1 GROUP REORGANISATION AND PRINCIPAL ACTIVITIES

The Company was established in the People's Republic of China ("PRC") on 30th April 2003 as a joint stock company with limited liability under the PRC laws as a result of a group reorganisation (the "Reorganisation") of China Aviation Industry Corporation II ("AVIC II" or "Holding Company") in the preparation for the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited.

In accordance with the reorganisation agreement entered into among the Company, AVIC II, 中國華融資產管理公司 ("China Hua Rong Asset Management Corporation" or "Hua Rong"), 中國信達資產管理公司 ("China Cinda Asset Management Corporation" or "Cinda") and 中國東方資產管理公司 ("China Orient Asset Management Corporation" or "Orient") (the "Reorganisation Agreement") effective as of 30th April 2003 (the "date of Reorganisation"), the Company issued 2,981,388,500 shares of RMB1.00 per share to AVIC II in exchange for various assets and liabilities relating to the manufacture, assembly, sales and servicing of automobiles, helicopters, jet trainers and aircraft, transferred to the Company by AVIC II. In addition, 104,620,000 shares, 15,470,000 shares and 15,040,000 shares, all of RMB 1.00 each, were issued to Hua Rong, Cinda and Orient (collectively the "Asset Management Companies") respectively for the transfer of their equity interests of 14.61%, 2.16% and 2.1% in Harbin Aircraft Industry Group, Ltd ("Hafei Industry Company") to the Company respectively.

The aggregate number of shares issued in this connection amounting to 3,116,518,500 shares were the initial registered capital of the Company with a par value of RMB1.00 per share (collectively the "Domestic Shares"). Shareholder's rights are governed by the PRC Company Law, which requires an increase in registered capital to be approved by shareholders in general meeting and the relevant PRC government and regulatory authorities.

Pursuant to the Reorganisation, AVIC II transferred to the Company certain of its assets, liabilities and interests in the PRC related to (i) the development, manufacture and sales of mini-sized vehicles, economy sedan, and auto motors engines, (ii) the development, manufacture, sales and modification of civilian aircraft, helicopters and related aviation products, (iii) a helicopter research institute, and (iv) an electrical aviation products development company (collectively the "Transferred Businesses").

AVIC II retained assets, liabilities and interests related to the (i) design, research and development, manufacture and sales of non-civilian aircraft (ii) manufacture and sales of motor parts, (iii) ownership of certain assets and liabilities including staff quarters, certain office buildings, bank balances, investments in securities, borrowings and tax liabilities, and (iv) provision of social welfare and the operations that provided ancillary support services.

During the year, the Company completed its initial public offering and placing of 1,679,800,500 H Shares (the "Offering") which comprised 1,527,090,000 new shares issued by the Company and 152,710,500 shares offered by AVIC II and the Asset Management Companies (collectively the "Promoters"). As a result, the issued share capital of the Company increased from 3,116,518,500 shares to 4,643,608,500 shares, comprising 2,963,808,000 Domestic Shares and 1,679,800,500 H Shares, representing 63.83% and 36.17% of the issued capital respectively.

2 BASIS OF PREPARATION

As AVIC II controlled the Transferred Businesses before the Reorganisation and continues to control the Company after the Reorganisation, the consolidated financial statements of the Group for the years ended 31st December 2002 and 2003 have been prepared as a reorganisation of business under common control in a manner similar to a uniting of interests. Accordingly, the assets and liabilities transferred to the Company have been stated at historical amounts.

The consolidated financial statements of the Group for the years ended 31st December 2002 and 2003 present the consolidated results and the state of affairs of the Group as if the Group had been in existence throughout the period and as if the Transferred Businesses were transferred to the Company by AVIC II at 1st January 2002 or when such businesses were acquired by AVIC II, whichever is later. The Company's directors are of the opinion that the consolidated financial statements prepared on this basis present fairly the consolidated financial position, consolidated results and consolidated cash flows of the Group as a whole. Therefore, the net profit for the year ended 31st December 2003 includes the consolidated results before the Reorganisation.

As set out in Note 1 to the financial statements, the Group increased its interests in the assets and liabilities in Hafei Industry Company previously owned by the Asset Management Companies from 81.13% to 100% with effect from 30th April 2003. Accordingly, the minority interests in Hafei Industry Company have been recognised in the consolidated profit and loss account and consolidated cash flow statements up to 30th April 2003, and in the consolidated balance sheet as of 31st December 2002.

The financial statements include the historical costs of operations relating to the Transferred Businesses. Expenses that could be specifically identified include the following:

- purchases of goods and services;
- staff costs (excluding those attributable directly to administration staff);
- depreciation (excluding those attributable directly to property, plant and equipment used for general and administrative functions);
- selling and distribution expenses;
- research and development costs;
- taxes other than income taxes; and
- finance costs

Costs for which a specific identification method was not practical include only general and administrative expenses, which are allocated to the Group by AVIC II based on the average of the percentages of the respective historical number of employees, assets and turnover of the Transferred Businesses to the total historical number of employees, assets and turnover of AVIC II.

2 BASIS OF PREPARATION (continued)

As the Company was only established on 30th April 2003, there are no comparative figures in the Company's balance sheet as at 31st December 2002.

The preparation of the financial statements requires management to make 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 year. Actual results could differ from these estimates.

3 PRINCIPAL ACCOUNTING POLICIES

The acounts have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except that non-current investments and trading investments are shown at fair value as disclosed in Note 3(h) of the accounting policies below.

(a) Basis of consolidation

The financial statements include the financial statements of the Company, its subsidiaries and associates as set out in Note 43. The results of operations of subsidiaries are included in the consolidated profit and loss account, and the share attributable to minority interests is deducted from the consolidated net profits.

(b) Subsidiaries

Subsidiaries are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations and are consolidated. Subsidiaries are included from the date on which control is transferred to the Group and are excluded from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses, if any, are also eliminated unless cost cannot be recovered. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Investments in subsidiaries are accounted for using the equity method in the Company's financial statements. Equity accounting involves recognising in the profit and loss account the Company's share of the subsidiaries' profit or loss for the year. The Company's interests in the subsidiaries are carried in the balance sheet at amounts that reflect its share of the net assets of the subsidiaries.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(c) Associates

Associates are entities, not being subsidiaries, 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.

Investments in associates are accounted for by the equity method of accounting. Equity accounting involves recognising in the consolidated profit and loss account the Group's share of the profit or loss of the associates for the year; and the consolidated balance sheet includes the Group's share of the net assets of the associates. 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, if any, are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Equity accounting is discontinued when the carrying amount of the investment in an associate reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associate.

(d) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes the purchase price of the asset and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Depreciation is calculated on a straight-line basis to write off the cost less accumulated impairment losses of each asset to their residual values over their estimated useful lives as follows:

Buildings	12 - 45 years
Plant and equipment	5 - 18 years
Furniture and fixtures, other equipment and motor vehicles	4 - 10 years

Pursuant to a resolution passed by the board of directors of Harbin Dongan Auto Engine Co., Limited ("Dongan"), a subsidiary of the Group, during the year, the directors of Dongan reassessed the estimated useful lives and residual values of property, plant and equipment in Dongan, after taking into account the current business environment, condition and the expected pattern of economic benefits from the respective assets, and approved to revise the accounting estimates accordingly. The revised accounting estimates on depreciation of each class of assets are within the range of the Group as shown above. The aggregate effect of the changes is that depreciation charge for the year has been increased by RMB59,322,000 and the Group's profit attributable to shareholders for the year has been decreased by RMB44,290,000.

Expenditure incurred after the property, plant and equipment have been put into operation, such as repairs and maintenance and overhead costs, is normally charged to the consolidated profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the property, plant and equipment, the expenditure is capitalised as an additional cost of the assets.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(d) Property, plant and equipment (continued)

Property, plant and equipment are reviewed periodically for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Estimated recoverable amount is determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the consolidated profit and loss account.

(e) Construction-in-progress

Construction-in-progress represents buildings, plant and machinery under construction and pending installation and is stated at cost. Cost includes the costs of construction of buildings, the costs of plant and machinery, and interest charges arising from borrowings used to finance these assets during the period of construction or installation and testing. All other borrowing costs are expensed. No provision for depreciation is made on construction-in-progress until such time as the relevant assets are completed and ready for intended use. When the assets concerned are brought into use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated in Note 3(d) to the financial statements.

(f) Land use rights

Land use rights are stated at cost less accumulated amortisation and impairment losses. Cost represents consideration paid for the rights to use the land on which various plants and buildings are situated for periods varying from 30 to 50 years. Amortisation of land use right is calculated on a straight-line basis over the period of the land use right.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Intangible assets

(i) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets to the extent that such expenditure is expected to generate future economic benefits. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit. The amortisation periods adopted do not exceed five years.

Where the research phase and the development phase of an internal project cannot be clearly distinguished, all expenditure incurred on the project is charged to the consolidated profit and loss account.

(ii) Electricity use rights

Expenditure on acquired electricity use rights is capitalised and amortised using the straight-line method over the period of electricity use rights of 30 years.

(iii) Impairment of intangible assets

Intangible assets are reviewed periodically for impairment losses whenever events or changes in circumstance indicate that the carrying amount of the asset may not be recoverable.

When the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Estimated recoverable amount is determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price.

(h) Investments

The Group classified its investments into the following categories: held-to-maturity, available-for-sale and trading.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the year, the Group did not hold any investment in this category.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(h) Investments (continued)

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are categorised as available-for-sale investments and are classified as non-current investments; these are included in non-current assets unless management has the express intention of holding the investment for less than twelve months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. Cost of purchase includes transaction costs. Trading and non-current investments are subsequently carried at fair value.

Non-current investments where an active market exist, are measured at their fair values. Those that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at amortised cost using the effective interest rate method if they have a fixed maturity, or are measured at cost if they do not have a fixed maturity. Impairment of the investments is assessed at each balance sheet date. Unrealised gains and losses arising from changes in the fair value of non-current investments are recognised in equity. Where non-current investments are sold or impaired, the accumulated fair value adjustments are included in the profit and loss account as gains and losses from investments.

Realised and unrealised gains and losses arising from changes in the fair value of trading investments are included in the consolidated profit and loss account in the period in which they arise.

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined by the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(j) Contracts in progress

Contracts in progress in connection with the manufacturing of aircraft are accounted for under construction contracts.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred and that it is probable to be recoverable; and contract costs are recognised when incurred.

