



## 1 ORGANISATION AND PRINCIPAL ACTIVITIES

AviChina Industry & Technology Company Limited (the "Company") was established in the People's Republic of China (the "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 ("H Shares") on the Main Board of The Stock Exchange of Hong Kong Limited. The Company and its subsidiaries are collectively referred to as the "Group". The Group is principally engaged in the research, development, manufacture and sale of automobile and aviation products.

These consolidated financial statements are presented in thousands of Renminbi ("RMB'000"), unless otherwise stated, and have been approved for issue by the Board of Directors on 4th April 2006.

## 2 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IASs") and Interpretations promulgated by the International Accounting Standards Board. These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

The principal accounting policies applied in the preparation of the financial statements as at and for the year ended 31st December 2005 are consistent with those adopted for the preparation of the financial statements as at and for the year ended 31st December 2004 except that the Group has changed certain of its accounting policies following its adoption of new/revised standards and interpretations which are effective for accounting periods commencing on or after 1st January 2005.



## 2 BASIS OF PREPARATION (continued)

In the current year, the Group has adopted the new/revised standards and interpretation below, which are relevant to the Group's operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Balance Sheet Date
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 24	Related Party Disclosures
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 36	Impairment of Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IFRS 3	Business Combinations
IFRIC Interpretation 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities

The adoption of the new/revised IASs 1, 2, 8, 10, 16, 17, 21, 24, 32, 33, 36, 38 and 39, IFRS 3 and IFRIC Interpretation 1 did not result in substantial changes to the Group's accounting policies. In summary:

- IAS 1 has affected the presentation of minority interests, share of net after-tax results of associates and other disclosures.
- IASs 2, 8, 10, 16, 17, 21, 32, 33, 36, 38, 39, IFRS 3 and IFRIC Interpretation 1 had no material effect on the Group's policies.
- IAS 24 has affected the identification of related parties and some other related party disclosures.
- The adoptions of revised IASs 27 and 28 have resulted in changes in accounting policies for investments in subsidiaries and associates in the separate financial statements of the Company. Investments in subsidiaries and associates were previously accounted for using the equity method. Following the adoption of the revised IASs 27 and 28, the Company has accounted for the investments in subsidiaries and associates using the cost method, whereby the investments are restated at cost less accumulated impairment losses. The results of subsidiaries and associates are accounted for by the Company on the basis of dividends received and receivable.



## 2 BASIS OF PREPARATION (continued)

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards. All of the new/revised standards adopted require retrospective application other than:

- IAS 16 – the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction is accounted at fair value prospectively only to future transactions; and
- IFRS 3 – prospectively for business combinations for which the agreement date is on or after 31st March 2004.

The adoption of the revised IAS 1 resulted in:

### Group

	Effect on adoption of IAS 1	
	2005 RMB'000	2004 RMB'000
<b>Consolidated income statement</b>		
Share of results of associates	(2,202)	(6,172)
Taxation	2,202	6,172
Other income	73,968	65,701
Finance costs, net	(73,968)	(65,701)
	<u>                    </u>	<u>                    </u>

The adoption of the revised IAS 27 resulted in:

### Company

	Effect on adoption of IAS 27		
	2005 RMB'000	2004 RMB'000	2003 RMB'000
<b>Stand-alone balance sheet</b>			
Interests in subsidiaries	(493,225)	(444,798)	(439,230)
Reserves	493,225	444,798	439,230
Profit attributable to equity holders of the Company	(48,427)	(5,568)	(362,259)
	<u>                    </u>	<u>                    </u>	<u>                    </u>



## 2 BASIS OF PREPARATION (continued)

The Group has not early adopted the following new standards, amendments or interpretations that have been issued but are not yet effective. The directors anticipate that the adoption of these standards, amendments and interpretations in future periods will have no material impact on the financial statements of the Group.

IAS 1 (Amendment)	Presentation of Financial Statements: Capital Disclosures
IAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
IAS 21 (Amendment)	Net Investment in a Foreign Operation
IAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intra-group Transactions
IAS 39 (Amendment)	The Fair Value Option
IAS 39 and IFRS 4 (Amendment)	Financial Guarantee Contracts
IFRS 1 and IFRS 6 (Amendment)	First-time Adoption of International Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRIC 4	Determining whether an Arrangement contains a Lease
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economics
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives



### 3 PRINCIPAL ACCOUNTING POLICIES

#### (a) Consolidation

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

##### (i) *Subsidiaries*

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the consolidated income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, interests in subsidiaries are carried at cost less accumulated impairment losses. The results of the subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

##### (ii) *Transactions and minority interests*

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the consolidated income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (a) Consolidation (continued)

##### (iii) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

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

#### (b) 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.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.



## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (b) Property, plant and equipment (continued)

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 3 (f)).

Gains and losses on disposals are determined by comparing net proceeds with carrying amount of the relevant assets and are included in the consolidated income statement.

### (c) Construction-in-progress

Construction-in-progress represents buildings, plant and machinery under construction and pending installation and is stated at cost less accumulated impairment losses. 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(b) to the financial statements.

### (d) Land use rights

Land use rights are stated at cost less accumulated amortisation and accumulated impairment losses (if any). 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 rights is calculated on a straight-line basis over the period of the land use rights.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (e) Intangible assets

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 when it is probable that the project will be a success considering its commercial and technical feasibility and its costs can be measured reliably. Other development expenditures that do not meet their criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its expected useful life, not exceeding five years; and tested for impairment according to Note 3(f) below.

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 income statement.

#### (f) Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

#### (g) Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

##### (i) *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.





## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (g) Financial assets (continued)

#### (ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet (Note 3(j)).

#### (iii) Held-to-maturity investments

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. During the year, the Group did not hold any financial asset in this category.

#### (iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are classified as "Other non-current financial assets" and included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category, including interest and dividend income, are recognised in profit and loss in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of monetary securities classified as available-for-sale and non-monetary securities classified as available-for-sale are recognised in equity.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (g) Financial assets (continued)

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as “gains and losses from investment securities”. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group’s right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted investments), the Group establishes fair value by using valuation techniques. These include the use of recent arm’s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, such financial assets are carried at cost less accumulated impairment losses.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

#### (h) 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)

### (i) 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 and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The Group uses the percentage of completion method to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, prepayments or other assets, depending on their nature.

The Group presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings. Progress billings not yet paid by customers and retention are included within "accounts receivable".

The Group presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

### (j) Accounts receivable

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Such provision for impairment of accounts receivable is established when 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 asset's carrying amount and the present value of estimated cash flows, discounted at the effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement within "general and administrative expenses".

### (k) Cash and cash equivalents

Cash and cash equivalents includes cash in hand and deposits held at call with banks.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (l) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the consolidated income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

#### (m) Borrowings costs

Borrowing costs incurred for the construction of property, plant and equipment (qualifying asset) 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.

#### (n) 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 consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income 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 by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.



## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (o) 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.

#### (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 income statement.

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 income statement 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 income statement in the year ended 31st December 2000 when the State Council circular in respect of cash subsidies was issued.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (o) Employee benefits (continued)

##### (iii) Housing benefits (continued)

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 sheet 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.

#### (p) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Warranty obligations are accrued at the time the sales are recognised, based on the estimated amounts 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.

#### (q) Operating leases

Leases in which 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 income statement 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.



## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (r) Foreign currency translation

#### (i) *Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Renminbi ("RMB"), which is the Company's functional and presentation currency.

#### (ii) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary financial assets and liabilities such as equity instruments held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the fair value reserve in equity.

#### (iii) *Group companies*

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (b) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (c) all resulting exchange differences are recognised as a separate component of equity.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (s) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sales of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts after eliminated sales within the Group. Revenue is recognised as follows:

Turnover represents revenues recognised on sales of automobiles and aviation products. Sales of goods are recognised when a Group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

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

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

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

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 using the effective interest method.

#### (t) 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 income statement over the period necessary to match them with the costs they are intended to compensate.

Government grants relating 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 income statement on a straight-line basis over the expected lives of the related assets.

#### (u) Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

#### (v) Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. During the year, the Group did not enter into any derivative financial instruments.





### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (w) 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.

In accordance with the Group's internal financial reporting system, the Group has determined business segments be presented as the primary reporting format. The Group's operations are principally carried out in the PRC and the related assets are located there. Accordingly, no geographical segments are presented.

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, deposits and cash and cash equivalents, and mainly exclude deferred income tax assets, investments in associates and corporate assets. Segment liabilities comprise operating liabilities and exclude items such as current and deferred income tax liabilities and corporate liabilities. Capital expenditures mainly comprise additions to property, plant and equipment, land use rights and intangible assets.

### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

#### (i) Depreciation and amortisation

The Group's management determines the estimated useful lives and related depreciation/amortisation charges for the property, plant and equipment and intangible assets with reference to the estimated periods that the Group intends to derive future economic benefits from the use of these assets. Management will revise the depreciation and amortisation charge where useful lives are different to previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.



