435</b>	<b>5,968,529</b>	<b>91,989</b>
<b>Company</b>				
Within one year	869,944	45,343	854,673	42,742
In the second year	940,995	12,175	643,767	12,959
In the third to fifth year inclusive	1,910,171	24,313	1,563,284	19,735
After the fifth year	1,080,134	11,206	143,515	10,436
	<b>4,801,244</b>	<b>93,037</b>	<b>3,205,239</b>	<b>85,872</b>

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### 37. Commitments and Contingent Liabilities (Cont'd)

#### (c) *Investment in GE Engine Services (Xiamen) Co., Ltd.*

In May 2001, the Group entered into an agreement with General Electric ("GE"), an unrelated third party, to obtain a 30% interests in GE Engine Services (Xiamen) Co., Ltd. ("GE Xiamen") at a consideration of US\$3.6 million. The Group is not required to settle the consideration immediately and the ownership of the 30% interests in GE Xiamen is conditional upon the Group's fulfilment of a commitment to deliver to GE Xiamen annually a specified percentage of its CFM 56 engines for repair services for a period of 10 years. The Group will be entitled to dividends from GE Xiamen and the dividends received will be used to set off against the consideration payable to GE if this commitment is fulfilled. In 2003, the Group did not send any CFM56 engine to GE Xiamen for repair, nor GE Xiamen declared any dividend.

#### (d) *Contingent liabilities*

As at 31 December 2003, the Group had provided a guarantee to a bank in respect of bank facilities granted to Nanjing Lu Kou International Airport Company ("Lu Kou Airport"). The guarantee is set to expire in 20 October 2004 with the final maturity of the bank loan. The Group's maximum exposure to the guarantee is RMB150,000,000 (2002: RMB150,000,000) and is only payable if Lu Kou Airport defaults in the repayments of its bank loan when they fall due. However, default by Lu Kou Airport is considered remote and therefore no liability was recorded by the Group at the time of the guarantee.

### 38. Segmental Reporting

#### (a) *Primary reporting format by business segment*

The Group operates in one business segment which is the common carriage of passengers, cargo and mail over various routes authorised by CAAC.



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### 38. Segmental Reporting (Cont'd)

#### (b) Secondary reporting format by geographical segment

The Group's turnover and operating profit by geographical segments are analysed as follows:-

	Domestic RMB'000	Hong Kong RMB'000	Japan RMB'000	Other countries(*) RMB'000	Total RMB'000
<b>2003</b>					
<b>Traffic revenues</b>					
– Passenger	5,591,640	1,627,093	977,610	2,064,684	10,261,027
– Cargo and mail	279,003	390,088	588,361	1,929,532	3,186,984
	5,870,643	2,017,181	1,565,971	3,994,216	13,448,011
<b>Other operating revenues</b>	<b>788,811</b>	<b>10,738</b>	<b>8,336</b>	<b>21,262</b>	<b>829,147</b>
<b>Turnover</b>	<b>6,659,454</b>	<b>2,027,919</b>	<b>1,574,307</b>	<b>4,015,478</b>	<b>14,277,158</b>
<b>Segment results</b>	<b>(518,390)</b>	<b>224,683</b>	<b>190,042</b>	<b>322,686</b>	<b>219,021</b>
<b>Unallocated income (note 4)</b>					<b>2,442</b>
<b>Operating profit</b>					<b>221,463</b>
<b>2002</b>					
<b>Traffic revenues</b>					
– Passenger	4,669,731	1,911,016	1,279,083	2,178,000	10,037,830
– Cargo and mail	246,146	257,270	535,915	1,405,336	2,444,667
	4,915,877	2,168,286	1,814,998	3,583,336	12,482,497
<b>Other operating revenues</b>	<b>563,904</b>	<b>–</b>	<b>10,957</b>	<b>21,631</b>	<b>596,492</b>
<b>Turnover</b>	<b>5,479,781</b>	<b>2,168,286</b>	<b>1,825,955</b>	<b>3,604,967</b>	<b>13,078,989</b>
<b>Segment results</b>	<b>(95,766)</b>	<b>448,359</b>	<b>503,628</b>	<b>152,626</b>	<b>1,008,847</b>
<b>Unallocated income (note 4)</b>					<b>226,373</b>
<b>Unallocated costs</b>					<b>(171,753)</b>
<b>Operating profit</b>					<b>1,063,467</b>

(\*) include U.S., Europe and other Asian countries

The major revenue-earning assets of the Group are its aircraft fleet, all of which are registered in the PRC. Since the Group's aircraft fleet is deployed flexibly across its route network, there is no suitable basis of allocating such assets and the related liabilities to geographical segments.