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs are recognised over the period of the contract, respectively, as revenue and expenses. The Group uses the percentage of completion method with reference to stage of completion to determine the appropriate amount of revenue and costs to recognise in a given period. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

In determining costs incurred up to the balance sheet date, any costs relating to future activity on a contract are excluded and shown as a contract work in progress. The aggregate of the costs incurred and the profit and loss recognised on each contract is compared against the progress billings up to the balance sheet dates.

Where costs incurred and recognised profits (less recognised losses) exceed progress billings, the balance is shown as due from customers on construction contract under accounts receivable. Where progress billings exceed costs incurred plus recognised profits (less recognised losses), the balance is shown as due to customers on construction contract, under other payables.

(k) Accounts receivable

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

(l) Cash and cash equivalents

Cash and cash equivalents are carried in the consolidated balance sheet at cost. For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and deposits held at call with banks.

(m) Borrowings

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the consolidated profit and loss account over the period of the borrowings.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(n) Borrowings costs

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed as incurred.

(o) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements for financial reporting purposes. The principal temporary differences arise from provision for impairment of receivables and inventories, provision for impairment of property, plant and equipment, provision for tax value of losses carried forward and capitalisation of development costs. Tax rates enacted or substantively enacted by the balance sheet date are used to determine 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.

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

(p) Employee benefits

(i) Pension obligations

The Group contributes on a monthly basis to various defined contribution retirement benefit plans organised by relevant municipal and provincial governments in the PRC. The municipal and provincial governments undertake to assume the retirement benefit obligations payable to all existing and future retired employees under these plans and the Group has no further obligation for post-retirement benefits beyond the contributions made. Contributions to these plans are expensed as incurred.

In addition, the Group also made supplementary pension subsidies to certain employees, who retired or early retired before the commencement of the above defined contribution retirement benefit plans, prior to the Reorganisation. As detailed in Note 32(a), the pension and related costs in respect of these former employees as of 30th June 2002 were assessed using the projected unit credit method: the cost of providing pensions was charged to the consolidated profit and loss account so as to spread the service cost over the average service lives of such former employees, in accordance with the advice of the actuaries who carried out full valuations of the plans at 30th June 2002. Employees who retire after 30th June 2002 will no longer be entitled to such supplementary pension subsidies.

These supplementary pension obligations were measured as the present value of the estimated future cash outflows using interest rates of government securities which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses were recognised in the period in which they incurred.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(p) Employee benefits (continued)

(ii) Early retirement benefits

Early retirement benefits are recognised as expense in the period the Group reaches agreements with the relevant employees for the early retirement.

(iii) Housing benefits

The Group sold staff quarters to its employees, subject to a number of eligibility requirements, at preferential prices. When staff quarters are identified as being subject to sale under these arrangements, the carrying value of the staff quarters is written down to the net recoverable amount. Upon sale, any difference between sales proceeds and the carrying amount of the staff quarters is charged to the consolidated profit and loss account.

The above discounted quarters allocation plans were phased out in accordance with the policies of the PRC government. In 1998, the State Council of the PRC issued a circular which stipulated that the sale of quarters to employees at preferential prices should be withdrawn. In 2000, the State Council further issued a circular stating that cash subsidies should be made to the employees following the withdrawal of allocation of staff quarters. 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.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who have not been allocated with quarters at all or who have not been allocated with quarters up to the prescribed standards before the discounted quarters sale plans were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. These cash housing subsidies are charged to the consolidated profit and loss account in the year in which it was determined that the payment of such subsidies is probable and the amounts can be reasonably estimated. Based on the available information and its best estimate, the Group estimated the required provision for these cash housing subsidies which was charged to the consolidated profit and loss account in the year ended 31st December 2000 when the State Council circular in respect of cash subsidies was issued.

Pursuant to the Reorganisation, AVIC II would bear any further one-off cash housing subsidies in excess of the amount provided for in the consolidated balance sheets of the Group. Employees joining the Group after the incorporation of the Company would not be entitled to any one-off cash housing subsidies.

In addition, all full-time employees of the Group are entitled to participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(q) 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, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The costs of the warranty obligation are accrued at the time the sales are recognised, based on the estimated costs of fulfilling the total obligations, including handling and transportation costs. The assumptions used to estimate warranty expenses are evaluated periodically and based on historical experience.

(r) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated profit and loss account on a straight-line basis over the period of the lease.

Assets leased out under operating leases are included in property, plant and equipment in the consolidated balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income is recognised on a straight-line basis over the lease term.

(s) Foreign currency translation

The Group maintains its books and records in RMB. Transactions in other currencies are translated into RMB at the applicable rates of exchange stipulated by the People's Bank of China ("PBOC") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are translated into RMB at the applicable PBOC rates prevailing at the balance sheet date. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated profit and loss account.

(t) Contingent liabilities

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

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

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(u) Revenue recognition

Turnover represents revenues recognised on sales of automobiles and aviation products, net of VAT, if any.

Sales are recognised upon delivery of products and customer acceptance, if any, or on the performance of services. Sales are shown net of sales taxes and discounts, and after eliminating sales within the Group. Revenues are recognised only when the Group has transferred to the customers the significant risks and rewards of ownership of the goods, and when the amount of revenue and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Recognition policy of revenue relating to long-term construction contracts is disclosed in Note 3 (j) above.

Rental income under operating leases is recognised on a straight-line basis over the lease periods.

Interest income from bank deposits is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

Revenue from the provision of technical consultancy services is recognised when the services are rendered.

Dividend income and income from investments are recognised when the right to receive payment is established.

(v) Government grants

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 consolidated profit and loss account over the period necessary to match them with the costs they are intended to compensate.

Government grants related to the purchase of property, plant and equipment are included in non-current liabilities as deferred income from government grants and are credited to the consolidated profit and loss account on a straight line basis over the expected lives of the related assets.

(w) Financial instruments

Financial instruments carried on the consolidated balance sheet include cash and bank balances, deposits in approved financial institutions, investments, accounts receivable and other receivables, trade payables, borrowings and other payables. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies.

Disclosures about financial instruments of the Group are provided in Note 40 to the financial statements.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(x) Dividends/Profit distributions

Profit distributions proposed or declared after the balance sheet date are disclosed as a post balance sheet event and are not recognised as a liability at the balance sheet date. This has been applied throughout the year.

(y) Segment reporting

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

Operating expenses of a functional unit are allocated to the relevant segment which is the predominant user of the services provided by the unit. Operating expenses of other shared services which cannot be allocated to a specific segment are included as unallocated costs. Unallocated costs mainly represent corporate expenses.

Segment assets consist primarily of property, plant and equipment, land use rights, intangible assets, inventories, operating receivables and cash and cash equivalents, and mainly exclude deferred tax assets, investments in associates and corporate assets. Segment liabilities comprise operating liabilities and exclude items such as employee benefits, current and deferred tax liabilities, and corporate liabilities. Capital expenditures mainly comprise additions to property, plant and equipment, land use rights and intangible assets.

(z) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

The Group is a large group of companies under AVIC II and has significant transactions and relationships with other entities under AVIC II. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

AVIC II itself is owned by the PRC Government. There are also other enterprises directly or indirectly owned or controlled by the PRC Government ("state-owned enterprises"). As the Group will carry out its business activities in the ordinary course of business in the PRC with the PRC Government or state-owned enterprises both directly through their numerous authorities and indirectly through their numerous affiliates and other organisations, the Group considers that these sales are activities in the ordinary course of business in the PRC. Accordingly, transactions with the PRC Government or state-owned enterprises whose relationship with the Group were merely by virtue of common control or significant influence by the PRC Government are not disclosed as related party transactions.

4 SEGMENT INFORMATION

The Group is principally engaged in the manufacturing, assembly, sales and servicing of automobiles and civilian aircraft.

Primary reporting format — business segments

The Group is organised into two main business segments:

- Automobiles — manufacturing, assembly, sales and servicing of automobiles.
- Aviation — manufacturing, assembly, sales and servicing of helicopters, trainers and aircraft.

Secondary reporting format — geographical segments

All assets and operations of the Group for the year were located in the PRC, which is considered as one geographical location in an economic environment with similar risk and returns.

No geographical segments analysis is presented as less than 10% of the Group's turnover and contribution to operating profit is attributable to markets outside the PRC.

4 SEGMENT INFORMATION (continued)

Primary reporting format — business segments

	2003		
	Aviation	Automobiles	Total
	RMB'000	RMB'000	RMB'000
Operating results			
Turnover	2,585,125	12,480,817	15,065,942
Segment results	280,523	597,212	877,735
Other revenues			85,477
Other operating income			31,901
Unallocated costs			(6,697)
Operating profit			988,416
Finance costs, net			(209,873)
Share of results of associates before taxation	(6,888)	(6,923)	(13,811)
Profit before taxation			764,732
Taxation			(60,830)
			703,902
Minority interests			(251,828)
Profit for the year			452,074
Assets			
Segment assets	4,428,125	14,019,552	18,447,677
Investments in associates	78,878	87,181	166,059
Unallocated assets*			2,187,501
Total assets			20,801,237

4 SEGMENT INFORMATION (continued)

Primary reporting format — business segments (continued)

	2003		
	Aviation	**Automobiles**	**Total**
	RMB'000	**RMB'000**	**RMB'000**
Liabilities			
Segment liabilities	**1,882,351**	**9,924,907**	**11,807,258**
Unallocated liabilities			**974,813**
Total liabilities			**12,782,071**
Other segment items			
Capital expenditure	**283,951**	**1,390,689**	**1,674,640**
Depreciation	**93,563**	**569,032**	**662,595**
Amortisation	**176**	**38,448**	**38,624**
Other non-cash expenses	**34,618**	**80,974**	**115,592**

* Unallocated assets mainly represent proceeds from issue of shares by the Company amounting to approximately RMB2,167 million.