## 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

### (ii) Development costs

The Group's management determines the capitalisation of development costs when it is probable that the project will be a success considering its commercial and technology feasibility. It could change significantly as a result of technological innovations and the changes of estimated projections. Management will write-off or write-down development costs when there are adverse changes in technological innovations or estimated projections.

### (iii) Impairment of non-financial assets

Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its recoverable amount in accordance with the accounting policy stated in Note 3(f). The recoverable amount of an asset or a cash-generating unit is determined based on value-in-use calculations. The value-in-use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value, which has been prepared on the basis of management's assumptions and estimates. Detailed sensitivity analyses have been performed and management is confident that the carrying amount of the relevant assets will be recovered in full.

### (iv) Impairment of account and other receivables

Provision for impairment of account and other receivables is determined based on the evaluation of collectibility of account and other receivables. A considerable amount of judgment is required in assessing the ultimate realisation of these receivables, including the current creditworthiness, the past collection history of each customer and the current market condition.

### (v) Inventories

Management estimates the net realisable value for finished goods and work-in progress based primarily on the latest invoice prices and current market conditions. The Group carries out an inventory review on a product-by-product basis at each balance sheet date and make provision for impairment on obsolete and slow-moving items or write-off or write-down inventories to net realisable value.

### (vi) Revenue recognition

The Group uses the percentage of completion method in accounting for its contract revenues. Use of the percentage of completion method requires the Group to estimate the contract costs incurred up to the balance sheet date as a proportion of the total estimated cost for each contract. Base on the Group's experience and nature of the construction contracts undertaken by the Group, the Group makes estimates of the point at which it considers the work is sufficiently advanced such that costs to complete and revenue can be reliably estimated. Management is confident that the actual outcome will not materially differ from the estimates made at the balance sheet date.



### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

#### (vii) Income taxes

The Group is subject to income taxes in the PRC. There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

#### (viii) Provisions

The Group gives warranties on certain automobile and aviation products and undertakes to repair or replace items that fail to perform satisfactorily based on certain pre-determined conditions. Management estimates the related warranty claims based on historical warranty claim information including level of repairs and returns as well as recent trends that might suggest that past cost information may differ from future claims.

Factors that could impact the estimated claim information include the success of the Group's productivity and quality initiatives, as well as parts and labor costs. Any increase or decrease in the provision would affect profit or loss in future years.

### 5 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.



## 5 SEGMENT INFORMATION (continued)

### Primary reporting format - business segments

	2005		
	Aviation RMB'000	Automobiles RMB'000	Total RMB'000
<b>Operating results</b>			
Turnover	3,550,166	10,715,942	14,266,108
Segment results	275,125	108,887	384,012
Other unallocated income			2,031
Unallocated costs			(37,840)
Operating profit			348,203
Finance costs, net	(77,167)	(76,729)	(153,896)
Share of results of associates	50,023	(4,656)	45,367
Profit before taxation			239,674
Taxation			(52,078)
Profit for the year			187,596
<b>Assets</b>			
Segment assets	7,114,388	14,400,585	21,514,973
Interests in associates	182,184	70,679	252,863
Unallocated assets			943,666
Total assets			22,711,502
<b>Liabilities</b>			
Segment liabilities	3,715,239	9,653,737	13,368,976
Unallocated liabilities			633,320
Total liabilities			14,002,296
<b>Other segment items</b>			
Capital expenditure	256,714	2,307,396	2,564,110
Depreciation	117,521	546,568	664,089
Amortisation	656	98,836	99,492
Other non-cash expenses	30,456	112,388	142,844



# Notes to the Financial Statements

## 5 SEGMENT INFORMATION (continued)

### Primary reporting format - business segments (continued)

	2004		
	Aviation RMB'000	Restated Automobiles RMB'000	Total RMB'000
<b>Operating results</b>			
Turnover	2,608,152	10,269,300	12,877,452
Segment results	285,853	211,837	497,690
Other unallocated income			9,724
Unallocated costs			(54,716)
Operating profit			452,698
Finance costs, net	(58,406)	(178,099)	(236,505)
Share of results of associates	10,081	(2,066)	8,015
Profit before taxation			224,208
Taxation			(86,342)
Profit for the year			137,866
<b>Assets</b>			
Segment assets	5,109,652	12,618,794	17,728,446
Interests in associates	116,133	108,059	224,192
Unallocated assets			1,863,324
Total assets			19,815,962
<b>Liabilities</b>			
Segment liabilities	1,495,482	9,602,574	11,098,056
Unallocated liabilities			680,167
Total liabilities			11,778,223
<b>Other segment items</b>			
Capital expenditure	190,836	1,463,367	1,654,203
Depreciation	84,473	613,557	698,030
Amortisation	165	88,749	88,914
Other non-cash expenses	34,925	65,452	100,377



## 6 OTHER INCOME

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
		Restated
Interest income on bank balances and deposits	<b>73,968</b>	65,701
Sales of scrap materials	<b>16,511</b>	19,542
Income from investments	<b>2,031</b>	9,724
Amortisation of government grants	<b>96,634</b>	15,046
Discretionary value-added tax and real estate tax refund (note)	<b>4,706</b>	9,279
Technical consultancy services	<b>9,838</b>	—
Rental income from plant and equipment	<b>5,069</b>	3,041
	<b>208,757</b>	122,333

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.



## Notes to the Financial Statements

### 7 OPERATING PROFIT

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

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
		Restated
Auditors' remuneration	<b>6,840</b>	6,816
Amortisation of land use rights (included in "Administrative expenses") (Note 16)	<b>4,904</b>	4,295
Amortisation of intangible assets (Note 17)		
- development costs (included in "Administrative expenses")	<b>93,408</b>	83,360
- electricity use rights (included in "Administrative expenses")	<b>1,180</b>	1,259
Costs of inventories recognised as expenses included in cost of sales (note)	<b>12,395,184</b>	10,947,908
Depreciation on property, plant and equipment (Note 15)	<b>664,089</b>	698,030
Fair value losses (including loss on disposal) on other financial assets		
at fair value through profit or loss	<b>3,015</b>	14,648
Loss on disposal of subsidiaries (Note 37(c))	<b>1,918</b>	—
Loss on disposal of property, plant and equipment	<b>9,513</b>	2,052
Operating lease rentals in respect of		
- land and buildings	<b>38,515</b>	50,642
- plant and machinery	<b>430</b>	23
Provision for impairment of other non-current financial assets	<b>25,000</b>	25,000
Provision for impairment of intangible assets (Note 17)	<b>96,603</b>	—
Provision for impairment of property, plant and equipment (Note 15)	<b>1,305</b>	—
Provision for impairment of receivables	<b>33,877</b>	45,959
Repairs and maintenance expense on property, plant and equipment	<b>15,670</b>	8,964
Research and development expense	<b>86,714</b>	168,081
Reversal of provision for inventories	<b>(13,941)</b>	—
Staff costs (including directors' emoluments) (Note 14)	<b>793,454</b>	873,941
Warranty expense (Note 32)	<b>59,235</b>	26,498
Write-down of inventories to net realisable value	<b>—</b>	29,418
	<b>=====</b>	<b>=====</b>

Note:

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



## 8 FINANCE COSTS, NET

	2005 RMB'000	2004 RMB'000 Restated
Interest expense on bank borrowings		
- wholly repayable within 5 years	281,765	242,282
- not wholly repayable within 5 years	854	—
Interest expense on other borrowings		
- wholly repayable within 5 years	661	669
- not wholly repayable within 5 years	121	121
Less: amount capitalised in property, plant and equipment (note (a))	(36,918)	(34,697)
Less: government interest subsidies (note (b))	(37,100)	(4,849)
	<u>209,383</u>	<u>203,526</u>
Exchange (gains)/losses, net	(57,993)	29,714
Bank charges	2,506	3,265
	<u>153,896</u>	<u>236,505</u>

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:

	2005	2004
Interest rates per annum at which finance costs were capitalised	<u>3.68% to 5.58%</u>	<u>4.00% to 6.63%</u>

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





## 9 TAXATION

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
		Restated
PRC current income tax	<b>64,621</b>	37,988
Deferred income taxes	<b>(12,543)</b>	48,354
	<b>52,078</b>	86,342

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 (2004: 33%), except for certain subsidiaries which are taxed at preferential rates ranging from 7.5% to 33% (2004: 0% to 33%) based on the relevant PRC tax rules and regulations.

