1. BASIS OF ACCOUNTING

The accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (which include all applicable Hong Kong Accounting Standards ("HKAS"), Hong Kong Financial Reporting Standards ("HKFRS"), Statements of Standard Accounting Practice ("HK SSAP") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") with the exception of the recognition of certain exchange differences as explained in accounting policy 4 below. These accounts also comply with the requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Listing Rules of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The measurement basis used is historical cost modified by the revaluation of investments as explained in accounting policies 8, 10 and 13 below.

HKICPA has issued new and revised standards (HKAS and HKFRS) which are effective for accounting periods beginning on or after 1st January 2005. The Group has decided not to early adopt these new standards in its financial statements for the year ended 31st December 2004 except for HKAS 24 "Related Party Disclosures". The Group is in the process of making an assessment on the impact of the new standards and has so far concluded that the adoption of them will not have a significant impact on its results of operations and financial position. The Group will continue with the assessment of the impact of the other new standards and significant changes may be identified as a result.

2. BASIS OF CONSOLIDATION

The consolidated accounts incorporate the accounts of the Company and its subsidiary companies made up to 31st December together with the Group's share of the results and net assets of its associated companies. Subsidiary companies are those entities in which the Group controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

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

Goodwill arising on consolidation represents the excess of the cost of subsidiary and associated companies over the fair value of the Group's share of the net assets at the date of acquisition. Goodwill arising on consolidation is recognised as an intangible asset and amortised on a straight line basis over its estimated useful economic life, not exceeding a period of 20 years.

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

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

2. BASIS OF CONSOLIDATION *(continued)*

In the Company's balance sheet investments in subsidiary companies are stated at cost less any impairment loss recognised. The results of subsidiary companies are accounted for by the Company on the basis of dividends received and receivable.

3. ASSOCIATED COMPANIES

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

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

In the Company's balance sheet, investments in associated companies are stated at cost less any impairment loss recognised and loans to those companies.

4. FOREIGN CURRENCIES

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

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

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

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

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

This accounting treatment is supported by that element of International Financial Reporting Standards ("IFRS") which deals with accounting for hedge transactions. HKAS 39 "Financial Instruments: Recognition and Measurement", which is the same as the equivalent IFRS, became effective on 1st January 2005 and replaced HK SSAP 11 which required all such exchange differences be charged to the profit and loss account immediately. Note 21 to the accounts sets out the effect had HK SSAP 11 been adopted. The Directors consider that the immediate recognition of all such exchange fluctuations in the profit and loss account could materially distort year on year results and have concluded that the adopted treatment gives a true and fair view of the financial position, financial performance and cash flow of the Group.

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

5. FIXED ASSETS AND DEPRECIATION

Fixed assets are stated at cost less accumulated depreciation and impairment.

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

Passenger aircraft	over 20 years to residual value of between 0% to 10% of cost
Freighter aircraft	over 20-27 years to residual value of between 0% to 20% of cost
Other equipment	over 3-7 years to nil residual value
Leasehold land and buildings	over the period of the lease to nil residual value

Major modifications to aircraft and reconfiguration costs are capitalised as part of aircraft cost and are depreciated over periods of up to 10 years.

The depreciation policy and the carrying amount of fixed assets are reviewed annually taking into consideration factors such as changes in fleet composition, current and forecast market values and technical factors which affect the life expectancy of the assets. Any impairment in value is recognised by writing down the carrying amount to estimated recoverable amount which is the higher of the value in use (the present value of future cash flows) and the net selling price.

6. LEASED ASSETS

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

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

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

7. INTANGIBLE ASSETS

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

Expenditure on computer system development which gives rise to economic benefits is capitalised as part of intangible assets and is amortised on a straight line basis over its useful life not exceeding a period of four years.

8. INVESTMENTS

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

9. DEFEASANCE OF LONG-TERM LIABILITIES

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

10. RETIREMENT BENEFITS

Arrangements for staff retirement benefits vary from country to country and are made in accordance with local regulations and customs.

The retirement benefit obligation in respect of defined benefit retirement plans refers to the obligation less the fair value of plan assets where the obligation is calculated by estimating the present value of the expected future payments required to settle the benefit that employees have earned using the projected unit credit method. Actuarial gains and losses are not recognised unless their cumulative amounts exceeds either 10% of the present value of the defined benefit obligation or 10% of the fair value of plan assets whichever is greater. The amount exceeding this corridor is recognised on a straight line basis over the expected average remaining working lives of the employees participating in the plans.

11. DEFERRED TAXATION

Provision for deferred tax is made on all temporary differences.

Deferred tax assets relating to unused tax losses and deductible temporary differences are recognised to the extent that it is probable that future taxable profits will be available against which these unused tax losses and deductible temporary differences can be utilised.

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

12. STOCK

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

13. FUNDS WITH INVESTMENT MANAGERS AND OTHER LIQUID INVESTMENTS

Funds with investment managers and other liquid investments are valued on a mark to market basis and any gain or loss arising from the revaluation is taken to the profit and loss account.

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

14. REVENUE RECOGNITION

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

15. FUEL PRICE DERIVATIVES

Fuel derivatives are used to reduce exposure to fluctuating fuel prices. Gains and losses on these instruments are recognised upon contract expiry as a component of fuel expense during the period the related fuel is used.

16. MAINTENANCE AND OVERHAUL COSTS

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

17. FREQUENT-FLYER PROGRAMME

The Company operates a frequent-flyer programme called Asia Miles ("the programme"). The incremental cost of providing awards in exchange for redemption of miles earned by members is accrued as an operating cost and a liability after allowing for miles which are not expected to be redeemed. As members redeem their miles the liability is reduced to reflect the reduction in the outstanding obligation.

The Company sells miles to participating partners in the programme. In the past, revenue earned from selling miles was recognised immediately. That portion of revenue earned from miles sold which is expected to be redeemed on Cathay Pacific's flights is now deferred and amortised to the profit and loss account over the expected redemption period. As a result of this change, the retained earnings as at 1st January 2004 and the attributable profit to shareholders in 2004 are reduced by HK$250 million and HK$58 million respectively. Comparative figures have not been restated as the impact is immaterial.

18. RELATED PARTIES

Related parties were previously considered to be related to the Group if the Group had the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party were subject to common control or common significant influence. Related parties may be individuals or entities. With the introduction of HKAS 24, parties that are subject to significant influence by shareholders of Cathay Pacific are no longer defined as related parties. Comparatives have been restated to comply with this new definition.