4 SEGMENT INFORMATION (continued)

Primary reporting format — business segments (continued)

	2002		
	Aviation	Automobiles	Total
	RMB'000	RMB'000	RMB'000
Operating results			
Turnover	1,890,951	9,418,440	11,309,391
Segment results	220,340	606,578	826,918
Other revenues			51,638
Unallocated costs			(35,193)
Operating profit			843,363
Finance costs, net			(139,058)
Share of results of associates before taxation	(270)	3,176	2,906
Profit before taxation			707,211
Taxation			(124,597)
			582,614
Minority interests			(185,899)
Profit for the year			396,715
Assets			
Segment assets	3,976,959	12,565,133	16,542,092
Investments in associates	28,241	54,439	82,680
Unallocated assets			68,927
Total assets			16,693,699

4 SEGMENT INFORMATION (continued)

Primary reporting format — business segments (continued)

	2002		
	Aviation	Automobiles	Total
	RMB'000	RMB'000	RMB'000
Liabilities			
Segment liabilities	2,116,195	8,494,836	10,611,031
Unallocated liabilities			717,277
Total liabilities			11,328,308
Other segment items			
Capital expenditure	353,474	2,117,795	2,471,269
Depreciation	58,575	384,434	443,009
Amortisation	181	20,084	20,265
Provision for impairment of property, plant and equipment	4,151	1	4,152
Other non-cash expenses	6,309	43,722	50,031

5 OTHER REVENUES

	2003	2002
	RMB'000	RMB'000
Sales of scrap materials	**19,173**	9,762
Income from investments and designated deposits	**18,935**	18,006
Amortisation of government grants	**15,046**	—
Discretionary value-added tax and real estate tax refund (note)	**14,287**	7,437
Technical consultancy services	**14,266**	9,175
Rental income from plant and equipment	**3,770**	7,258
	85,477	51,638

Note:

Pursuant to relevant tax laws and regulations, certain subsidiaries of the Group are entitled to refunds of certain real estate tax and value-added tax for sales of aircraft.

6 OPERATING PROFIT

Operating profit is stated after charging/(crediting) the following:

	2003	2002
	RMB'000	RMB'000
Auditors' remuneration	**5,615**	1,578
Amortisation of land use rights (included in "Administrative expenses") (Note 15)	**4,307**	3,224
Amortisation of intangible assets (Note 16)		
— electricity use rights (included in "Administrative expenses")	**1,259**	1,259
— development costs (included in "Administrative expenses")	**33,058**	15,782
Costs of inventories recognised as expenses included in cost of sales (note)	**12,414,260**	8,885,468
Depreciation on property, plant and equipment (Note 14)	**662,595**	443,009
Gain on disposal of subsidiaries (Note37 (d))	**(31,901)**	—
Loss on disposal of property, plant and equipment	**7,920**	2,327
Operating lease rentals in respect of		
— land and buildings	**57,035**	60,380
— plant and machinery	**1,967**	3,570
Provision for impairment of property, plant and equipment (included in "Administrative expenses") (Note 14)	**—**	4,152
Provision for impairment of receivables	**75,920**	31,429
Repairs and maintenance expense on property, plant and equipment	**15,140**	15,028
Research and development expense	**63,225**	105,357
Staff costs (Note 13)	**903,410**	855,923
Warranty expense (Note 32)	**104,527**	70,654
Write-down of inventories to net realisable value	**39,672**	18,602

Note:

Costs of inventories recognised as expenses include purchases, direct employee compensation costs and the relevant depreciation.

7 FINANCE COSTS, NET

	2003 RMB'000	2002 RMB'000
Interest expense on bank loans and overdrafts		
— wholly repayable within 5 years	**243,081**	240,649
— not wholly repayable within 5 years	**2,880**	2,880
Interest expense on other loans		
— wholly repayable within 5 years	**782**	890
— not wholly repayable within 5 years	**121**	121
Less: amount capitalised in property, plant and equipment (note (a))	**(33,477)**	(42,306)
Less: government interest subsidies (note (b))	**(23,618)**	(17,880)
	189,769	184,354
Interest income on bank balances and deposits	**(41,382)**	(43,277)
Exchange losses/(gains), net	**54,722**	(3,420)
Bank charges	**6,764**	1,401
	209,873	139,058

Note:

(a) Amounts capitalised are borrowing costs related to funds borrowed specifically for the purpose of obtaining a qualifying asset. Interest rates on such capitalised borrowings are as follows:

	2003	2002
Interest rates per annum at which finance costs were capitalised	**3.69% to 6.63%**	3.69% to 7.65%

(b) Interest subsidies have been granted by local governments to certain subsidiaries of the Group as an encouragement to technical innovation and improvements.

8 TAXATION

	2003 RMB'000	2002 RMB'000
PRC current income tax	**64,761**	120,788
Deferred taxation	**(4,735)**	2,796
Share of taxation attributable to associates	**804**	1,013
	60,830	124,597

The provision for PRC current income tax is calculated based on the statutory income tax rate of 33% of the assessable income of the Group as determined in accordance with the relevant PRC income tax rules and regulations for the year (2002: 33%), except for certain subsidiaries or associates which are taxed at preferential rates ranging from 0% to 30% (2002: 0% to 30%) based on the relevant PRC tax rules and regulations.

(a) The reconciliation between the Group's actual tax charge and the amount which is calculated based on the statutory tax rate of 33% in the PRC is as follows:

	2003 RMB'000	2002 RMB'000
Profit before taxation	**764,732**	707,211
Tax calculated at the statutory tax rate of 33%	**252,362**	233,380
Preferential tax rates on the income of certain subsidiaries and associates	**(101,624)**	(52,588)
Non-taxable income	**(123,883)**	(90,648)
Expenses not deductible for tax purposes	**12,852**	30,575
Deferred tax benefits arising from tax losses in certain entities not recognised (note)	**40,741**	11,635
Utilisation of prior year unrecognised tax losses	**(18,652)**	(6,557)
Others	**(966)**	(1,200)
Tax charge	**60,830**	124,597

Note:

The tax losses in certain entities in which deferred tax benefits have not been recognised are expiring within 5 years.

9 PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders is dealt with in the accounts of the Company to the extent of RMB354,535,000.

10 DIVIDENDS/PROFIT DISTRIBUTIONS

	2003	2002
	RMB'000	RMB'000
Profit distributions (note (i))	**67,697**	216,539
Special dividend (note (ii))	**7,125**	—
Final dividend, proposed of RMB0.0105 per share (note (iii))	**48,758**	—
	123,580	216,539

(i) The profit distributions disclosed during the years ended 31st December 2002 and 2003 represent profit distributions and dividends declared by the relevant subsidiaries of the Group to their then owners or shareholders prior to the completion of the Reorganisation of the Group, after setting aside a required percentage of their net profits to the relevant statutory reserves in accordance with the rules and regulations applicable in the PRC and the Articles of Association of the relevant subsidiaries.

The rates of dividend and the number of shares ranking for dividends are not presented for those profit distributions as such information is not meaningful.

(ii) Pursuant to the Reorganisation, the Company agreed to distribute a special dividend to AVIC II immediately after its establishment, which represents the undistributed profit of the Group for the period from 1st July 2002 to 30th April 2003, as determined in accordance with the PRC GAAP, amounting to approximately RMB7,125,000 (see also Note 36(c)).

(iii) At a meeting held on 5th April 2004, the directors proposed a final dividend of RMB0.0105 per share. This proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31st December 2004.

11 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(a) Directors' emoluments

Details of emoluments paid and payable to the directors of the Company by the Group in respect of their services rendered for managing the business of the Group during the year are as follows:

	2003 RMB'000	2002 RMB'000
Fees	91	—
Other emoluments		
Basic salaries, housing allowances, other allowances and benefits in kind	1,380	1,072
Contributions to retirement schemes	42	58
	1,513	1,130

Director emoluments for the year ended 31st December 2002 represent historical amounts incurred by the Group.

Directors' fees disclosed above include RMB91,000 (2002: Nil) paid to independent non-executive directors.

No director of the Company waived any emoluments during the years ended 31st December 2002 and 2003.

The emoluments of the directors are within the following band:

	Number of directors	
	2003	2002
Nil - RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	13	11

11 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(b) Supervisors' emoluments

	2003	2002
	RMB'000	RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	**731**	358
Contributions to retirement schemes	**21**	39
	752	397

The emoluments of the supervisors are within the following band:

	Number of directors	
	2003	2002
Nil - RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	**9**	9

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year are as follows:

	Number of individuals	
	2003	2002
In the capacity as:		
Directors	**2**	5
Supervisors	**1**	—
Senior management	**2**	—
	5	5

11 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(c) Five highest paid individuals (continued)

The five individuals whose emoluments were highest in the Group for the year included two (2002: five) directors and one supervisor (2002: Nil) whose emoluments are reflected in the analyses present above. The emoluments payable to the remaining two (2002: Nil) individuals during the year are as follows:

	2003	2002
	RMB'000	RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	**303**	—
Contributions to retirement schemes	**8**	—
	311	—

The emoluments fell within the following band:

	Number of individuals	
	2003	2002
Nil - RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	**2**	—

(d) During the year, no emoluments have been paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

12 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the Group's profit attributable to shareholders of RMB452,074,000 (2002: RMB396,715,000) and based on the weighted average of 3,377,707,623 (2002: 3,116,518,500) shares in issue during the year.

There was no dilution effect on the basic earnings per share for the years ended 31st December 2002 and 2003 as there were no dilutive shares outstanding during the years ended 31st December 2002 and 2003.

13 STAFF COSTS

	Note	**2003**	2002
		RMB'000	RMB'000
Wages, salaries and bonuses		**665,705**	589,620
Housing benefits	(a)	**38,731**	42,683
Contributions to pension plans	(b)	**123,142**	107,408
Cost of supplementary pension subsidies to retirees	(c)		
— current service cost		**—**	490
— interest cost		**—**	10,540
— actuarial gains and losses		**—**	23,090
Early retirement benefits	(d)	**—**	8,340
Labour insurance		**9,202**	11,536
Labour union fee		**12,796**	11,672
Labour education expenses		**12,191**	11,726
Welfare and other expenses		**41,643**	38,818
		903,410	855,923

(a) These mainly include the Group's contributions to government sponsored housing funds for employees at rates ranging from 5% to 30% of the employees' basic salary during the year (See also Note 3 (p) (iii)).

(b) The employees of the Group participate in various pension plans organised by the relevant municipal and provincial governments under which the Group was required to make monthly defined contributions to these plans at rates ranging from 20% to 22%, dependent upon the applicable local regulations, of the employees' basic salary.

(c) The Group also provided supplementary pension subsidies to retired employees prior to the Reorganisation. The costs of providing these pension subsidies were charged to the consolidated profit and loss account so as to spread the service cost over the average service lives of the retirees (See also Note 32(a)). Pursuant to the Reorganisation, the Group is no longer obliged to pay such supplementary pension subsidies to such former employees after 30th June 2002 (See also Note 32(a)).