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:

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
		Restated
Profit before taxation	<b>239,674</b>	224,208
Tax calculated at the statutory tax rate of 33% (2004: 33%)	<b>79,092</b>	73,989
Preferential tax rates on the income of certain subsidiaries	<b>(47,049)</b>	(64,393)
Non-taxable income	<b>(47,894)</b>	(29,563)
Expenses not deductible for tax purposes	<b>20,479</b>	31,396
Tax losses for which no deferred income tax asset was recognised	<b>69,856</b>	82,852
Utilisation of previously unrecognised tax losses	<b>(25,280)</b>	(8,758)
Others	<b>2,874</b>	819
Tax charge	<b>52,078</b>	86,342

Share of taxation attributable to associates for the year ended 31st December 2005 of RMB2,202,000 (2004: RMB6,172,000) are included in the consolidated income statement as share of results of associates.



## 10 PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of RMB 69,645,000 (2004: RMB 65,871,000 as restated).

## 11 DIVIDENDS

	2005 RMB'000	2004 RMB'000
Final dividend, proposed, of RMB0.0105 (2004: RMB Nil) per share	<b>48,758</b>	—

At a meeting held on 4th April 2006, 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 2006.

**12 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS****(a) Details of directors' emoluments**

The remuneration of each of the directors of the Company for the year ended 31st December 2005 and 2004 is set out below.

Name of director	Year ended 31st December 2005				
	Fees RMB'000	Basic salaries, housing allowances, other allowances and benefits in kind RMB'000	Bonuses RMB'000	Employer's contributions to retirement schemes RMB'000	Total RMB'000
<b>Executive directors:</b>					
Zhang Hongbiao	—	180	—	—	180
Wu Xiandong	—	160	—	—	160
<b>Non-executive directors:</b>					
Liang Zhenhe	—	120	—	—	120
Song Jingang	—	120	—	—	120
Tan Ruisong *	—	60	—	—	60
Wang Bin *	—	60	—	—	60
Chen Huaqiu	—	120	—	—	120
Tian Min	—	120	—	—	120
Wang Yong *	—	15	—	—	15
Maurice Savart	—	—	—	—	—
Xu Tongxing *	—	60	—	—	60
Cui Xuewen *	—	60	—	—	60
Yang Jinhuai *	—	60	—	—	60
Hu Jiarui *	—	15	—	—	15
<b>Independent non-executive directors:</b>					
Dr. The Hon. Li Kwok-Po, David	106	—	—	—	106
Guo Chongqing	57	—	—	—	57
Li Xianzong	57	—	—	—	57
	<b>220</b>	<b>1,150</b>	<b>—</b>	<b>—</b>	<b>1,370</b>



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

### (a) Details of directors' emoluments (continued)

Year ended 31st December 2004					
Name of director	Basic salaries, housing allowances, other allowances and benefits			Employer's contributions to retirement schemes	Total
	Fees RMB'000	in kind RMB'000	Bonuses RMB'000	RMB'000	
<b>Executive directors:</b>					
Zhang Hongbiao	—	180	—	—	180
Wu Xiandong	—	160	—	—	160
<b>Non-executive directors:</b>					
Liang Zhenhe	—	120	—	—	120
Song Jingang	—	120	—	—	120
Chen Huaqiu	—	120	—	—	120
Tian Min	—	120	—	—	120
Maurice Savart	—	—	—	—	—
Xu Tongxing *	—	120	—	—	120
Cui Xuwen *	—	120	—	—	120
Yang Jinhuai *	—	120	—	—	120
Hu Jiarui *	—	30	—	—	30
<b>Independent non-executive directors:</b>					
Dr. The Hon. Li Kwok-Po, David	127	—	—	—	127
Guo Chongqing	60	—	—	—	60
Li Xianzong (appointed on 30th December 2004)	—	—	—	—	—
	187	1,210	—	—	1,397

• Appointed on 16th June 2005

\* Resigned on 16th June 2005



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

**(b) Supervisors' emoluments**

The remuneration of each of the supervisors of the Company for the year ended 31st December 2005 and 2004 is set out below.

Name of supervisor	Year ended at 31st December 2005			
	Basic salaries, housing allowances, other allowances and benefits in kind RMB'000	Bonuses RMB'000	Employer's contributions to retirement schemes RMB'000	Total RMB'000
<b>Supervisors:</b>				
Wang Shouxin	160	—	—	160
Li Shentian	120	—	—	120
Bai Ping	120	—	—	120
Tang Jianguo	120	—	—	120
Lu Liubao	120	—	—	120
Liu Xianping	20	—	—	20
Yu Yan	20	—	—	20
<b>Independent supervisors:</b>				
Zheng Li	30	—	—	30
Xie Zhihua	30	—	—	30
	<b>740</b>	<b>—</b>	<b>—</b>	<b>740</b>



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

### (b) Supervisors' emoluments (continued)

Name of supervisor	Year ended 31st December 2004			
	Basic salaries, housing allowances, other allowances and benefits	Bonuses	Employer's contributions to retirement schemes	Total
	in kind			
	RMB'000	RMB'000	RMB'000	RMB'000
<b>Supervisors:</b>				
Wang Shouxin	160	—	—	160
Li Shentian	120	—	—	120
Bai Ping	120	—	—	120
Tang Jianguo	120	—	—	120
Lu Liubao	120	—	—	120
Liu Xianping	20	—	—	20
Yu Yan	20	—	—	20
<b>Independent supervisors:</b>				
Zheng Li	30	—	—	30
Xie Zihua	30	—	—	30
	740	—	—	740
	740	—	—	740

### (c) Five highest paid individuals

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

In the capacity as:	Number of individuals	
	2005	2004
Directors	2	2
Supervisor	1	1
Senior management	2	2
	5	5
	5	5



## 12 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 (2004: two) directors and one (2004: one) supervisor whose emoluments are reflected in the analyses presented above. The emoluments payable to the remaining two (2004: two) individuals during the year are as follows:

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	<b>395</b>	395
Contributions to retirement schemes	<b>—</b>	—
	<b>395</b>	395

The emoluments fell within the following band:

	<b>Number of individuals</b>	
	<b>2005</b>	2004
Nil – RMB1,040,000 (equivalent to Hong Kong Dollar 1,000,000)	<b>2</b>	2

- (d) No directors or supervisors of the Company waived any emoluments during the years ended 31st December 2004 and 2005. During the year, no emoluments have been paid by the Group to the directors or supervisors of the Company 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 (2004: Nil).

## 13 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the Group's profit attributable to equity holders of the Company of RMB 118,072,000 (2004: RMB 71,439,000) and based on the weighted average number of 4,643,608,500 (2004: 4,643,608,500) shares in issue during the year.

There was no dilution effect on the basic earnings per share for the years ended 31st December 2004 and 2005 as there were no potential dilutive shares outstanding during the years ended 31st December 2004 and 2005.



## 14 STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	Note	2005 RMB'000	2004 RMB'000
Wages, salaries and bonuses		531,077	636,550
Housing benefits	(a)	26,408	44,025
Contributions to pension plans	(b)	122,398	107,487
Welfare and other expenses		113,571	85,879
		<b>793,454</b>	<b>873,941</b>

- (a) These mainly include the Group's contributions to government sponsored housing funds for employees at rates ranging from 5% to 30% (2004: 5% to 30%) of the employees' basic salary during the year (See also Note 3(o)(iii)).
- (b) The employees of the Group participate in various pension plans organised by the relevant municipal and provincial governments under which the Group is required to make monthly defined contributions to these plans at rates ranging from 20% to 22% (2004: 20% to 22%), dependent upon the applicable local regulations, of the employees' basic salary.





## 15 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
<b>Cost</b>					
As at 1st January 2005	1,623,668	1,674,862	6,734,330	476,240	10,509,100
Additions	2,139,333	84,269	95,553	54,112	2,373,267
Transfer upon completion	(2,133,338)	414,604	1,573,369	145,365	—
Disposals	—	(70,293)	(148,103)	(36,075)	(254,471)
As at 31st December 2005	<u>1,629,663</u>	<u>2,103,442</u>	<u>8,255,149</u>	<u>639,642</u>	<u>12,627,896</u>
<b>Accumulated depreciation and impairment</b>					
As at 1st January 2005	—	484,632	2,394,866	242,965	3,122,463
Impairment expense	1,305	—	—	—	1,305
Charge for the year	—	124,888	479,775	59,426	664,089
Disposals	—	(36,031)	(80,857)	(16,151)	(133,039)
As at 31st December 2005	<u>1,305</u>	<u>573,489</u>	<u>2,793,784</u>	<u>286,240</u>	<u>3,654,818</u>
<b>Net book value</b>					
As at 31st December 2005	<u>1,628,358</u>	<u>1,529,953</u>	<u>5,461,365</u>	<u>353,402</u>	<u>8,973,078</u>