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### 39. Related Party Transactions

(a) **Balances with related companies**

(i) Amounts due from/to related companies

Amounts due from/to related companies arising from trading activities are unsecured, interest free and with no fixed terms of repayment. As at 31 December 2003, such balances mainly included the following:–

**CAAC**

Balances with CAAC comprised civil aviation infrastructure levies payable to CAAC.

**China Eastern Airlines Northwest Co., Ltd. (“CEA Northwest Airlines”)**

Balances with CEA Northwest Airlines comprised amount of air tickets sold by CEA but uplift by CEA Northwest Airlines.

**China Eastern Airlines Yunnan Co., Ltd. (“CEA Yunnan Airlines”)**

Balances with CEA Yunnan Airlines comprised amount of air tickets sold by CEA but uplift by CEA Yunnan Airlines.

**Nanjing Airlines Co., Ltd. (“Nanjing Airlines”)**

Balances with Nanjing Airlines comprised amount of air tickets sold by CEA but uplift by Nanjing Airlines, and lease rental charges for operating lease of aircraft.

(ii) Amounts due from/to associates

**China Eastern Airlines Wuhan Co., Ltd. (“CEA Wuhan Airlines”)**

Balances with CEA Wuhan Airlines comprised amount of air tickets sold by CEA but uplift by CEA Wuhan Airlines.

**Eastern Aviation Import & Export Co., Ltd. (“EAIEC”)**

Balances with EAIEC comprised prepayments and purchases of flight equipment and flight equipment spare parts payable to EAIEC.

**Shanghai Dongmei Aviation Travel Co., Ltd. (“SDATC”)**

Balances with SDATC comprised amount of travelling and accommodation agency services rendered by SDATC.



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### 39. Related Party Transactions (Cont'd)

#### (a) Balances with related companies (Cont'd)

##### (iii) Short-term deposits with an associate

The Group and the Company have short-term deposits of RMB214,241,000 and RMB88,124,000 (2002: RMB94,502,000 and RMB72,826,000) respectively placed with Eastern Air Group Finance Co., Ltd. ("EAGF"), an associate. The short-term deposits yield interest at an average rate of 0.72% per annum (2002: 0.72% per annum).

#### (b) Guarantee by the holding company

As at 31 December 2003, certain long-term bank loans of the Group are guaranteed by CEA Holding (note 27).

#### (c) Related party transactions

Except as disclosed in note 8, the Group had the following material transactions with its related parties in the normal course of business during the year ended 31 December 2003:–

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(i) With CAAC and its affiliates :–</b>			
Commission income on carriage service provided by other airlines with air tickets sold by the Group at fixed rates ranging from 3% to 9% of value of tickets sold	PRC airlines	4,117	6,532
Take-off and landing fees charged at predetermined scale of rates published by CAAC	PRC airports	(1,372,896)	(981,860)
Purchase of aircraft fuel at State controlled prices	Civil Aviation Oil Supply Company	(2,128,628)	(1,616,324)

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### 39. Related Party Transactions (Cont'd)

#### (c) Related party transactions (Cont'd)

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(i) With CAAC and its affiliates (Cont'd):-</b>			
Commission expenses on air tickets sold on behalf of the Group at rates ranging from 3% to 9% of value of tickets sold	– CAAC	<b>(40,204)</b>	(46,207)
	– PRC airlines	<b>(1,080)</b>	(1,885)
Civil aviation infrastructure levies collected on behalf of CAAC and calculated at the rates of 5% and 2% of the Group's annual gross domestic and international traffic revenues respectively	CAAC	<b>(129,646)</b>	(431,162)
Aircraft insurance premium paid through CAAC who entered into the insurance policy on behalf of the Group	CAAC	<b>(157,278)</b>	(178,625)





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### 39. Related Party Transactions (Cont'd)