(d) Certain employees of the Group were directed to retire early prior to the Reorganisation. Early retirement benefits were recognised in the consolidated profit and loss account in the period in which the Group entered into an agreement specifying the terms of early retirement, or after the individual employee has been advised of the specific terms. These specific terms vary among the early retired employees depending on various factors including position, length of service and district of the employee concerned.

The Group has no other obligations for the payment of pension and other post-retirement benefits of employees or retirees other than the payments mentioned above. As at 31st December 2003, the Group had approximately 33,293 employees (2002: 36,460).

14 PROPERTY, PLANT AND EQUIPMENT

Group

(a) Movement

	Construction in progress RMB'000	Buildings RMB'000	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost					
As at 1st January 2003	1,092,897	1,536,725	5,270,969	390,009	8,290,600
Additions	1,178,721	33,098	152,618	52,723	1,417,160
Transfer upon completion	(1,099,597)	106,096	943,157	50,344	—
Disposal of subsidiaries	(98,520)	(69,365)	(109,351)	(6,240)	(283,476)
Disposals	—	(127,082)	(76,669)	(44,690)	(248,441)
As at 31st December 2003	1,073,501	1,479,472	6,180,724	442,146	9,175,843
Accumulated depreciation					
As at 1st January 2003	252	416,230	1,469,623	187,083	2,073,188
Charge for the year	—	92,458	516,182	53,955	662,595
Transfer upon completion	(252)	—	252	—	—
Disposal of subsidiaries	—	(34,940)	(16,189)	(3,105)	(54,234)
Disposals	—	(58,461)	(62,984)	(28,692)	(150,137)
As at 31st December 2003	—	415,287	1,906,884	209,241	2,531,412
Net book value					
As at 31st December 2003	1,073,501	1,064,185	4,273,840	232,905	6,644,431

14 PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

(a) Movement (continued)

	Construction in progress RMB'000	Buildings RMB'000	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost					
As at 1st January 2002	1,343,971	1,114,392	3,421,695	343,142	6,223,200
Additions	1,424,572	26,549	809,525	69,487	2,330,133
Transfer upon completion	(1,675,646)	418,658	1,229,463	27,525	—
Disposals	—	(22,568)	(181,328)	(58,837)	(262,733)
Reclassification	—	(306)	(8,386)	8,692	—
As at 31st December 2002	1,092,897	1,536,725	5,270,969	390,009	8,290,600
Accumulated depreciation					
As at 1st January 2002	3,206	342,694	1,287,179	163,398	1,796,477
Charge for the year	—	77,033	312,303	53,673	443,009
Impairment losses	252	1,525	2,088	287	4,152
Transfer upon completion	(3,206)	—	3,206	—	—
Disposals	—	(6,220)	(134,018)	(30,212)	(170,450)
Reclassification	—	1,198	(1,135)	(63)	—
As at 31st December 2002	252	416,230	1,469,623	187,083	2,073,188
Net book value					
As at 31st December 2002	1,092,645	1,120,495	3,801,346	202,926	6,217,412

(b) Certain of the Group's property, plant and equipment with carrying value of approximately RMB740,617,000 at 31st December 2003 (2002: RMB759,599,000) were situated on leasehold land in the PRC which are granted by AVIC II for the Group's use at no cost or have been leased from certain fellow subsidiaries under long-term leases. The remaining period of the Group's rights on those leasehold land at 31st December 2003 range from 19 to 46 years (2002: 20 to 47 years).

14 PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

(c) Property, plant and equipment pledged as securities for bank loans were as follows:

	2003	2002
	RMB'000	RMB'000
Net book value of property, plant and equipment pledged (Note 33(d))	**401,246**	106,734

Company

	Plant and equipment	**Furniture and fixtures, other equipment and motor vehicles**	**Total**
	RMB'000	**RMB'000**	**RMB'000**
Cost			
Transferred from AVIC II upon establishment	**6,550**	**7,546**	**14,096**
Additions	**87**	**—**	**87**
As at 31st December 2003	**6,637**	**7,546**	**14,183**
Accumulated depreciation			
Transferred from AVIC II upon establishment	**2,224**	**1,558**	**3,782**
Charge for the year	**333**	**377**	**710**
As at 31st December 2003	**2,557**	**1,935**	**4,492**
Net book value			
As at 31st December 2003	**4,080**	**5,611**	**9,691**

15 LAND USE RIGHTS

	Group	
	2003	2002
	RMB'000	RMB'000
Cost		
At 1st January	**107,857**	85,569
Additions	**—**	22,288
At 31st December	**107,857**	107,857
Accumulated amortisation		
At 1st January	**12,466**	9,242
Amortisation for the year	**4,307**	3,224
At 31st December	**16,773**	12,466
Net book value		
At 31st December	**91,084**	95,391

16 INTANGIBLE ASSETS

	Group		
	Development costs RMB'000	Electricity use rights RMB'000	Total RMB'000
Cost			
As at 1st January 2003	**296,460**	**37,760**	**334,220**
Additions	**257,480**	**—**	**257,480**
As at 31st December 2003	**553,940**	**37,760**	**591,700**
Accumulated amortisation			
As at 1st January 2003	**35,605**	**4,997**	**40,602**
Amortisation for the year	**33,058**	**1,259**	**34,317**
As at 31st December 2003	**68,663**	**6,256**	**74,919**
Net book value			
As at 31st December 2003	**485,277**	**31,504**	**516,781**
Cost			
As at 1st January 2002	177,612	37,760	215,372
Additions	118,848	—	118,848
As at 31st December 2002	296,460	37,760	334,220
Accumulated amortisation			
As at 1st January 2002	19,823	3,738	23,561
Amortisation for the year	15,782	1,259	17,041
As at 31st December 2002	35,605	4,997	40,602
Net book value			
As at 31st December 2002	260,855	32,763	293,618

17 INVESTMENTS IN SUBSIDIARIES

	Company 2003 RMB'000
Investments, at cost	
Shares listed in the PRC	1,044,117
Unlisted equity investments	2,411,254
	3,455,371
Share of undistributed post-acquisition profits, net	362,259
Reserve arising from the issuance of additional shares by a subsidiary	76,971
	3,894,601
Market value of listed shares	1,953,953

Particulars of the principal subsidiaries of the Group are set out in Note 43.

18 INVESTMENTS IN ASSOCIATES

	Group	
	2003 RMB'000	2002 RMB'000
Share of net assets	166,059	82,680

Particulars of the principal associates of the Group are set out in Note 43.

19 NON-CURRENT INVESTMENTS

	Group	
	2003 RMB'000	2002 RMB'000
Investments in shares of companies listed outside Hong Kong, at cost	73,221	11,044
Unlisted investments, at cost	59,647	58,404
	132,868	69,448

19 NON-CURRENT INVESTMENTS (continued)

The Group's non-current investments represent investments in promoters' shares of certain companies listed in the PRC, which are transferable subject to approval from relevant local authorities, and shares in certain unlisted companies, which do not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly unworkable. Accordingly, these investments are carried at cost less accumulated impairment losses, if any.

20 DEFERRED TAXATION

Deferred income taxes are calculated in respect of temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

The movement in the deferred taxation accounts is as follows:

Deferred tax assets:

	Group	
	2003	2002
	RMB'000	RMB'000
At 1st January	**68,927**	51,321
Increase during the year	**30,991**	17,606
At 31st December	**99,918**	68,927

Deferred tax liabilities:

	Group	
	2003	2002
	RMB'000	RMB'000
At 1st January	**37,705**	17,303
Increase during the year	**26,256**	20,402
At 31st December	**63,961**	37,705

20 DEFERRED TAXATION (continued)

The deferred taxation are provided, prior to offsetting of balances within the same tax jurisdiction, in respect of:

	Group	
	2003	2002
	RMB'000	RMB'000
Deferred tax assets:		
Provision for impairment of receivables	**47,534**	34,143
Provision for impairment of inventories	**14,666**	9,415
Provision for impairment of investments	**2,231**	2,255
Provision for impairment of property, plant and equipment	**6,143**	7,746
Provision for warranty expense	**5,888**	—
Tax value of unused tax losses/tax credits carried forward	**26,410**	2,400
Other temporary differences	**5,437**	3,613
	108,309	59,572
Deferred tax liabilities:		
Interest income	**1,317**	2,465
Development costs	**69,153**	23,124
Other temporary differences	**1,882**	2,761
	72,352	28,350
Total deferred tax assets less total deferred tax liabilities	**35,957**	31,222

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

	Group	
	2003	2002
	RMB'000	RMB'000
Representing:		
Deferred tax assets	**99,918**	68,927
Deferred tax liabilities	**(63,961)**	(37,705)
Total deferred tax assets less total deferred tax liabilities	**35,957**	31,222

As at 31st December 2003, deferred tax assets in respect of tax losses of certain subsidiaries amounting to RMB40,741,000 (2002: RMB11,635,000) have not been recognised as it is uncertain that these subsidiaries have sufficient future taxable profits to utilise these tax losses before their expiries.

21 ACCOUNTS RECEIVABLE

	Group	
	2003	2002
	RMB'000	RMB'000
Trade receivables, net (note (a))	**332,077**	464,748
Notes receivable (note (b))	**1,579,706**	1,370,356
Due from related parties (note (c))	**894,499**	262,549
	2,806,282	2,097,653

(a) Trade receivables, net

	Group	
	2003	2002
	RMB'000	RMB'000
Gross trade receivables	**477,309**	561,457
Less: provision for impairment of receivables	**(145,232)**	(96,709)
	332,077	464,748

No specific credit period is granted by the Group to its customers. Certain of the Group's sales were on advance payment or documents against payment, and sales to small, new or short-term customers are normally expected to be settled shortly after delivery. A credit period, which may be extended for up to six months, may be granted, subject to negotiation, in respect of sales to large or long-established customers. Ageing analysis of trade receivables is as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Current to 6 months	**162,802**	282,320
6 months to 1 year	**124,788**	44,169
1 year to 2 years	**30,803**	115,322
2 years to 3 years	**73,363**	34,955
Over 3 years	**85,553**	84,691
	477,309	561,457

(b) Notes receivable are bills of exchange with average maturity dates of within six months.

21 ACCOUNTS RECEIVABLE (continued)

(c) Due from related parties

The amounts due from related parties, which are trade in nature, can be analysed as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Trade receivables		
— Fellow subsidiaries (note (i))	**776,566**	241,628
— Other related parties (note (i))	**97,279**	14,291
	873,845	255,919
Less: provision for impairment of receivables	**(41,922)**	(18,970)
	831,923	236,949
Notes receivable		
— Fellow subsidiaries (note (ii))	**62,576**	25,600
	894,499	262,549

Trade and notes receivable from related parties are unsecured and non-interest bearing. The credit period granted to related parties are similar to that of the period granted by the Group to its third-party customers.