## 15 PROPERTY, PLANT AND EQUIPMENT (continued)

### Group (continued)

#### (a) Movement (continued)

	<b>Construction in progress</b>	<b>Buildings</b>	<b>Plant and equipment</b>	<b>Furniture and fixtures, other equipment and motor vehicles</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>Cost</b>					
As at 1st January 2004	1,073,501	1,479,472	6,180,724	442,146	9,175,843
Additions	1,340,311	13,519	115,476	46,404	1,515,710
Transfer upon completion	(790,144)	194,266	565,481	30,397	—
Disposals	—	(12,395)	(127,351)	(42,707)	(182,453)
As at 31st December 2004	<u>1,623,668</u>	<u>1,674,862</u>	<u>6,734,330</u>	<u>476,240</u>	<u>10,509,100</u>
<b>Accumulated depreciation and impairment</b>					
As at 1st January 2004	—	415,287	1,906,884	209,241	2,531,412
Charge for the year	—	73,786	567,247	56,997	698,030
Disposals	—	(4,441)	(79,265)	(23,273)	(106,979)
As at 31st December 2004	<u>—</u>	<u>484,632</u>	<u>2,394,866</u>	<u>242,965</u>	<u>3,122,463</u>
<b>Net book value</b>					
As at 31st December 2004	<u>1,623,668</u>	<u>1,190,230</u>	<u>4,339,464</u>	<u>233,275</u>	<u>7,386,637</u>



## 15 PROPERTY, PLANT AND EQUIPMENT (continued)

- (b) Certain of the Group's property, plant and equipment with carrying value of approximately RMB 1,036,780,000 at 31st December 2005 (2004: RMB 870,469,000) 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 2005 range from 17 to 44 years (2004: 18 to 45 years).
- (c) Property, plant and equipment pledged as securities for bank borrowings were as follows:

	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
Net book value of property, plant and equipment pledged (Note 33(d))	<b>406,563</b>	423,926



## 15 PROPERTY, PLANT AND EQUIPMENT (continued)

### Company

	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
<b>Cost</b>			
As at 1st January 2005	6,637	7,861	14,498
Additions	—	503	503
As at 31st December 2005	<u>6,637</u>	<u>8,364</u>	<u>15,001</u>
<b>Accumulated depreciation and impairment</b>			
As at 1st January 2005	2,890	2,362	5,252
Charge for the year	204	629	833
As at 31st December 2005	<u>3,094</u>	<u>2,991</u>	<u>6,085</u>
<b>Net book value</b>			
As at 31st December 2005	<u>3,543</u>	<u>5,373</u>	<u>8,916</u>
<b>Cost</b>			
As at 1st January 2004	6,637	7,546	14,183
Additions	—	315	315
As at 31st December 2004	<u>6,637</u>	<u>7,861</u>	<u>14,498</u>
<b>Accumulated depreciation and impairment</b>			
As at 1st January 2004	2,557	1,935	4,492
Charge for the year	333	427	760
As at 31st December 2004	<u>2,890</u>	<u>2,362</u>	<u>5,252</u>
<b>Net book value</b>			
As at 31st December 2004	<u>3,747</u>	<u>5,499</u>	<u>9,246</u>



## 16 LAND USE RIGHTS

	Group	
	2005	2004
	RMB'000	RMB'000
<b>Cost</b>		
At 1st January	111,466	107,857
Additions	13,820	3,609
At 31st December	<u>125,286</u>	<u>111,466</u>
<b>Accumulated amortisation</b>		
At 1st January	21,068	16,773
Amortisation for the year	4,904	4,295
At 31st December	<u>25,972</u>	<u>21,068</u>
<b>Net book amount</b>		
At 31st December	<u>99,314</u>	<u>90,398</u>



## 17 INTANGIBLE ASSETS

	Development costs RMB'000 (note (i))	Group Electricity use rights RMB'000	Total RMB'000
<b>Cost</b>			
As at 1st January 2005	688,824	37,760	726,584
Additions	177,023	—	177,023
As at 31st December 2005	<u>865,847</u>	<u>37,760</u>	<u>903,607</u>
<b>Accumulated amortisation and impairment</b>			
As at 1st January 2005	152,023	7,515	159,538
Impairment expense (note (ii))	67,538	29,065	96,603
Amortisation for the year	93,408	1,180	94,588
As at 31st December 2005	<u>312,969</u>	<u>37,760</u>	<u>350,729</u>
<b>Net book amount</b>			
As at 31st December 2005	<u><u>552,878</u></u>	<u><u>—</u></u>	<u><u>552,878</u></u>
<b>Cost</b>			
As at 1st January 2004	553,940	37,760	591,700
Additions	134,884	—	134,884
As at 31st December 2004	<u>688,824</u>	<u>37,760</u>	<u>726,584</u>
<b>Accumulated amortisation and impairment</b>			
As at 1st January 2004	68,663	6,256	74,919
Amortisation for the year	83,360	1,259	84,619
As at 31st December 2004	<u>152,023</u>	<u>7,515</u>	<u>159,538</u>
<b>Net book amount</b>			
As at 31st December 2004	<u><u>536,801</u></u>	<u><u>30,245</u></u>	<u><u>567,046</u></u>



# Notes to the Financial Statements

## 17 INTANGIBLE ASSETS (continued)

Note:

- (i) The Group has entered into a jointly controlled asset arrangement to develop a new aircraft in the PRC with a fellow subsidiary of the Group during the year. The Group has 60.56% participating interests in the joint venture. At 31st December 2005, the aggregate amounts of development costs recognised in the financial statements relating to the Group's interests in the jointly controlled assets arrangement amounted to RMB134,988,000. No significant liabilities have been incurred as of 31st December 2005.
- (ii) Impairment losses on intangible assets are mainly in relation to certain development costs for which sales of the relevant products are below budget and management estimated that the carrying amounts of these assets have exceeded their recoverable amounts as determined based on value-in-use calculations.

## 18 INTERESTS IN SUBSIDIARIES

	Company	
	2005 RMB'000	2004 RMB'000 Restated
Investments, at cost		
Shares listed in the PRC	1,044,117	1,044,117
Unlisted equity investments	2,411,254	2,411,254
	3,455,371	3,455,371
Amounts due from subsidiaries (note)	955,188	662,313
	4,410,559	4,117,684
Market value of listed shares	1,281,060	1,235,778

Particulars of the principal subsidiaries of the Group are set out in Note 44.

Note:

Amounts due from subsidiaries are unsecured, non-interest bearing and are repayable on demand.



## 19 INTERESTS IN ASSOCIATES

	Group	
	2005	2004
	RMB'000	RMB'000
Share of net assets at 1st January	224,192	166,059
Share of results of associates		
- Profit before taxation	47,569	14,187
- Taxation	(2,202)	(6,172)
	<u>45,367</u>	<u>8,015</u>
Dividend received from an associate	(39)	—
Additions	6,902	50,118
Disposals	(23,559)	—
	<u>252,863</u>	<u>224,192</u>

Particulars of the principal associates of the Group are set out in Note 44.

## 20 OTHER NON-CURRENT FINANCIAL ASSETS

	Group	
	2005	2004
	RMB'000	RMB'000
Investments in promoters' shares, at cost	<u>73,221</u>	<u>73,221</u>
Unlisted investments, at cost	92,665	76,641
Less: Provision for impairment	(50,000)	(25,000)
	<u>42,665</u>	<u>51,641</u>
	<u>115,886</u>	<u>124,862</u>

The Group's other non-current financial assets represent investments in promoters' shares of certain companies listed in the PRC which are transferable subject to approval from relevant regulatory authorities, and interests in certain unlisted companies; all of which do not have a quoted market price in an active market and for which the range of other methods of reasonably estimating fair value is significant and the probabilities of the various estimates cannot be reasonably assessed. Accordingly, these investments are carried at cost less accumulated impairment losses.





## 21 DEFERRED INCOME TAXES

Deferred income taxes are calculated in respect of temporary differences under the liability method using the tax rates enacted or substantively enacted by the balance sheet date.

The movement on the deferred income tax accounts is as follows:

Deferred income tax assets:

	Group	
	2005	2004
	RMB'000	RMB'000
At 1st January	38,713	99,918
Credited/(charged) to consolidated income statement	10,776	(61,205)
At 31st December	<u>49,489</u>	<u>38,713</u>

Deferred income tax liabilities:

	Group	
	2005	2004
	RMB'000	RMB'000
At 1st January	51,110	63,961
Credited to consolidated income statement	(1,767)	(12,851)
At 31st December	<u>49,343</u>	<u>51,110</u>



## 21 DEFERRED INCOME TAXES (continued)

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

	Group	
	2005 RMB'000	2004 RMB'000
Deferred income tax assets:		
Provision for impairment of receivables	58,355	49,638
Provision for impairment of inventories	13,562	16,719
Provision for impairment of investments	375	1,737
Provision for impairment of property, plant and equipment	2,676	3,556
Provision for warranty expense	14,778	7,734
Other temporary differences	8,391	8,912
	<u>98,137</u>	<u>88,296</u>
Deferred income tax liabilities:		
Interest income	396	1,483
Development costs	97,595	99,210
	<u>97,991</u>	<u>100,693</u>
Total deferred income tax assets less total deferred income tax liabilities	<u>146</u>	<u>(12,397)</u>

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 taxes related to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	Group	
	2005 RMB'000	2004 RMB'000
Representing:		
Deferred income tax assets	49,489	38,713
Deferred income tax liabilities	(49,343)	(51,110)
Total deferred income tax assets less total deferred income tax liabilities	<u>146</u>	<u>(12,397)</u>



## 21 DEFERRED INCOME TAXES (continued)

Deferred income tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group did not recognise deferred income tax assets of RMB89,268,000 (2004: RMB82,852,000) in respect of tax losses amounting to RMB270,510,000 (2004: RMB251,066,000) that can be carried forward against future taxable income. These unrecognised tax losses are expiring within 5 years.