#### (c) Related party transactions (Cont'd)

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(ii) With CEA Holding or companies directly or indirectly held by CEA Holding:–</b>			
Interest income on deposits at rates of 0.72% per annum (2002: 0.72% per annum)	EAGF	4,096	2,738
Interest expenses on loans at rates of 4.54% per annum (2002: 4.19% to 4.65% per annum)	EAGF	(6,396)	(1,373)
Commission income on carriage service provided by other airlines with air tickets sold by the Group at fixed rates ranging from 3% to 9% of value of tickets sold	– CEA Northwest Airlines	47,457	–
	– CEA Yunnan Airlines	50,442	–
	– CEA Wuhan Airlines	28,964	–
	– Nanjing Airlines	4,210	–
Commission expenses on air tickets sold on behalf of the Group at rates ranging from 3% to 9% of value of tickets sold	– Shanghai Tourism Company (Hong Kong) Limited	(6,046)	(7,944)
	– CEA Northwest Airlines	(17,776)	–
	– CEA Yunnan Airlines	(10,743)	–
	– Certain other subsidiaries of CEA Holding	(25,466)	(39,016)
	– CEA Wuhan Airlines	(8,547)	–
	– SDATC	(24,940)	(11,302)
Purchase of aircraft, flight equipment, flight equipment spare parts and other fixed assets, and repair of aircraft inclusive of handling charges of 0.1% to 2%	EAIEC	(3,100,664)	(3,434,976)

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### 39. Related Party Transactions (Cont'd)

#### (c) Related party transactions (Cont'd)

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(ii) With CEA Holding or companies directly or indirectly held by CEA Holding (Cont'd):-</b>			
Ticket reservation service charges for utilisation of computer reservation system	TravelSky Technology Limited	<b>(71,884)</b>	(72,925)
Repairs and maintenance expenses payable for ground service facilities	Shanghai Eastern Air Industrial Corporation ("SEAIC")	<b>(20,112)</b>	(35,055)
Repairs and maintenance expenses payable for aircraft and engines	Shanghai Eastern Union Aviation Wheels & Brakes Overhaul Engineering Co., Ltd.	<b>(25,361)</b>	(24,146)
Lease rental income from operating lease of aircraft	CEA Wuhan Airlines	<b>31,209</b>	-
Lease rental charges for operating lease of aircraft	- CEA Northwest Airlines	<b>(69,118)</b>	-
	- CEA Yunnan Airlines	<b>(27,726)</b>	-
	- Nanjing Airlines	<b>(23,348)</b>	-
Source of food and beverages	- Eastern Air (Shantou) Economic Development Co., Ltd.	<b>(36,413)</b>	(46,666)
	- Shanghai Eastern Air Catering Co., Ltd.	<b>(96,984)</b>	(117,242)
	- SEAIC	<b>(4,941)</b>	(13,893)
	- Qilu Eastern Air Catering Co., Ltd.	<b>(5,285)</b>	(8,824)
	- Qingdao Air Service Co., Ltd.	<b>(2,518)</b>	(12,751)



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### 39. Related Party Transactions (Cont'd)

#### (c) Related party transactions (Cont'd)

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(ii) With CEA Holding or companies directly or indirectly held by CEA Holding (Cont'd):-</b>			
Advertising expenses	Eastern Aviation Advertising Service Co., Ltd. ("EAASC")	(2,676)	(4,857)
Purchase of aviation equipment	Shanghai Eastern Aviation Equipment Manufacturing Corporation	(3,149)	(8,394)
Inflight hygiene and cleaning service expenses	Shanghai Eastern General Service Co., Ltd.	(20,561)	(1,683)
Printing expenses	Shanghai Aviation Printing Co., Ltd.	(10,447)	(1,594)
Rental expenses	– Shanghai Eastern Aviation Equipment Manufacturing Corporation	(5,945)	(4,509)
	– Shanghai Eastern Real Estate Operation Co., Ltd.	(6,048)	(3,291)
Investment in an associate, EAIEC, a company 55% owned by CEA Holding (note 16)	CEA Holding	(43,820)	–

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### 39. Related Party Transactions (Cont'd)

#### (c) Related party transactions (Cont'd)

Nature of transaction	Related party	Revenue/ (Expenses, payments or purchase consideration)	
		2003 RMB'000	2002 RMB'000
<b>(ii) With CEA Holding or companies directly or indirectly held by CEA Holding (Cont'd):-</b>			
Investment in an associate, China Eastern Air Catering Investment Co., Ltd., 55% interests of which is owned by CEA Holding (note 16)	CEA Holding	(157,500)	-
Investment in an associate, SDATC, 55% interests of which is owned by CEA Holding (note 16)	CEA Holding	(6,828)	-
Additional investment in an associate, EAASC, 55% interests of which is owned by CEA Holding (note 16)	CEA Holding	-	(15,762)