Note:

(i) The ageing of the amounts due from related parties, which are trade in nature, is summarised as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Current to 1 year	**762,766**	219,370
1 year to 2 years	**85,495**	2,637
2 years to 3 years	**1,846**	432
Over 3 years	**23,738**	33,480
	873,845	255,919

(ii) Notes receivable are bills of exchange with average maturity dates of within six months.

22 OTHER RECEIVABLES, PREPAYMENTS AND OTHER CURRENT ASSETS

	Group	
	2003	2002
	RMB'000	RMB'000
Advances to suppliers	**257,122**	348,882
Advances for purchase of property, plant and equipment	**22,223**	95,969
Due from related parties (note)	**525,489**	409,758
Other receivables	**177,148**	53,475
Prepayments and deposits	**69,657**	50,455
Other current assets	**9,302**	1,102
	1,060,941	959,641

Note:

The amounts due from related parties can be analysed as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Holding company:		
— Other temporary advances	**—**	159,937
Fellow subsidiaries:		
— Advances for purchase of goods and raw materials (note (ii))	**340,181**	137,374
— Loan to a fellow subsidiary (note (iii))	**60,000**	—
— Other temporary advances (note (iv))	**13,803**	29,552
	413,984	166,926
Other related parties:		
— Advances for purchase of goods and raw materials (note (ii))	**111,505**	82,895
	525,489	409,758

(i) Amounts due from related parties are unsecured and non-interest bearing.

(ii) Advances for purchase of goods and raw materials are recurrent in nature and have no fixed terms of repayment.

(iii) The loan to a fellow subsidiary was repaid in March 2004.

(iv) Other temporary advances mainly represent current account balances with certain fellow subsidiaries arising before the listing of the Group and are expected to be fully settled after the listing of the Group.

23 INVENTORIES

	Group	
	2003	2002
	RMB'000	RMB'000
Raw materials	**1,627,577**	1,263,965
Work in progress	**658,055**	712,721
Finished goods	**1,496,206**	1,251,340
Consumables	**98,991**	104,978
	3,880,829	3,333,004
Less: provision for impairment losses	**(71,999)**	(34,336)
	3,808,830	3,298,668

As at 31st December 2003, inventories stated at net realisable value amounted to approximately RMB67,749,000 (2002: RMB258,067,000).

24 CONTRACTS IN PROGRESS

	Group	
	2003	2002
	RMB'000	RMB'000
At 1st January	**88,812**	26,007
Contract costs incurred in the year	**268,774**	372,729
Contract expenses recognised in the year	**(335,592)**	(309,924)
At 31st December	**21,994**	88,812
Contract costs incurred and recognised profits to date	**341,226**	429,669
Advances received on construction contracts	**25,918**	75,890

Advances received on construction contracts are included in customer deposits as shown in Note 30(a).

25 DESIGNATED DEPOSITS — GROUP

These deposits have been placed with a trust investment company approved by the relevant PRC authorities to conduct trust investment business in the PRC, for investment purposes. The deposits held at 31st December 2003 will be uplifted in May 2004.

26 TRADING INVESTMENTS — GROUP

Trading investments represent government bonds listed in the PRC and are stated at fair value at the close of business at year end date. Fair value is estimated by reference to the quoted bid prices.

27 PLEDGED DEPOSITS

	Group	
	2003	2002
	RMB'000	RMB'000
Deposits have been placed in certain banks as securities against certain trade finance facilities granted by the banks as follows:		
Deposits pledged	**153,763**	200,835
Corresponding trade finance facilities utilised	**154,607**	342,168

The corresponding trade finance facilities utilised mainly represent notes payable to suppliers.

28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

Group

(i) As at 31st December 2003, approximately RMB852,894,000 (2002: RMB667,704,000) of the Group's term deposits with initial term of over three months were denominated in Renminbi and deposited with banks in the PRC. The conversion of these Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(ii) As at 31st December 2003, approximately RMB1,562,361,000 (HK$1,466,042,000) (2002: Nil) of the Group's term deposits with initial term of over three months were denominated in the Hong Kong Dollar.

(iii) The weighted average effective interest rate on term deposits with initial term of over three months was 0.90% for the year (2002: 1.89%).

28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS (continued)

Company

(i) As at 31st December 2003, approximately RMB200,000,000 of the Company's term deposits with initial term of over three months were denominated in Renminbi and deposited with banks in the PRC. The conversion of these Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(ii) As at 31st December 2003, approximately RMB1,562,361,000 (HK$1,466,042,000) of the Company's term deposits with initial term of over three months were denominated in the Hong Kong Dollar.

(iii) The weighted average effective interest rate on term deposits with initial term of over three months was 0.50% for the year.

29 TRADE PAYABLES

	Group	
	2003	2002
	RMB'000	RMB'000
Trade payables (note (a))	**3,019,916**	2,810,532
Notes payable (note (b))	**719,758**	750,624
Due to related parties (note (c))	**847,235**	390,729
	4,586,909	3,951,885

(a) Trade payables

The normal credit period for trade payables generally ranges from 0 to 6 months. Ageing analysis of trade payables at 31st December 2003 is as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Current to 1 year	**2,947,455**	2,751,502
1 year to 2 years	**29,806**	25,492
2 years to 3 years	**17,964**	17,366
Over 3 years	**24,691**	16,172
	3,019,916	2,810,532

(b) Notes payable are bills of exchange with maturity dates of within six months.

29 TRADE PAYABLES (continued)

(c) Due to related parties

The amounts due to related parties, which are trading in nature, can be analysed as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Trade payables:		
— Fellows subsidiaries (note (i))	**667,737**	367,080
— Other related parties (note (i))	**61,070**	13,792
	728,807	380,872
Notes payable:		
— Fellows subsidiaries (note (ii))	**89,484**	—
— Other related parties (note (ii))	**28,944**	9,857
	118,428	9,857
	847,235	390,729

Note:

(i) Trade payables to related parties are unsecured and non-interest bearing. The credit period granted by related parties are similar to that of the period granted to the Group by its third-party suppliers. The ageing of the amounts due to related parties, which are trade in nature, is summarised as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Current to 1 year	**656,824**	378,940
1 year to 2 years	**70,862**	1,470
2 years to 3 years	**1,029**	462
Over 3 years	**92**	—
	728,807	380,872

(ii) Notes payable are bills of exchange with maturity dates of within six months.

30 OTHER PAYABLES, ACCRUALS AND OTHER CURRENT LIABILITIES

	Group		Company
	2003	2002	**2003**
	RMB'000	RMB'000	**RMB'000**
Other payables and accruals (note (a))	**1,447,711**	1,599,088	**16,894**
Due to related parties (note (b))	**495,603**	285,656	**287,667**
	1,943,314	1,884,744	**304,561**

(a) Other payables and accruals

	Group		Company
	2003	2002	**2003**
	RMB'000	RMB'000	**RMB'000**
Customer deposits	**380,638**	610,516	**—**
Payable for property, plant and equipment	**289,723**	196,560	**—**
Wages, salaries and bonuses payables	**178,200**	164,659	**—**
Welfare payables	**183,788**	231,317	**—**
Accrued expenses	**166,210**	166,136	**16,894**
Deferred income from government grants	**33,269**	44,643	**—**
Consumption tax, business tax and other taxes payable	**75,124**	85,372	**—**
Value-added tax payable	**50,595**	34,896	**—**
Other current liabilities	**90,164**	64,989	**—**
	1,447,711	1,599,088	**16,894**

30 OTHER PAYABLES, ACCRUALS AND OTHER CURRENT LIABILITIES (continued)

(b) Due to related parties

The amounts due to related parties can be analysed as follows:

	Group		Company
	2003	2002	**2003**
	RMB'000	RMB'000	**RMB'000**
Holding company:			
— Special dividend (Note 10 (ii))	**7,125**	—	**7,125**
— Other temporary advances (note (iii))	**260,636**	—	**272,643**
	267,761	—	**279,768**
Fellow subsidiaries:			
— Deposits for sales of aircraft and automobiles (note (ii))	**20,504**	74,565	**—**
— Payable for property, plant and equipment (note (ii))	**13,776**	102,002	**—**
— Other temporary advances (note (iii))	**177,190**	16,506	**7,899**
	211,470	193,073	**7,899**
Other related parties:			
— Deposits for sales of aircraft and automobiles (note (ii))	**2,508**	75,891	**—**
— Other temporary advances (note (iii))	**13,864**	16,692	**—**
	16,372	92,583	**—**
	495,603	285,656	**287,667**

(i) Amounts due to related parties are unsecured and non-interest bearing.

(ii) Deposits for sales of aircraft and automobiles, and payable for property, plant and equipment are recurrent in nature and have no fixed terms of repayment.

(iii) Other temporary advances mainly represent current account balances with the relevant related parties arising before the listing of the Group and are expected to be fully settled after the listing of the Group.