## 22 ACCOUNTS RECEIVABLE

	Group	
	2005	2004
	RMB'000	RMB'000
Trade receivables, net (note (a))	792,096	457,206
Notes receivable (note (b))	834,979	582,457
Due from fellow subsidiaries and other related parties (note (c))	1,302,024	856,833
	<hr/>	<hr/>
	<b>2,929,099</b>	1,896,496
	<hr/> <hr/>	<hr/> <hr/>

The carrying amounts of accounts receivable approximate their fair values.



## 22 ACCOUNTS RECEIVABLE (continued)

### (a) Trade receivables, net

	Group	
	2005	2004
	RMB'000	RMB'000
Gross trade receivables	994,502	651,113
Less: provision for impairment of receivables	(202,406)	(193,907)
	<b>792,096</b>	<b>457,206</b>
	<b>792,096</b>	<b>457,206</b>

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	
	2005	2004
	RMB'000	RMB'000
Current to 6 months	653,924	286,760
6 months to 1 year	118,331	161,762
1 year to 2 years	48,709	22,510
2 years to 3 years	22,849	29,380
Over 3 years	150,689	150,701
	<b>994,502</b>	<b>651,113</b>
	<b>994,502</b>	<b>651,113</b>

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



## 22 ACCOUNTS RECEIVABLE (continued)

### (c) Due from fellow subsidiaries and other related parties

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

	Group	
	2005 RMB'000	2004 RMB'000
Trade receivables		
- Fellow subsidiaries (note (i))	1,116,620	545,568
- Other related parties (note (i))	165,317	210,380
	<u>1,281,937</u>	<u>755,948</u>
Less: provision for impairment of receivables	(50,313)	(46,065)
	<u>1,231,624</u>	709,883
Notes receivable		
- Fellow subsidiaries (note (ii))	70,400	146,950
	<u>1,302,024</u>	<u>856,833</u>

Trade and notes receivable from fellow subsidiaries and other related parties are unsecured and non-interest bearing. The credit period granted to fellow subsidiaries and other 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 fellow subsidiaries and other related parties, which are trade in nature, is summarised as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Current to 1 year	1,214,944	679,992
1 year to 2 years	39,472	52,340
2 years to 3 years	6,019	428
Over 3 years	21,502	23,188
	<u>1,281,937</u>	<u>755,948</u>

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



## 23 OTHER RECEIVABLES, PREPAYMENTS AND OTHER CURRENT ASSETS

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Advances to suppliers	339,580	332,636	—	—
Advances for purchase of property, plant and equipment	33,259	31,523	—	—
Due from holding company, fellow subsidiaries and other related parties (note (a))	698,726	538,519	32,350	40,946
Other receivables	59,669	25,892	—	—
Prepayments and deposits	98,226	96,711	1,320	—
Value-added tax recoverable	24,822	32,539	—	—
Other current assets	27,648	25,880	—	—
	<b>1,281,930</b>	<b>1,083,700</b>	<b>33,670</b>	<b>40,946</b>

Notes:

(a) The amounts due from holding company, fellow subsidiaries and other related parties can be analysed as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Holding company:				
- Other temporary advances (note (iii))	58,090	95,156	32,350	40,946
Fellow subsidiaries:				
- Advances for purchase of goods and raw materials (note (ii))	368,401	288,454	—	—
- Other temporary advances (note (iii))	35,788	36,688	—	—
	404,189	325,142	—	—
Other related parties:				
- Advances for purchase of goods and raw materials (note (ii))	236,447	118,221	—	—
	698,726	538,519	32,350	40,946

- (i) Amounts due from holding company, fellow subsidiaries and other related parties are unsecured and non-interest bearing.
- (ii) Advances for purchase of goods and raw materials are recurrent in nature and will be settled in accordance with the relevant trading terms.
- (iii) Other temporary advances mainly represent current account balances with the respective companies and are repayable on demand.



## 24 INVENTORIES

	Group	
	2005	2004
	RMB'000	RMB'000
Raw materials	1,978,068	1,639,809
Work in progress	640,449	506,714
Finished goods	1,487,906	1,615,955
Consumables	93,189	104,892
	<hr/>	<hr/>
	4,199,612	3,867,370
Less: provision for impairment losses	(72,994)	(86,907)
	<hr/>	<hr/>
	<b>4,126,618</b>	<b>3,780,463</b>
	<hr/> <hr/>	<hr/> <hr/>

## 25 CONTRACTS IN PROGRESS

	Group	
	2005	2004
	RMB'000	RMB'000
Contracts in progress at balance sheet date:		
Amounts due from contract customers	136,167	169,109
Amounts due to contract customers	—	—
	<hr/>	<hr/>
	136,167	169,109
	<hr/> <hr/>	<hr/> <hr/>
Contract costs incurred and recognised profits to date	1,984,293	1,260,732
	<hr/> <hr/>	<hr/> <hr/>

At 31st December 2005, there were no retentions held by customers for contract work and no advances received on construction contracts (2004: Nil).

## 26 OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS - GROUP

Other financial assets at fair value through profit or loss represent stocks and 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	
	2005	2004
	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 (denominated in RMB)	<b>405,574</b>	434,795
Corresponding trade finance facilities utilised	<b>943,472</b>	512,324

Pledged deposits earn interest at fixed rates ranging from 0.72% to 2.07%. The corresponding trade finance facilities utilised mainly represent notes payable to suppliers.

## 28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

Term deposits with initial term of over three months deposited with banks in the PRC are analysed as follows:

	Group		Company	
	2005	2004	2005	2004
Currency	RMB'000	RMB'000	RMB'000	RMB'000
RMB	<b>701,187</b>	682,900	<b>534,000</b>	400,000
Hong Kong Dollar	<b>104,030</b>	531,850	<b>104,030</b>	531,850
	<b>805,217</b>	1,214,750	<b>638,030</b>	931,850

The weighted average effective interest rates of the Group and the Company on term deposits with initial term of over three months were 2.33% (2004: 2.23%) and 2.39% (2004: 2.35%) per annum respectively. The conversion of RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.





## 29 TRADE PAYABLES

	Group	
	2005	2004
	RMB'000	RMB'000
Trade payables (note (a))	<b>3,476,023</b>	2,681,222
Notes payable (note (b))	<b>1,320,873</b>	664,997
Due to fellow subsidiaries and other related parties (note (c))	<b>1,017,665</b>	617,840
	<b><u>5,814,561</u></b>	<u>3,964,059</u>

The carrying amounts of trade payables approximate their fair values.

(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 2005 is as follows:

	Group	
	2005	2004
	RMB'000	RMB'000
Current to 1 year	<b>3,270,329</b>	2,612,318
1 year to 2 years	<b>186,751</b>	34,123
2 years to 3 years	<b>13,544</b>	9,009
Over 3 years	<b>5,399</b>	25,772
	<b><u>3,476,023</u></b>	<u>2,681,222</u>

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



## 29 TRADE PAYABLES (continued)

### (c) Due to fellow subsidiaries and other related parties

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

	Group	
	2005	2004
	RMB'000	RMB'000
Trade payables:		
- Fellow subsidiaries (note (i))	277,370	327,552
- Other related parties (note (i))	529,391	93,957
	806,761	421,509
Notes payable:		
- Fellow subsidiaries (note (ii))	210,904	194,353
- Other related parties (note (ii))	—	1,978
	210,904	196,331
	1,017,665	617,840

Note:

- (i) Trade payables to fellow subsidiaries and other related parties are unsecured and non-interest bearing. The credit period granted by fellow subsidiaries and other 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 fellow subsidiaries and other related parties, which are trade in nature, is summarised as follows:

	Group	
	2005	2004
	RMB'000	RMB'000
Current to 1 year	801,863	332,662
1 year to 2 years	4,861	44,725
2 years to 3 years	37	43,604
Over 3 years	—	518
	806,761	421,509
	806,761	421,509

- (ii) Notes payable are bills of exchange with average maturity period of within six months.