### 40. Financial Risk Management

Financial assets of the Group mainly include short-term deposits and bank balances, deposits with and amounts due from related companies, trade receivables, long-term receivables, bank deposits, zero coupon bonds, short-term investments and derivative assets. Financial liabilities of the Group include bank and other loans, obligations under finance leases, amounts due to related companies, trade payables, derivative liabilities and other payables.

#### (a) Business risk

The operations of the air transportation industry are substantially influenced by global political and economic development. Accidents, wars, natural disasters, etc. may have material impact on the Group's operations or the industry as a whole. In addition, the Group conducts its principal operations in the PRC and accordingly is subject to special consideration and significant risks not typically associated with companies in the United States of America and Western Europe. These include risks associated with, among others, the political, economic and legal environment, competition and influence of CAAC in the PRC civil aviation industry.



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#### 40. Financial Risk Management (Cont'd)

**(b) Price risk**

The Group's results of operations may be significantly affected by the fluctuation of the fuel prices which is a major expense category. While the international fuel prices are determined by worldwide market demand and supply, domestic fuel prices are regulated by CAAC. It is the Group's plan to strengthen the control over the fuel price risk through financial derivatives.

**(c) Interest rate risk**

The Group has significant bank borrowings and is exposed to risk arising from changes in market interest rates. To hedge against the change in market interest rates, the Group entered into certain interest rate swaps during the year (note 41(a)). The interest rates and terms of repayment of loans made to the Group are disclosed in notes 26, 27 and 28.

**(d) Credit risk**

The Group has no significant concentrations of credit risk. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any one financial institution.

- (i) Deposits with an associate and cash and bank balances  
Substantially all the Group's cash and bank balances are placed with a number of international and PRC banks and an associate, EAGF. Details of deposits placed with EAGF have been disclosed in note 39(a)(iii).
- (ii) Trade receivables  
These are mainly tickets sales receivable from sales agents and receivables related to uplifts by the Company on behalf of other carriers which are spread among numerous third parties.
- (iii) Other receivables  
These are spread among numerous third parties.
- (iv) Amounts due from or to the related companies  
These balances are disclosed in note 39 (a).



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#### 40. Financial risk management (Cont'd)

**(d) Credit risk (Cont'd)**

**(v) Short-term investments**

Short-term investments as at 31 December 2002 were placed with a PRC financial institution which executes the buying or selling securities on behalf of the Group, the short-term investments have been fully settled during the year ended 31 December 2003.

**(e) Liquidity risk**

The Group's primary cash requirements have been for additions of and upgrades on aircraft and flight equipment and payments on related debts. The Group finances its working capital requirements through a combination of funds generated from operations and short-term bank loans. The Group generally acquires aircraft through long-term finance leases. To take advantage of the low interest rate for long-term loans, recently the Group also purchased certain number of aircraft through long-term loans from banks in the PRC.

The Group generally operates with a working capital deficit. As at 31 December 2003, the Group's net current liabilities amounted to RMB 9,941million (2002: RMB7,437 million). For the year ended 31 December 2003, the Group recorded a net cash inflow from operating activities of RMB 3,267 million (2002: RMB2,160 million), a net cash outflow from investing activities and financing activities of RMB 3,645 million (2002: RMB1,587 million), and a decrease in cash and cash equivalents of RMB378 million (2002: increase of RMB574 million).

The directors of Company believe that cash from operations and short-term bank borrowings will be sufficient to meet the Group's operating cashflow. Due to the dynamic nature of the underlying businesses, the Group treasury aims at maintaining flexibility in funding by keeping credit lines available. The directors of the Company believe that the Group has obtained sufficient general credit facilities from PRC banks for financing future capital commitments and for working capital purposes.



