Principal Accounting Policies

1. Basis of accounting

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

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1st January 2005.

The group has not early adopted these new HKFRSs in the financial statements for the year ended 31st December 2004, and is in the process of assessing the impact of these HKFRSs on future accounting periods.

The most significant impact identified to date relates to changes in the fair value of investment properties. Hong Kong Accounting Standard ("HKAS") 40 now requires surpluses and deficits arising on the revaluation of investment properties to be reflected in the profit and loss account for the year, rather than in the group's property valuation reserve. The new HKFRSs also require deferred taxation to be calculated, using profits tax rates, on these surpluses and deficits. For the year ended 31st December 2004 this treatment would have resulted in an increase in the group's reported profit attributable to shareholders of HK$12,381 million, representing the increase in the fair value of the group's investment property and reversal of transfers from property valuation reserve to profit and loss during the year, net of deferred taxation thereon. In addition, the calculation of deferred taxation on the cumulative amount of the group's property valuation reserve surpluses using profits tax rates would have resulted in a reduction in revenue reserve and net assets, as at 31st December 2004 and 2003, of HK$6,069 million and HK$3,443 million respectively.

The group is continuing to assess the impact of the new HKFRSs on the group's financial statements.

2. Basis of consolidation

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

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

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

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

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

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

3. Jointly controlled and associated companies

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

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

4. Translation of foreign currencies

(i) Transactions in foreign currencies entered into during the year are translated at the market rates or forward contract rates ruling at the relevant transaction dates. With the exception of the Perpetual Capital Securities as set out in (iii) below, monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases, with the exception of note (iv) below, are dealt with in the profit and loss account.

(ii) The balance sheets of subsidiary, jointly controlled and associated companies expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss accounts are translated at average rate. Unrealised differences on net investments in foreign subsidiary, jointly controlled and associated companies (including intra-group balances of an equity nature) and related long-term liabilities are taken directly to reserves.

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

(iv) In order to reduce its exposure to exchange rate fluctuations on future operating cash flows, the Cathay Pacific group arranges its borrowings and leasing obligations in foreign currencies such that repayments can be met by anticipated operating cash flows. In addition, currency derivatives are used to hedge anticipated operating cash flows. Any unrealised exchange differences on these borrowings, leasing obligations, currency derivatives and on related security deposits are recognised directly 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 26 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 of Cathay Pacific group 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.

5. Valuation of investment properties

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

6. Fixed assets and depreciation

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

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

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

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

7. Goodwill

Goodwill arising on consolidation represents the excess of cost of acquisition of subsidiary, jointly controlled and associated companies over the group's share of the fair value ascribed to the separable net assets at the date of acquisition. Goodwill arising on or after 1st January 2001 is capitalised in the balance sheet as a separate asset or included within investment in jointly controlled and associated companies, and is amortised to the profit and loss account on a straight-line basis over its estimated useful life. Goodwill arising from acquisitions before 1st January 2001 was written off against revenue reserve. Any impairment of goodwill is recognised in the profit and loss account.

8. Investments in securities

(i) Held-to-maturity securities

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

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

(ii) Investment securities

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

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

9. Deferred expenditure

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

10. Stocks and work in progress

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

11. Properties under development for sale

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

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

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

When a development property in the United States is sold in advance of completion, no profit is recognised until the transaction has legally closed.

12. Accounts receivable

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

13. Cash and cash equivalents

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

14. Borrowing costs

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

15. Operating leases

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

16. Deferred taxation

Deferred taxation 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 accounts. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

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 taxation is provided on temporary differences arising on investments in subsidiary, jointly controlled and associated companies, 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.

17. Revenue recognition

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

Cathay Pacific group operates a frequent-flyer programme called Asia Miles ("the programme") and 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 group'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 revenue reserve as at 31st December 2003 and the profit attributable to the group in 2004 are reduced by HK$116 million and HK$27 million respectively. Comparative figures have not been restated as the impact is immaterial.

18. Related parties

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

19. Retirement benefits

The group operates a number of defined benefit and defined contribution retirement benefit schemes for its employees, the assets of which are generally held in separate trustee – administered funds. The schemes are generally funded by payments from the relevant group companies and, in some cases, employees themselves, taking account of the recommendations of independent qualified actuaries.

The group's contributions to the defined contribution schemes are charged to the profit and loss account in the period to which the contributions relate.

For defined benefit schemes, retirement benefit costs are assessed using the projected unit credit method. Under this method, the cost of providing retirement benefits is charged to the profit and loss account so as to spread the regular cost over the service lives of employees in accordance with the advice of the actuaries or the main administration manager of the plans who carry out a valuation of the plans on an annual basis. The retirement benefit obligation is either measured as the present value of the estimated future cash outflows using market yields on Exchange Fund Notes which have terms to maturity approximating the terms of the related liability or is estimated based on formulae which provide a reliable approximation of the present value calculations. Plan assets are measured at fair value. Cumulative unrecognised net actuarial gains and losses at the previous financial year end, to the extent that the amount is in excess of 10% of the greater of the present value of the defined benefit obligations and the fair value of the plan assets, are recognised during the year over the expected average remaining service lives of the employees. Past service costs are recognised as an expense on a straight-line basis over the average period until the benefits become vested.

20. Segment reporting

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

21. Comparative amounts

Certain comparative amounts have been reclassified to conform with the current year's presentation. The change mainly relates to a more meaningful reclassification of expenses from cost of sales and distribution costs to turnover.