## 30 OTHER PAYABLES, ACCRUALS AND OTHER CURRENT LIABILITIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Other payables and accruals (note (a))	1,587,948	1,117,164	3,942	4,210
Due to holding company, fellow subsidiaries and other related parties (note (b))	236,961	538,288	22,916	19,063
	<b>1,824,909</b>	<b>1,655,452</b>	<b>26,858</b>	<b>23,273</b>

(a) Other payables and accruals

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Customer deposits	349,516	347,629	—	—
Payable for property, plant and equipment	417,601	158,694	—	—
Wages, salaries and bonuses payables	158,355	162,516	—	—
Welfare payables	167,419	133,869	135	—
Accrued expenses	279,429	157,353	3,807	4,210
Deferred income from government grants	25,442	22,417	—	—
Consumption tax, business tax and other taxes payable	56,334	25,291	—	—
Other current liabilities	133,852	109,395	—	—
	<b>1,587,948</b>	<b>1,117,164</b>	<b>3,942</b>	<b>4,210</b>



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

(b) Due to holding company, fellow subsidiaries and other related parties

The amounts due to holding company, fellow subsidiaries and other related parties can be analysed as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Holding company:				
- Special dividend	—	7,125	—	7,125
- Other temporary advances (note (iii))	<b>24,082</b>	6,280	<b>10,845</b>	1,860
	<b>24,082</b>	13,405	<b>10,845</b>	8,985
Fellow subsidiaries:				
- Deposits for sales of aircraft and automobiles (note (ii))	<b>37,777</b>	1,600	—	—
- Payable for property, plant and equipment (note (ii))	<b>3,621</b>	385	—	—
- Other temporary advances (note (iii))	<b>130,800</b>	399,010	<b>12,071</b>	10,078
	<b>172,198</b>	400,995	<b>12,071</b>	10,078
Other related parties:				
- Deposits for sales of aircraft and automobiles (note (ii))	<b>14,467</b>	—	—	—
- Other temporary advances (note (iii))	<b>26,214</b>	123,888	—	—
	<b>40,681</b>	123,888	—	—
	<b>236,961</b>	538,288	<b>22,916</b>	19,063

- (i) Amounts due to holding company, fellow subsidiaries and other 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 will be settled in accordance with the relevant trading terms.
- (iii) Other temporary advances mainly represent current account balances with the respective companies and are repayable on demand.



## 31 AMOUNT PAYABLE TO ULTIMATE HOLDING COMPANY

	Group and Company	
	2005	2004
	RMB'000	RMB'000
At 1st January and 31st December	<b>532,298</b>	573,244
Less: amount payable within one year	<b>(532,298)</b>	(40,946)
	<u>—</u>	<u>532,298</u>

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 above obligations were actuarially determined by a PRC insurance company using the projected unit credit method and are repayable to AVIC II with no fixed repayment terms under the Reorganisation. In prior years, the Group settled these employee benefits obligations by installments as agreed by AVIC II. As of 31st December 2005, the directors classified the balance under current liabilities as they intended to settle these obligations fully in the next twelve months.



## 32 PROVISIONS

	Group		
	One-off cash housing subsidies RMB'000 (note (a))	Warranty RMB'000 (note (b))	Total RMB'000
At 1st January 2005	56,226	68,902	125,128
Additional provisions	—	59,235	59,235
Utilised during the year	—	(46,501)	(46,501)
	<u>56,226</u>	<u>81,636</u>	<u>137,862</u>
At 31st December 2005	<u>56,226</u>	<u>81,636</u>	<u>137,862</u>
<b>Analysis of total provisions:</b>			
Non-current	56,226	—	56,226
Current	—	81,636	81,636
	<u>56,226</u>	<u>81,636</u>	<u>137,862</u>
At 1st January 2004	56,226	90,536	146,762
Additional provisions	—	26,498	26,498
Utilised during the year	—	(48,132)	(48,132)
	<u>56,226</u>	<u>68,902</u>	<u>125,128</u>
At 31st December 2004	<u>56,226</u>	<u>68,902</u>	<u>125,128</u>
<b>Analysis of total provisions:</b>			
Non-current	56,226	—	56,226
Current	—	68,902	68,902
	<u>56,226</u>	<u>68,902</u>	<u>125,128</u>

### (a) One-off cash housing subsidies

It represents the Group's provision for one-off housing subsidies made prior to the Reorganisation when a provision of approximately RMB56,226,000 was charged to the consolidated income statement in the year ended 31st December 2000 as detailed in Note 3(o)(iii). AVIC II has, however, agreed to bear any further one-off cash housing subsidies in excess of the amount provided above.

### (b) Warranty

The Group gives warranties on certain automobile and aviation products and undertakes to repair or replace items that fail to perform satisfactorily based on certain pre-determined conditions.

A provision of approximately RMB81,636,000 has been recognised as of 31st December 2005 (2004: RMB68,902,000) in connection with the expected warranty claims based on historical warranty information after taking into account of the Group's recent claim experience.



## 33 BORROWINGS

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

	Group	
	2005	2004
	RMB'000	RMB'000
<b>Current borrowings:</b>		
Bank borrowings	<b>4,097,287</b>	3,898,425
Current portion of non-current bank borrowings	<b>366,969</b>	482,314
Current portion of non-current other borrowings	<b>33,025</b>	33,183
	<b>4,497,281</b>	4,413,922
<b>Non-current borrowings:</b>		
Bank borrowings	<b>877,670</b>	929,870
Other borrowings	<b>154,343</b>	12,067
	<b>1,032,013</b>	941,937
Total borrowings	<b>5,529,294</b>	5,355,859
<b>Representing:</b>		
Unsecured	<b>1,382,917</b>	1,068,855
Secured	<b>4,146,377</b>	4,287,004
	<b>5,529,294</b>	5,355,859



### 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	
	2005	2004
	RMB'000	RMB'000
<b>Bank borrowings:</b>		
- at fixed rates	4,989,611	4,615,298
- at floating rates	352,315	695,311
	5,341,926	5,310,609
<b>Other borrowings:</b>		
- at fixed rates	187,368	45,092
- at floating rates	—	158
	187,368	45,250
	5,529,294	5,355,859
Weighted average effective interest rates:		
- bank borrowings	4.80%	4.71%
- other borrowings	0.42%	1.75%
	4.80%	1.75%

The carrying amounts of borrowings by currencies are as follows:

	2005	2004
	RMB'000	RMB'000
Renminbi	4,887,068	4,607,075
US dollar	330,886	207,550
Euro dollar	311,340	366,038
Japanese Yen	—	175,196
	5,529,294	5,355,859
	5,529,294	5,355,859





## 33 BORROWINGS (continued)

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

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

	Group			
	Carrying amounts		Fair values	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Bank borrowings	877,670	929,870	880,486	919,427
Other borrowings	154,343	12,067	147,482	8,624
	<u>1,032,013</u>	<u>941,937</u>	<u>1,027,968</u>	<u>928,051</u>

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 5.76% to 6.12% as of 31st December 2005 (2004: 5.76% to 6.12%), 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	
	2005 RMB'000	2004 RMB'000
<b>Bank borrowings:</b>		
Wholly repayable within five years	1,182,639	1,412,184
Not wholly repayable within five years	62,000	—
	<u>1,244,639</u>	<u>1,412,184</u>
<b>Other borrowings:</b>		
Wholly repayable within five years	175,301	33,183
Not wholly repayable within five years	12,067	12,067
	<u>187,368</u>	<u>45,250</u>
	<u>1,432,007</u>	<u>1,457,434</u>



### 33 BORROWINGS (continued)

(c) At 31st December 2005, the Group's non-current bank borrowings and other borrowings are repayable as follows:

	Group	
	2005 RMB'000	2004 RMB'000
<b>Bank borrowings:</b>		
Within one year	366,969	482,314
In the second year	535,670	419,200
In the third to fifth years	280,000	510,670
After the fifth years	62,000	—
	1,244,639	1,412,184
Less: current portion	(366,969)	(482,314)
	877,670	929,870
<b>Other borrowings:</b>		
Within one year	33,025	33,183
In the third to fifth years	142,276	—
After the fifth year	12,067	12,067
	187,368	45,250
Less: current portion	(33,025)	(33,183)
	154,343	12,067
<b>Total:</b>		
Within one year	399,994	515,497
In the second year	535,670	419,200
In the third to fifth years	422,276	510,670
After the fifth year	74,067	12,067
	1,432,007	1,457,434
Less: current portion	(399,994)	(515,497)
	1,032,013	941,937



## Notes to the Financial Statements

### 33 BORROWINGS (continued)

#### (d) Borrowings facilities

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

	Group	
	2005	2004
	RMB'000	RMB'000
Net book value of property, plant and equipment pledged (Note 15(c))	406,563	423,926
Guarantees provided by AVIC II and fellow subsidiaries of the Group	643,408	945,888
Cross guarantees among subsidiaries of the Group	3,118,969	2,650,366
Guarantees provided by third parties	153,000	167,000
	<u>4,146,377</u>	<u>4,287,004</u>
Corresponding borrowing facilities utilised	<u>4,146,377</u>	<u>4,287,004</u>

All guarantees provided by AVIC II and fellow subsidiaries of the Group should have been released or withdrawn within six months after the listing of the Company's shares. The directors have confirmed that all remaining guarantees will gradually be released or withdrawn.