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#### 40. Financial risk management (Cont'd)

##### (f) Foreign currency risk

The Group's finance lease obligation as well as certain bank and other loans are denominated in US dollars, Japanese Yen and Euro, and certain expenses of the Group are denominated in currencies other than RMB. The Group generates foreign currency revenues from ticket sales made in overseas offices and would normally generate sufficient foreign currencies after payment of foreign currency expenses, to meet its foreign currency liabilities repayable within one year. RMB against US dollars had been comparatively stable in the past. However, RMB against Japanese Yen and Euro had experienced a significant level of fluctuation over the past two years which is the major reason for the significant exchange differences recognised by the Group for the years ended 31 December 2002 and 2003.

The Group enters into certain foreign currency forward contracts with PRC banks to hedge against foreign currency risk (note 41(b)).

##### (g) Fair value

The carrying amounts and estimated fair value of the Group's significant financial assets and liabilities at 31 December 2003 are set out as follows:-

	Group and Company			
	2003		2002	
	Carrying amount RMB'000	Fair value RMB'000	Carrying amount RMB'000	Fair value RMB'000
Long-term bank loans	11,222,923	10,131,805	6,494,631	5,939,491
Obligations under finance leases	7,100,886	7,069,346	8,183,966	8,202,528
Long-term bank deposits	1,743,924	1,840,139	1,463,044	1,547,671

The fair values of the long-term bank loans, obligation under finance leases and long-term bank deposits are estimated by applying a discounted cashflow approach using current market interest rates for similar indebtedness/investment.

The fair value of cash and bank balances, trade receivables, other receivables, amounts due from and to related companies, trade payables, other payables and short-term bank loans are not materially different from their carrying amounts because of the short maturities of these instruments.



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#### 40. Financial risk management (Cont'd)

##### (g) Fair value (Cont'd)

Investments in subsidiaries and associates represent unquoted equity interests in companies established in the PRC. There is no quoted market price for such interests and accordingly a reasonable estimate of their fair value could not be made without incurring excessive costs.

Fair value estimates are made at specific point in time and are based on relevant market information. This estimate is subjective in nature and involves uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in valuation methods and assumptions could significantly affect the estimates.

#### 41. Derivative Financial Instruments

	Group and Company	
	Assets RMB'000	Liabilities RMB'000
<b>At 31 December 2003</b>		
Interest rate swaps (note (a))	2,814	40,390
Forward foreign exchange contracts (note (b))	–	54,047
	<b>2,814</b>	<b>94,437</b>
<b>At 31 December 2002</b>		
Interest rate swaps (note (a))	–	37,261
Forward foreign exchange contracts (note (b))	9,891	5,836
	<b>9,891</b>	<b>43,097</b>

##### (a) Interest rate swaps

The Group uses interest rate swaps to reduce risk of changes in market interest rates (note 40(c)). The interest rate swaps entered into by the Group fulfill the criteria for hedge accounting and are accounted for as cashflow hedge. As at 31 December 2003, the notional amount of the outstanding interest rate swap agreements was approximately US\$164 million (2002: US\$96 million) which will expire between 2004 and 2010. For the year ended 31 December 2003, a net loss of RMB315,000 (2002: RMB 37,261,000) arising from changes in the fair value of the interest rate swaps subsequent to initial recognition is recognised directly in the hedging reserve (note 30).





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### 41. Derivative Financial Instruments (Cont'd)

#### *(b) Forward foreign exchange contract*

The Group uses currency forward contracts to reduce risks of changes in currency exchange rates in respect of ticket sales and expenses denominated in foreign currencies (note 40(f)). The Group's currency forward contracts qualify for hedging accounting and are accounted for as cashflow hedges. These currency forward contracts will expire between 2004 and 2010. For the year ended 31 December 2003, a net loss of RMB58,102,000 (2002: RMB1,341,000) arising from changes in the fair value of these foreign currency forwards subsequent to initial recognition is recognised directly in the hedging reserve (note 30).

### 42. Ultimate Holding Company

The directors regard CEA Holding, a company established in the PRC, as being the ultimate holding company.

### 43. Post Balance Sheet Date Event

Subsequent to the balance sheet date, the Company entered into an agreement with Rockwell Collins International Inc ("RCI"), to establish Collins Aviation Maintenance Service Shanghai Limited ("CAMSSL"), a joint venture which will be principally engaged in the provision of repair and maintenance services for avionics and aircraft entertaining facilities in the PRC. The registered capital of CAMSSL is RMB 57,943,000, which is to be contributed by the Company and RCI at 35% and 65% respectively.