31 LONG-TERM PAYABLE TO ULTIMATE HOLDING COMPANY

	Group and Company RMB'000
At 1st January 2002 and 2003	—
Transfer from provisions (Note 32 (a))	614,190
At 31st December 2003	614,190
Less: current portion repayable within one year (Note 32(a))	(40,946)
	573,244

32 PROVISIONS

	Group				
	Supplementary pension subsidies RMB'000 (note (a))	Early retirement RMB'000 (note (a))	One-off cash housing subsidies RMB'000 (note (b))	Warranty RMB'000 (note (c))	Total RMB'000
At 1st January 2003	**553,710**	**60,480**	**56,226**	**60,157**	**730,573**
Additional provisions	**—**	**—**	**—**	**104,527**	**104,527**
Utilised during the year	**—**	**—**	**—**	**(74,148)**	**(74,148)**
Transfer to long-term payable to ultimate holding company (Note 31)	**(553,710)**	**(60,480)**	**—**	**—**	**(614,190)**
At 31st December 2003	**—**	**—**	**56,226**	**90,536**	**146,762**
Analysis of total provisions:					
Non-current	**—**	**—**	**56,226**	**—**	**56,226**
Current	**—**	**—**	**—**	**90,536**	**90,536**
	—	**—**	**56,226**	**90,536**	**146,762**
At 1st January 2002	533,750	56,650	56,226	52,204	698,830
Additional provisions	34,120	8,340	—	70,654	113,114
Utilised during the year	(14,160)	(4,510)	—	(62,701)	(81,371)
At 31st December 2002	553,710	60,480	56,226	60,157	730,573
Analysis of total provisions:					
Non-current	516,796	56,448	56,226	—	629,470
Current	36,914	4,032	—	60,157	101,103
	553,710	60,480	56,226	60,157	730,573

32 PROVISIONS (continued)

(a) Supplementary pension subsidies and early retirement obligations

Prior to the Reorganisation, the Group paid supplementary pension subsidies to its retired employees who retired prior to the Reorganisation. In addition, the Group was committed to make periodic benefits payments to certain former employees who were asked to retire early in accordance with various rationalisation programmes adopted by the Group prior to the Reorganisation. Pursuant to the Reorganisation, the Group and AVIC II agreed that, upon establishment of the Company, the Group's obligations to make these supplementary pension benefits and early retirement payments as at 30th June 2002 were assumed by AVIC II and the actual payments of these obligations will be made by AVIC II. The Group is not obliged to any further liabilities in respect of these supplementary pension benefits and early retirement payments to these former employees after 30th June 2002. The Company is however obliged to settle such amount assumed by AVIC II in 15 equal annual instalments from 2003. Accordingly, an amount due to AVIC II in the amount of approximately RMB614,190,000 was recorded by the Company and the Group as at 31st December 2003. The above obligations were actuarially determined by a PRC insurance company using the projected unit credit method.

The material actuarial assumptions used in valuing these obligations are as follows:

(i) Discount rates adopted for the period from 1st January 2002 to 30th June 2002: 4%;

(ii) Medical cost trend rate adopted for the period from 1st January 2002 to 30th June 2002: 7%;

(iii) Mortality: Average life expectancy of residents in the PRC;

(iv) No survivorship adjustment was included in the period up to normal retirement date for the early retirees. A survival adjustment was however included in calculating the normal component for the early retirees; and

(v) Medical costs paid to early retirees are assumed to continue until the death of the retirees.

(b) One-off cash housing subsidies

This represents the Group's provision for one-off housing subsidies. As set out in Note 3 (p)(iii) to the financial statements, certain provincial governments have not yet promulgated the detailed local regulations in relation to the reformed housing subsidy policies and certain entities within the Group have not yet adopted any formal cash housing subsidy plans. In respect of certain entities which have not adopted any cash housing subsidy plans, based on the available information and best estimates, the Group estimated a provision of approximately RMB56,226,000 which was charged to the consolidated profit and loss account in the year ended 31st December 2000 when the State Council issued a circular regarding the cash housing subsidies in the PRC. However, because of the significant uncertainties involved in view of the absence of detailed local government regulations and formal cash housing subsidy plans for these entities, this estimate is subject to a high degree of measurement uncertainty. Actual cash housing subsidies eventually to be paid out may differ significantly from this estimate. AVIC II has, however, agreed to bear any further one-off cash housing subsidies in excess of the amount provided above.

32 PROVISIONS (continued)

(c) Warranty

The Group gives a two-year or 40,000 kilometres first-to-occur limited warranties on certain automobile products and undertakes to repair or replace items that fail to perform satisfactorily. A provision of approximately RMB90,536,000 has been recognised as of 31st December 2003 (2002: RMB60,157,000) in connection with the expected warranty claims based on past experience of the level of repairs and returns.

33 BORROWINGS

(a) Borrowings including bank borrowings and other borrowings are analysed as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Current borrowings:		
Bank borrowings	**3,784,091**	2,688,686
Current portion of non-current borrowings	**199,725**	533,877
	3,983,816	3,222,563
Non-current borrowings:		
Bank borrowings	**1,373,875**	1,404,071
Other borrowings	**12,067**	16,344
	1,385,942	1,420,415
Total borrowings	**5,369,758**	4,642,978
Representing:		
Unsecured	**684,555**	871,312
Secured	**4,685,203**	3,771,666
	5,369,758	4,642,978

33 BORROWINGS (continued)

(a) Borrowings including bank borrowings and other borrowings are analysed as follows: (continued)

The exposure of the borrowings of the Group to interest rate changes and the effective interest rates is as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Total borrowings:		
— at fixed rates	**4,884,456**	3,879,864
— at floating rates	**485,302**	763,114
	5,369,758	4,642,978
Weighted average effective interest rates:		
— bank borrowings	**4.65%**	5.47%
— other borrowings	**1.85%**	2.06%

The carrying amounts and fair values of non-current borrowings are as follows:

	Group	
	Carrying values	
	2003	2002
	RMB'000	RMB'000
Bank borrowings	**1,373,875**	1,404,071
Other borrowings	**12,067**	16,344
	1,385,942	1,420,415

33 BORROWINGS (continued)

(a) Borrowings including bank borrowings and other borrowings are analysed as follows: (continued)

	Group Fair values 2003 RMB'000	2002 RMB'000
Bank borrowings	**1,363,870**	1,413,168
Other borrowings	**8,428**	12,697
	1,372,298	1,425,865

The fair values are based on discounted cash flows using applicable discount rates based upon the prevailing market rates of interest available to the Group for financial instruments with substantially the same terms and characteristic as at the balance sheet dates. Such discount rates ranged from 5.49% to 5.76% as of 31st December 2003 (2002: 5.49% to 5.76%), depending on the type of the debt. The carrying amounts of current borrowings approximate their fair values.

(b) The repayment terms of the non-current borrowings are analysed as follows:

	Group 2003 RMB'000	2002 RMB'000
Bank borrowings:		
Wholly repayable within five years	**1,486,959**	1,855,173
Not wholly repayable within five years	**50,000**	50,000
	1,536,959	1,905,173
Other borrowings:		
Wholly repayable within five years	**36,641**	37,052
Not wholly repayable within five years	**12,067**	12,067
	48,708	49,119
	1,585,667	1,954,292

33 BORROWINGS (continued)

(c) At 31st December 2003, the Group's non-current bank borrowings and other borrowings are repayable as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Bank borrowings:		
Within one year	**163,084**	501,102
In the second year	**713,916**	445,700
In the third to fifth years	**659,959**	908,371
After the fifth year	**—**	50,000
	1,536,959	1,905,173
Less: current portion	**(163,084)**	(501,102)
	1,373,875	1,404,071
Other borrowings:		
Within one year	**36,641**	32,775
In the second year	**—**	4,277
In the third to fifth years	**—**	—
After the fifth year	**12,067**	12,067
	48,708	49,119
Less: current portion	**(36,641)**	(32,775)
	12,067	16,344
Total:		
Within one year	**199,725**	533,877
In the second year	**713,916**	449,977
In the third to fifth years	**659,959**	908,371
After the fifth year	**12,067**	62,067
	1,585,667	1,954,292
Less: current portion	**(199,725)**	(533,877)
	1,385,942	1,420,415

33 BORROWINGS (continued)

(d) Borrowings facilities

The securities of the Group's borrowings are analysed as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Net book value of property, plant and equipment pledged (Note 14(c))	**401,246**	106,734
Guarantees provided by AVIC II and fellow subsidiaries of the Group	**1,369,146**	1,149,500
Cross guarantees among subsidiaries of the Group	**2,679,057**	2,285,166
Guarantees provided by third parties	**227,000**	307,000
Corresponding borrowing facilities utilised	**4,685,203**	3,771,666

Pursuant to the Reorganisation, all guarantees provided by the Holding company and fellow subsidiaries of the Group would be released or withdrawn within six months after the listing of the Company's shares.

At 31st December 2003, the Group has the following undrawn committed borrowing facilities:

	Group	
	2003	2002
	RMB'000	RMB'000
Expiring beyond one year at fixed rates	**2,643,848**	2,328,500

34 MINORITY INTERESTS

	Group	
	2003	2002
	RMB'000	RMB'000
Equity interests	**2,818,387**	2,616,687
Loans from minority shareholders of a subsidiary	**127,737**	128,237
	2,946,124	2,744,924

The loans from minority shareholders of a subsidiary are unsecured, interest free and have no fixed terms of repayment.

35 SHARE CAPITAL

	Company 2003 RMB'000
Registered, issued and fully paid:	
Upon establishment of the Company — 3,116,518,500 Domestic Shares of RMB1.00 each	**3,116,519**
Transfer of 152,710,500 Domestic Shares of RMB1.00 each to 152,710,500 H Shares of RMB1.00 each as part of the Offering	**(152,711)**
At 31st December 2003 2,963,808,000 Domestic Shares of RMB1.00 each	**2,963,808**
Offering of H Shares 1,527,090,000 new H Shares of RMB1.00 each	**1,527,090**
Transfer of 152,710,500 Domestic Shares of RMB1.00 each to 152,710,500 H Shares of RMB1.00 each as part of the Offering	**152,711**
At 31st December 2003	**1,679,801**
	4,643,609

The Company was established on 30th April 2003 with an initial registered share capital of RMB3,116,518,500, divided into 3,116,518,500 shares with par value RMB1.00 each. 2,981,388,500 shares, 104,620,000 shares, 15,470,000 shares and 15,040,000 shares were issued to AVIC II, Hua Rong, Cinda and Orient respectively, all of which were credited as fully paid, in consideration for the transfer of the relevant assets, liabilities and interests to the Company pursuant to the Reorganisation referred to in Note 1. These Domestic Shares rank pari passu in all respects with each other.

The share capital presented in the consolidated balance sheet as at 31st December 2002 represented the initial registered share capital issued by the Company in exchange of the relevant assets, liabilities and interests pursuant to the Reorganisation, which deemed to have been in issue at 31st December 2002, in accordance with the basis of preparation set out in Note 2.

35 SHARE CAPITAL (continued)

During the year, the Company completed its initial public offering and placing of 1,679,800,500 H Shares with a par value of RMB1.00 each at a price of HK$1.21 (equivalent to RMB1.28) per H Share in cash for an aggregate consideration of HK$2,033 million (equivalent to approximately RMB2,167 million), which comprised 1,527,090,000 new H Shares issued by the Company and 152,710,500 shares offered by the Promoters pursuant to an approval from the State Assets Commission to convert such relevant Domestic Shares owned by the Promoters into H Shares as part of the Offering. As a result, the issued share capital of the Company increased to 4,643,608,500 shares, comprising 2,963,808,000 Domestic Shares and 1,679,800,500 H Shares, representing 63.83% and 36.17% of the issued capital respectively.