At 31st December 2005, the Group has the following undrawn committed borrowing facilities:

	Group	
	2005	2004
	RMB'000	RMB'000
Expiring beyond one year at fixed rates	919,172	1,369,206
	<u>919,172</u>	<u>1,369,206</u>

### 34 MINORITY INTERESTS

	Group	
	2005	2004
	RMB'000	RMB'000
Equity interests	3,495,411	2,814,279
Loans from minority shareholders of a subsidiary	—	127,737
	<u>3,495,411</u>	<u>2,942,016</u>

The loans from minority shareholders of a subsidiary are unsecured, interest free and were fully repaid during the year.



### 35 SHARE CAPITAL

	Company	
	2005	2004
	RMB'000	RMB'000
Registered:	<b>4,643,609</b>	4,643,609
Issued and fully paid:		
2,963,808,000 Domestic Shares of RMB 1 each	<b>2,963,808</b>	2,963,808
1,679,800,500 H Shares of RMB 1 each	<b>1,679,801</b>	1,679,801
	<b>4,643,609</b>	4,643,609

During 2003, the Company completed its initial public offering (the "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-owned Assets Supervision and Administration Commission of the State Council 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.



# Notes to the Financial Statements

## 36 RESERVES

### Company

	Capital reserve RMB'000 (Note (b))	Statutory surplus reserve RMB'000 (Note (c))	Statutory public welfare fund RMB'000 (Note (d))	Retained earnings/ (accumulated losses) RMB'000 (Note (e))	Total RMB'000
At 1st January 2005, as previously reported	74,898	16,704	8,351	352,161	452,114
Effect of changes in accounting policy - adoption of IAS 27	(76,971)	—	—	(367,827)	(444,798)
Balance at 1st January 2005, as restated	(2,073)	16,704	8,351	(15,666)	7,316
Profit for the year	—	—	—	69,645	69,645
Transfer to reserves	—	1,105	552	(1,657)	—
As at 31st December 2005	<u>(2,073)</u>	<u>17,809</u>	<u>8,903</u>	<u>52,322</u>	<u>76,961</u>
<b>Representing:</b>					
Proposed dividend	—	—	—	48,758	48,758
Other reserves	(2,073)	17,809	8,903	3,564	28,203
	<u>(2,073)</u>	<u>17,809</u>	<u>8,903</u>	<u>52,322</u>	<u>76,961</u>
At 1st January 2004, as previously reported	74,898	16,259	8,129	330,147	429,433
Effect of changes in accounting policy - adoption of IAS 27	(76,971)	—	—	(362,259)	(439,230)
Balance at 1st January 2004, as restated	(2,073)	16,259	8,129	(32,112)	(9,797)
Profit for the year, as previously reported	—	—	—	71,439	71,439
Effect of changes in accounting policy - adoption of IAS 27	—	—	—	(5,568)	(5,568)
Profit for the year, as restated	—	—	—	65,871	65,871
Dividend relating to 2003	—	—	—	(48,758)	(48,758)
Transfer to reserves	—	445	222	(667)	—
As at 31st December 2004	<u>(2,073)</u>	<u>16,704</u>	<u>8,351</u>	<u>(15,666)</u>	<u>7,316</u>
<b>Representing:</b>					
Other reserves	(2,073)	16,704	8,351	(15,666)	7,316



## 36 RESERVES (continued)

Note:

- (a) Movements in the reserves of the Group are set out in the consolidated statement of changes in equity.
- (b) Capital reserve of the Company represents the difference between the amount of share capital issued by the Company and the historical net value of the assets, liabilities and interests transferred to the Company upon its establishment, set off by net premium on issue of shares upon listing of the Company. Capital reserves of the Group also included a reserve arising from the issuance of additional shares by a subsidiary.
- (c) 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 with the 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.

- (d) 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 2005.

- (e) In accordance with the relevant PRC regulations and Articles of Association of the Company, retained earnings 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 2005, the amount of retained earnings available for distribution was approximately RMB52,322,000 being the amount determined in accordance with IFRS.



## 37 CONSOLIDATED CASH FLOW STATEMENT

### (a) Reconciliation of profit before taxation to net cash generated from operations

	2005 RMB'000	2004 RMB'000 Restated
Profit before taxation	239,674	224,208
Adjustments for:		
Share of results of associates	(45,367)	(8,015)
Loss on disposal of subsidiaries	1,918	—
Amortisation of land use rights and intangible assets	99,492	88,914
Provision for impairment of intangible assets	96,603	—
Depreciation on property, plant and equipment	664,089	698,030
Provision for impairment of property, plant and equipment	1,305	—
Loss on disposal of property, plant and equipment	9,513	2,052
Amortisation of government grants	(96,634)	(15,046)
Provision for impairment of receivables	33,877	45,959
Write-down of inventories to net realisable value	—	29,418
Reversal of provision for inventories	(13,941)	—
Provision for impairment of other non-current financial assets	25,000	25,000
Fair value losses (including loss on disposal) of other financial assets at fair value through profit or loss	3,015	14,648
Interest income	(73,968)	(65,701)
Interest expense	209,383	203,526
	<b>1,153,959</b>	<b>1,242,993</b>
<b>Changes in working capital:</b>		
- (increase) /decrease in accounts receivable	(1,093,229)	849,487
- increase in other receivables, prepayments and other current assets	(247,365)	(30,501)
- increase in inventories	(437,425)	(1,051)
- decrease/(increase) in contracts in progress	32,942	(147,115)
- decrease/(increase) in other financial assets at fair value through profit or loss	202,759	(42,437)
- increase/(decrease) in trade payables	2,087,994	(622,850)
- decrease in other payables, accruals and other current liabilities	(88,748)	(422,209)
- increase/(decrease) in provisions	12,734	(21,634)
- decrease in amount payable to ultimate holding company	(40,946)	(40,946)
- increase in deferred income from government grants	196,956	9,145
Net cash generated from operations	<b>1,779,631</b>	<b>772,882</b>



### 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

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

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	2005 RMB'000	2004 RMB'000
Net book amount (Note 15(a))	121,432	75,474
Loss on disposal of property, plant and equipment	(9,513)	(2,052)
Receivables from sale of property, plant and equipment	(11,964)	(16,914)
	<u>99,955</u>	<u>56,508</u>

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

##### Borrowings

	2005 RMB'000	2004 RMB'000
At 1st January	5,355,859	5,369,758
Proceeds from borrowings	5,039,483	4,610,160
Repayments of borrowings	(4,866,048)	(4,624,059)
	<u>5,529,294</u>	<u>5,355,859</u>





## 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

### (c) Disposal of subsidiaries

	2005 RMB'000	2004 RMB'000
Property, plant and equipment	59,803	—
Current assets	273,163	43,476
Total assets	<u>332,966</u>	<u>43,476</u>
Total liabilities	<u>(296,006)</u>	<u>(779)</u>
Minority interests	<u>(7,150)</u>	<u>(19,052)</u>
Net assets at the date of disposal	29,810	23,645
Less: amount retained as investments in associates	<u>(3,431)</u>	<u>(22,866)</u>
Net assets sold	<u>26,379</u>	<u>779</u>
Proceeds received from sales	4,930	779
Proceeds receivable from sales	<u>19,531</u>	<u>—</u>
Total consideration	<u>24,461</u>	<u>779</u>
Loss on disposal of subsidiaries	<u>1,918</u>	<u>—</u>
The net cash outflow from sale is determined as follows:		
Proceeds received from sales	4,930	779
Less: cash and cash equivalents in subsidiaries sold	<u>(134,605)</u>	<u>(43,476)</u>
Net cash disposed of from sale of subsidiaries	<u>(129,675)</u>	<u>(42,697)</u>



### 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

#### (d) Cash and cash equivalents

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Cash and bank balances	2,614,562	2,273,752	10,751	63,468
Term deposits with initial term of less than three months	327,800	284,248	177,800	84,248
	<u>2,942,362</u>	<u>2,558,000</u>	<u>188,551</u>	<u>147,716</u>
	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
RMB	2,686,755	2,383,846	183,937	84,154
Other currencies	255,607	174,154	4,614	63,562
	<u>2,942,362</u>	<u>2,558,000</u>	<u>188,551</u>	<u>147,716</u>

The weighted average effective interest rates of the Group and the Company on short-term bank deposits, with maturity ranging from one to three months, was 1.66% (2004: 1.71%) per annum. Cash at bank earn interest at floating rates based on daily bank deposit rates. 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.