The H Shares rank pari passu in all respects with the Domestic Shares and rank equally for all dividends or distributions declared, paid or made except that all dividends in respect of H Shares are to be paid by the Company in Hong Kong dollars and H Shares may only be subscribed for by, and traded in Hong Kong dollars between legal or natural persons of Hong Kong, Macau, Taiwan or any other country other than the PRC. The transfer of the Domestic Shares is subject to such restrictions as the PRC laws may impose from time to time.

36 RESERVES

Company

	Capital reserve RMB'000 (note (b))	Statutory surplus reserve RMB'000 (note (e))	Statutory public welfare fund RMB'000 (note (f))	Retained earnings RMB'000 (note (c))	Total RMB'000
Upon establishment	**(345,725)**	**—**	**—**	**7,125**	**(338,600)**
Premium on issue of shares	**442,827**	**—**	**—**	**—**	**442,827**
Share issuance costs	**(99,175)**	**—**	**—**	**—**	**(99,175)**
Reserve arising from the issuance of additional shares by a subsidiary	**76,971**	**—**	**—**	**—**	**76,971**
Profit for the year	**—**	**—**	**—**	**354,535**	**354,535**
Special dividend (Note 10 (ii))	**—**	**—**	**—**	**(7,125)**	**(7,125)**
Transfer to reserves	**—**	**16,259**	**8,129**	**(24,388)**	**—**
As at 31st December 2003	**74,898**	**16,259**	**8,129**	**330,147**	**429,433**
Representing:					
Proposed final dividend	**—**	**—**	**—**	**48,758**	**48,758**
Others	**74,898**	**16,259**	**8,129**	**281,389**	**380,675**
	74,898	**16,259**	**8,129**	**330,147**	**429,433**

36 RESERVES (continued)

Note:

(a) Movements in the reserves of the Group during the year are set out in consolidated statement of changes in shareholders' equity.

(b) As described in Note 2, the financial statements of the Group for the years ended 31st December 2002 and 2003 have been prepared as if the Group had been in existence throughout the period and as if the Transferred Businesses were transferred to the Company by AVIC II at 1st January 2002 or when such businesses were acquired by AVIC II, whichever is later. Upon establishment of the Company on 30th April 2003, the historical net value of the assets, liabilities and interests transferred to the Company were converted into the Company's registered capital as described in Note 35 with all the then existing reserves eliminated and the resulting difference dealt with in the capital reserve. Accordingly, a capital reserve, being the difference between the amount of share capital issued and the historical net value of the assets, liabilities and interests transferred to the Company as at 30th June 2002, was presented in the reserves of both the Group and the Company. Separate class of reserves, including retained profits, of the Group prior to the establishment of the Company were not separately disclosed as all these reserves have been capitalised and incorporated in the capital reserve of the Group and the Company pursuant to the Reorganisation.

(c) Retained profit of the Group and the Company upon establishment of the Company represents the undistributed profits of the Group, as determined in accordance with the PRC GAAP, for the period from 1st July 2002 to 30th April 2003. Pursuant to the Reorganisation, such undistributed profits of the Group for the above period are attributable to AVIC II and the Company has agreed to distribute such amount to AVIC II by way of a special dividend (See also Note 10 (ii)). Therefore the amount was not capitalised by the Group and the Company upon establishment of the Company.

(d) Subsequent to the Reorganisation, in accordance with the relevant PRC regulations and Articles of Association of the Company, retained profits available for distribution by the Company will be deemed to be the lower of the amounts determined in accordance with the PRC GAAP and the amount determined in accordance with IFRS. As at 31st December 2003, the amount of retained profits available for distribution was approximately RMB135,970,000, being the amount determined in accordance with the PRC GAAP.

(e) Statutory surplus reserve

In accordance with the relevant PRC laws and financial regulations, every year the Company is required to transfer 10% of the profit after taxation prepared in accordance PRC accounting standards to the statutory surplus reserve until the balance reaches 50% of the paid-up share capital. Such reserve can be used to reduce any losses incurred and to increase share capital. Except for the reduction of losses incurred, any other usage should not result in this reserve balance falling below 25% of the registered capital.

(f) Statutory public welfare fund

In accordance with the relevant PRC laws and financial regulations, every year the Company is required to transfer between 5% to 10% of the profits after taxation prepared in accordance with PRC accounting standards to the statutory public welfare fund. The use of this fund is restricted to capital expenditure for employees' collective welfare facilities, the ownership in respect of which belongs to the Group. The statutory public welfare fund is not available for distribution to shareholders except under liquidation. Once the capital expenditure on staff welfare facilities has been made, an equivalent amount must be transferred from statutory public welfare fund to the discretionary surplus reserve, a reserve which can be used to reduce any losses incurred or to increase share capital. The Company decided to make a 5% transfer as statutory public welfare fund for the year ended 31st December 2003.

37 CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit for the year to net cash generated from operations

	2003	2002
	RMB'000	RMB'000
Profit for the year	452,074	396,715
Adjustments for:		
Minority interests	251,828	185,899
Taxation	60,830	124,597
Share of results of associates	13,811	(2,906)
Gain on disposal of subsidiaries	(31,901)	—
Amortisation of land use rights and intangible assets	38,624	20,265
Depreciation on property, plant and equipment	662,595	443,009
Loss on disposal of property, plant and equipment	7,920	2,327
Amortisation of government grants received	(15,046)	—
Provision for impairment of property, plant and equipment	—	4,152
Provision for impairment of receivables	75,920	31,429
Write-down of inventories to net realisable value	39,672	18,602
Interest income	(41,382)	(43,277)
Interest expense	189,769	184,354
	1,704,714	1,365,166
Changes in working capital:		
— increase in accounts receivable	(885,604)	(772,409)
— (increase)/decrease in other receivables, prepayments and other current assets	(127,340)	28,226
— increase in inventories	(834,292)	(351,653)
— decrease/(increase) in contracts in progress	66,818	(62,805)
— increase in trade payables	809,476	1,143,674
— increase in other payables, accruals and other current liabilities	107,089	270,738
— (decrease)/increase in provisions	(583,811)	31,743
— increase in long-term payable to ultimate holding company	614,190	—
— increase in deferred income from government grants	16,039	88,751
Net cash generated from operations	887,279	1,741,431

37 CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Analysis of changes in financing during the year:

(i) Borrowings

	2003	2002
	RMB'000	RMB'000
At 1st January	**4,642,978**	4,091,055
Proceeds from borrowings	**4,778,677**	3,335,316
Disposal of subsidiaries	**(228,450)**	—
Repayments of borrowings	**(3,823,447)**	(2,783,393)
At 31st December	**5,369,758**	4,642,978

(ii) Minority interests

	2003	2002
	RMB'000	RMB'000
At 1st January	**2,744,924**	2,631,915
Share of profit for the year	**251,828**	185,899
Contributions from minority shareholders of subsidiaries	**207,940**	7,510
Repayment of loans from minority shareholders of a subsidiary	**(500)**	(12,496)
Transfer to owner's equity (Note 37(c))	**(119,282)**	—
Profit distributions to minority shareholders of subsidiaries	**(106,396)**	(67,904)
Disposal of subsidiaries	**(32,390)**	—
At 31st December	**2,946,124**	2,744,924

(c) Principal non-cash transactions

As detailed in Note 1 to the financial statements, the Asset Management Companies transferred their equity interests in Hafei Industry Company for shares of the Company upon its establishment pursuant to the Reorganisation Agreement.

37 CONSOLIDATED CASH FLOW STATEMENT (continued)

(d) Disposal of subsidiaries

	At 30th November 2003 RMB'000
Property, plant and equipment	229,242
Other non-current assets	14,624
	243,866
Current assets	500,491
Total assets	744,357
Borrowings	(228,450)
Other current and non-current liabilities	(367,166)
Total liabilities	(595,616)
Minority interests	(32,390)
Net assets	116,351
Net assets sold	116,351
Proceeds receivable from sales	118,252
Proceeds received from sales	30,000
	148,252
Gains on disposal of subsidiaries	31,901
The net cash inflow on sale is determined as follows:	
Proceeds received from sales	30,000
Less: cash and cash equivalents in subsidiaries sold	(36,203)
Net cash disposed from sale of subsidiaries	(6,203)

37 CONSOLIDATED CASH FLOW STATEMENT (continued)

(e) Cash and cash equivalents

Group

	2003 RMB'000	2002 RMB'000
Cash and bank balances	**2,140,879**	2,472,910
Term deposits with initial term of less than three months	**443,140**	—
	2,584,019	2,472,910

(i) As at 31st December 2003, approximately RMB2,299,286,000 of the Group's cash and cash equivalents were denominated in RMB and deposited with banks in the PRC (2002: RMB2,449,946,000). The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(ii) The weighted average effective interest rates on deposits with banks as set out in note (i) above is 0.72% at 31st December 2003 (2002: 0.72%).

Company

	2003 RMB'000
Cash and bank balances	**112,000**
Term deposits with initial term of less than three months	**213,140**
	325,140

(i) As at 31st December 2003, approximately RMB71,551,000 of the Company's cash and cash equivalents were denominated in RMB and deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(ii) The weighted average effective interest rates on deposits with banks as set out in note (i) above is 0.72% at 31st December 2003.

38 COMMITMENTS

(a) Capital commitments

The Group has the following capital commitments not provided for at 31st December 2003:

	Group	
	2003	2002
	RMB'000	RMB'000
Acquisition of property, plant and equipment:		
— Authorised but not contracted for	**138,501**	—
— Contracted but not provided for	**300,860**	—
	439,361	—
Construction commitments:		
— Authorised but not contracted for	**159,675**	846,202
— Contracted but not provided for	**2,789**	385,759
	162,464	1,231,961
Investments in associates:		
— Authorised but not contracted for	**—**	23,500
— Contracted but not provided for	**12,008**	111,475
	12,008	134,975
	613,833	1,366,936

38 COMMITMENTS (continued)

(b) Operating lease commitments

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases at 31st December 2003:

	Group	
	2003	2002
	RMB'000	RMB'000
Land and buildings:		
Not later than one year	**37,114**	31,226
Later than one year and not later than five years	**89,977**	98,835
Later than five years	**132,109**	208,418
	259,200	338,479
Plant and equipment:		
Not later than one year	**23**	1,006
Later than one year and not later than five years	**—**	3,018
	23	4,024
	259,223	342,503

Generally, the Group's operating leases are for terms of 1 to 20 years.

The Company did not have any significant commitment at 31st December 2003.

39 SIGNIFICANT RELATED PARTY TRANSACTIONS

In addition to the related party transactions undertaken in connection with the Reorganisation described in Note 1 above, during the year, the Group entered into various transactions with related parties including the Holding Company, certain fellow subsidiaries, and other entities , directly or indirectly, controlled or significantly influenced by the Holding Company.

Set out below is a summary of significant related party transactions during the year.

39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

Profit and loss items:

The aggregate income and expenses arising from those significant related party transactions are summarised as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Revenues:		
Sales of goods and materials		
— Fellow subsidiaries	**2,153,115**	1,559,277
— Other related parties	**591,999**	317,652
Rendering of service		
— Fellow subsidiaries	**41,633**	11,515
Rental income		
— Fellow subsidiaries	**961**	1,307
Expenses:		
Purchase of goods and raw materials		
— Fellow subsidiaries	**2,130,597**	1,858,695
— Other related parties	**808,896**	650,117
Service fees payable		
— Fellow subsidiaries	**678,012**	345,385
— Other related parties	**5,280**	310
Rental expenses for property, plant and equipment		
— Fellow subsidiaries	**59,811**	58,515
Others:		
Guarantees obtained from		
— Holding company	**280,400**	290,000
— Fellow subsidiaries	**1,088,746**	859,500

These transactions are entered into at terms agreed with these related parties in the ordinary course of business and are continuing in nature except for the guarantees given by AVIC II and certain of its subsidiaries amounted to approximately RMB280,400,000 and approximately RMB1,088,746,000 respectively as at 31st December 2003 which will be released within six months after the listing of the Company's shares.

In addition, AVIC II granted certain leasehold land for the Group's use at no cost, details of which are disclosed in Note 14(b).

39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

Balance sheet items:

The significant balances with related parties at 31st December 2003 are as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
Balances with related parties included in:		
Accounts receivable		
— Fellow subsidiaries	**839,142**	267,228
— Other related parties	**97,279**	14,291
Other receivables, prepayments and other current assets		
— Holding company	**—**	159,937
— Fellow subsidiaries	**413,984**	166,926
— Other related parties	**111,505**	82,895
Trade payables		
— Fellow subsidiaries	**757,221**	367,080
— Other related parties	**90,014**	23,649
Other payables, accruals and other current liabilities		
— Holding company	**267,761**	—
— Fellow subsidiaries	**211,470**	193,073
— Other related parties	**16,372**	92,583
Contracts in progress receivable		
— Other related parties	**—**	10,232
Long-term payable to ultimate holding company	**614,190**	—

Other receivables from related parties, other payables to related parties and long-term payable to ultimate holding company have repayment terms as disclosed in Note 22, Note 30 and Note 31 respectively.

40 FINANCIAL INSTRUMENTS

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks, including the effects of: changes in debt and equity market prices, foreign currency exchange rates and interest rates.

(i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB.

The Group's assets and liabilities, and transactions arising from international trade that subject to foreign exchange risk are primarily with respect to the United States Dollar, Euro Dollar, Hong Kong Dollar and Japanese Yen. The Group has not used any forward contracts to hedge its exposure. As at 31st December 2003, the Group had US Dollar, Euro Dollar, Hong Kong Dollar and Japanese Yen denominated deposits in banks of approximately RMB10,303,000 (2002: RMB18,235,000), RMB10,722,000 (2002: RMB448,000), RMB253,589,000 (2002: Nil) and RMB2,369,000 (2002: RMB3,248,000) respectively.

As at 31st December 2003, the Group had US Dollar, Euro Dollar and Japanese Yen denominated loans of approximately RMB275,000,000 (2002: RMB392,960,000), RMB335,995,000 (2002: RMB12,083,000) and RMB327,054,000 (2002: RMB10,289,000) respectively.

(ii) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets. The Group's exposure to changes in interest rates is mainly attributable to its non-current borrowings, details of which have been disclosed in Note 33 to the financial statements. The Group enters into debt obligations to support general corporate purposes including capital expenditure and working capital needs. As of 31st December 2003, over 90% of its borrowings were at fixed rates. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

(iii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of trade receivables included in the consolidated balance sheets represent the Group's maximum exposure to credit risk in relation to its financial assets. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history and the Group performs periodic credit evaluations of its customers. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances and the directors are of the opinion that adequate provision for uncollectible trade receivables has been made in the financial statements.

40 FINANCIAL INSTRUMENTS

(b) Fair value estimation

The carrying amounts of the Group's financial assets including cash and cash equivalents, deposits in approved financial institutions, investments, trade receivables, notes receivable and other receivables; and financial liabilities including trade payables, borrowings and other payables, approximate their fair values due to their short maturities.

The fair value of non-current borrowings are disclosed in Note 33 to the financial statements.

In assessing the fair value of non-traded financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such as estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

As detailed in Note 19 to the financial statements, there are no quoted market price in an active market for the Group's non-current investments in the PRC and for which other methods of reasonably estimating fair value are clearly unworkable. Accordingly, a reasonable estimate of fair value could not be made without incurring excessive costs.

41 ULTIMATE HOLDING COMPANY

The Company's directors regard AVIC II, a company established in the PRC, as being the ultimate holding company of the Company.

42 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 5th April 2004.

43 PARTICULARS OF SUBSIDIARIES AND ASSOCIATES

At the date of these financial statements, the Company has interests in the following principal subsidiaries and associates, which, in the opinion of the directors, were significant to the results for the year or formed a substantial portion of the Group at the balance sheet date:

Name	Country and date of incorporation/ establishment	Registered capital	Attributable equity interest	Type of legal entity	Principal activities
Subsidiaries					
Directly held:					
哈爾濱飛機工業集團有限責任公司 (Harbin Aircraft Industry Group Ltd)	PRC 12th November 1991	RMB 775,832,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane and automobile
江西昌河航空工業有限公司 (Jiangxi Changhe Aviation Industry Company Limited)	PRC 18th December 2002	RMB 1,131,700,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane, automobile and automobile parts and components
江西洪都飛機工業有限公司 (Jiangxi Hongdu Aircraft Industry Co., Ltd.)	PRC 3rd December 2002	RMB 725,647,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane and aeroplane parts and components
哈爾濱東安汽車動力股份有限公司 (Harbin Dongan Auto Engine Co., Ltd.)	PRC 8th October 1998	RMB 462,080,000	70.01%	Joint stock company (listed on the Shanghai Stock Exchange)	Manufacture and sale of automobile engine
北京維思書爾航空電子技術有限公司 (Beijing WiseWell Avionics Technology Co., Ltd.)	PRC 15th March 2001	RMB 10,000,000	51%	Limited liability company	Development, production and sale of avionics and IT products

43 PARTICULARS OF SUBSIDIARIES AND ASSOCIATES (continued)

Name	Country and date of incorporation/ establishment	Registered capital	Attributable equity interest	Type of legal entity	Principal activities
Indirectly held:					
哈飛航空工業股份有限公司 (Hafei Aviation Industry Co., Ltd.)	PRC 30th July 1999	RMB 259,500,000	55.8%	Joint stock company (listed on the Shanghai Stock Exchange)	Research, development, design, manufacture and sale of aero products, including parts and components
江西洪都航空工業股份有限公司 (Jiangxi Hongdu Aviation Industry Co., Ltd.)	PRC 16th December 1999	RMB 210,000,000	54.75%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of basic trainers, general- purpose aeroplane and other aero products, including parts and components
江西昌河汽車股份有限公司 (Jiangxi Changhe Automobile Co., Ltd.)	PRC 26th November 1999	RMB 410,000,000	64.55%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of mini-sized vehicles
哈爾濱哈飛汽車模具製造有限責任公司 (Harbin Hafei Motor Mould Manufacturing Co., Ltd.)	PRC 29th August 2000	RMB 70,370,000	84.6%	Limited liability company	Design, manufacture and sale of press dies
江西昌河鈴木汽車有限責任公司 (Jiangxi Changhe Suzuki Automobile Co., Ltd.)	PRC 23rd January 1995	USD 55,300,000	36.47%	Equity joint venture	Manufacture and sale of mini-sized vehicles
九江昌河汽車有限責任公司 (Jiujiang Changhe Automobile Co., Ltd.)	PRC 17th December 1998	RMB 161,250,000	72.89%	Limited liability company	Development, manufacture and sale of parts and components for mini-sized vehicles
哈爾濱東安汽車發動機製造有限公司 (Harbin Dongan Automotive Engine Manufacturing Co., Ltd.)	PRC 4th September 1998	RMB 500,000,000	40.20%	Equity joint venture	Manufacture and assembly of 4G1 series petrol engines
哈飛汽車股份有限公司 (Hafei Motor Co., Ltd.)	PRC 24th March 1994	RMB 1,013,280,000	74.81%	Joint stock company	Manufacture and sale of automobile products

43 PARTICULARS OF SUBSIDIARIES AND ASSOCIATES (continued)

Name	Country and date of incorporation/ establishment	Registered capital	Attributable equity interest	Type of legal entity	Principal activities
Associates					
北京方正東安稀土新材料有限責任公司 (Beijing Founder & Dong-An Rare Earth Advanced Materials Ltd.)	PRC 20th December 2001	RMB 74,080,000	18.9%	Limited liability company	Mining, concentrating and smelting of rare earth material, processing and sale of rare earth products
哈爾濱勝邦哈飛汽車綫束有限公司 (Harbin Shengbang Hafei Motor Harness Co., Ltd.)	PRC 8th October 2001	RMB 20,000,000	31.96%	Limited liability company	Manufacture and after-sale service of automobile wiring harness and electronic products
哈爾濱萬向汽車底盤系統有限責任公司 (Harbin Wanxiang Hafei Motor Chassis System Co., Ltd.)	PRC 13th September 2000	RMB 60,000,000	35%	Limited liability company	Manufacture and sales of motor chassis system
萬都（哈爾濱）汽車底盤系統有限公司 (Wandu (Harbin) Motor Chassis System Co., Ltd.)	PRC 22nd October 2002	USD 8,500,000	14.96%	Limited liability company	Development, manufacture and sale of automobile chassis system
哈爾濱安博威飛機工業有限公司 (Harbin Embraer Aircraft Industry Co., Ltd.)	PRC 13th January 2003	USD 25,000,000	38.17%	Limited liability company	Production of regional jets and provision of relevant sales and afer-sale services