## 38 COMMITMENTS

### (a) Capital commitments

The Group has the following capital commitments not provided for at 31st December 2005:

	Group	
	2005	2004
	RMB'000	RMB'000
<b>Acquisition of property, plant and equipment:</b>		
- Authorised but not contracted for	<b>296,700</b>	517,856
- Contracted but not provided for	<b>521,904</b>	536,345
	<b>818,604</b>	1,054,201
<b>Construction commitments:</b>		
- Authorised but not contracted for	<b>60,000</b>	100,000
- Contracted but not provided for	<b>33,234</b>	80,238
	<b>93,234</b>	180,238
<b>Investment in jointly controlled asset:</b>		
- Contracted but not provided for	<b>107,261</b>	—
<b>Investments in associates:</b>		
- Contracted but not provided for	<b>14,600</b>	32,997
	<b>1,033,699</b>	1,267,436



### 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 2005:

	Group	
	2005	2004
	RMB'000	RMB'000
<b>Land and buildings:</b>		
Not later than one year	29,765	32,413
Later than one year and not later than five years	103,569	101,782
Later than five years	69,559	122,742
	202,893	256,937
<b>Plant and equipment:</b>		
Not later than one year	—	23
	202,893	256,960

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 2005 (2004: Nil).



### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS

The Group is controlled by AVIC II, which owns 61.06% of the Company's shares. The remaining 38.94% of the shares are widely held.

Related parties refer to entities in which AVIC II 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; or directors or officers of the Company and of its holding company and associated companies. Given that the PRC government still owns a significant portion of the productive assets in the PRC despite the continuous reform of the government structure, a majority of the Group's business activities had been conducted with enterprises directly or indirectly owned or controlled by the PRC government ("state-owned enterprises"), including AVIC II, its subsidiaries, associated companies and jointly controlled entities in the ordinary course of business.

In accordance with IAS 24 (revised 2003), "Related Party Disclosures", state-owned enterprises and their subsidiaries, other than entities under AVIC II (also a state-owned enterprise), directly or indirectly controlled by the PRC government are also defined as related parties of the Group. Neither AVIC II nor the PRC government publishes financial statements for public use. In the normal course of the Group's business, it may either enter into various transactions with one or more of such state-owned enterprises and their subsidiaries.

The following is a summary of significant related party transactions entered into in the ordinary course of business between the Group and its related parties and the balances arising from related party transactions in addition to the related party information shown elsewhere in the financial statements. Management of the Group are of the opinion that meaning information relating to related party disclosures has been adequately disclosed.



### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

#### Transactions with related parties:

	2005 RMB'000	2004 RMB'000
<b>Revenues:</b>		
Sales of goods and materials		
- Fellow subsidiaries	2,706,927	1,814,126
- Other related parties	384,720	643,266
- Other state-owned enterprises	1,580,885	1,436,067
Rendering of service		
- Fellow subsidiaries	145,449	163,790
- Other related parties	—	8,799
Rental income		
- Fellow subsidiaries	10,218	933
<b>Expenses:</b>		
Purchase of goods and raw materials		
- Fellow subsidiaries	1,796,846	1,578,935
- Other related parties	595,178	647,641
- Other state-owned enterprises	1,685,165	1,092,553
Service fees payable		
- Fellow subsidiaries	383,444	1,006,134
- Other related parties	20,075	33,756
- Other state-owned enterprises	97,139	35,296
Rental expenses for property, plant and equipment		
- Fellow subsidiaries	32,838	50,665
Interest expenses		
- Other state-owned enterprises	166,947	140,695
Key management compensations		
- Salaries, bonuses and other welfares	2,854	2,854
<b>Others:</b>		
Guarantees obtained from		
- Holding company	80,000	230,000
- Fellow subsidiaries	563,408	715,888



### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

Fellow subsidiaries and other related parties primarily represent those entities, directly or indirectly, controlled or significantly influenced by AVIC II. The above transactions are entered into at terms agreed with these related parties in the ordinary course of the Group's business and are continuing in nature except for the guarantees given by AVIC II and certain of its subsidiaries amounted to approximately RMB80,000,000 and RMB563,408,000 respectively as at 31st December 2005, details of which are disclosed in Note 33(d).

In addition, AVIC II granted certain leasehold land for the Group's use at no cost, details of which are disclosed in Note 15(b).



### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

#### Balances with related parties:

	2005 RMB'000	2004 RMB'000
<b>Balances with related parties included in:</b>		
Pledged deposits		
- Other state-owned enterprises	<b>405,574</b>	434,795
Term deposits with initial term of over three months		
- Other state-owned enterprises	<b>805,217</b>	1,184,750
Cash and cash equivalents		
- Other state-owned enterprises	<b>2,728,331</b>	2,481,729
Bank borrowings		
- Other state-owned enterprises	<b>3,844,319</b>	4,874,155
Accounts receivable		
- Fellow subsidiaries	<b>1,187,020</b>	692,518
- Other related parties	<b>165,317</b>	210,380
- Other state-owned enterprises	<b>127,636</b>	98,147
Other receivables, prepayments and other current assets		
- Holding company	<b>58,090</b>	95,156
- Fellow subsidiaries	<b>404,189</b>	325,142
- Other related parties	<b>236,447</b>	118,221
- Other state-owned enterprises	<b>144,176</b>	113,029
Trade payables		
- Fellow subsidiaries	<b>488,274</b>	521,905
- Other related parties	<b>529,391</b>	95,935
- Other state-owned enterprises	<b>1,040,048</b>	865,439
Other payables, accruals and other current liabilities		
- Holding company	<b>24,082</b>	13,405
- Fellow subsidiaries	<b>172,198</b>	400,995
- Other related parties	<b>40,681</b>	123,888
- Other state-owned enterprises	<b>169,554</b>	126,573





## 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

### Balance sheet items: (continued)

Note:

- (i) Whilst other state-owned enterprises are related parties of the Group as defined under IAS 24, the directors are of the opinion that each party is operating independently; and the above balances are arising in the ordinary course of the Group's business. Details of these balances are included under Notes 27, 28, 33 and 37(d) to the financial statements.
- (ii) Details of the balances with holding company, fellow subsidiaries and other related parties are disclosed in Notes 22, 23, 29 and 30 to the financial statements.

## 40 FINANCIAL RISK MANAGEMENT

### (a) Financial risk factors

The Group's activities expose it to a variety of financial risks, including foreign exchange risk, credit risk, liquidity risk and interest rate risk. The use of financial derivatives to hedge certain risk exposures is governed by the Group's policies approved by the board of directors. The Group does not use derivative financial instruments for speculative purposes.

#### (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 its operations that subject to foreign exchange risk are primarily with respect to the United States Dollar ("USD"), Euro Dollar, Hong Kong Dollar ("HK\$") and Japanese Yen. The Group has not used any forward contracts to hedge its exposure as foreign currency risk is considered minimal.

As at 31st December 2005, the Group had certain borrowings (Note 33) and deposits in banks (Notes 28&37(d)) denominated in foreign currencies. RMB against USD and HK\$ has been relatively stable over the past few years. Since July 2005, RMB experienced certain appreciation. The directors are of the opinion that such appreciation did not have any material adverse impact on the Group's net assets.

#### (ii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of operating receivables included in the consolidated balance sheet represents 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 receivables has been made in the financial statements.



## 40 FINANCIAL RISK MANAGEMENT (continued)

### (a) Financial risk factors (continued)

#### (iii) Liquidity risk

The Group's primary cash requirements have been for additions of and upgrades on property, plant and equipment, payment on related debts and payment for purchases and operating expenses. The Group finances its working capital requirements through a combination of funds generated from operations, long-term and short-term bank borrowings.

As at 31st December 2005, the net current liabilities of the Group amounted to RMB91,283,000. The directors believe that cash from operations and bank borrowings will be sufficient to meet the Group's operating cashflow. Due to the dynamic nature of the underlying businesses, the Group's policy is to maintain sufficient cash and cash equivalents or have available funding through adequate amount of committed credit facilities to meet its working capital requirements. The amount of undrawn credit facilities at the balance sheet date are disclosed in Note 33 to the financial statements. The directors believe that the Group has obtained sufficient general credit facilities from PRC banks for financing capital commitments in the near future and for working capital purposes.

#### (iv) 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 except for the bank deposits and cash and cash equivalents, details of which have been disclosed in Notes 27, 28 and 37(d). The Group's exposure to changes in interest rates is mainly attributable to its borrowings, details of which have been disclosed in Note 33 to the financial statements. Borrowings carry at floating rates expose the Group to cash flow interest-rate risk whereas those carry at fixed rates expose the Group to fair value interest-rate risk. As of 31st December 2005, over 93% (2004: 87%) of the Group's borrowings were at fixed rates. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

### (b) Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. 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 similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The carrying amounts of the Group's current financial assets including cash and cash equivalents, deposits, trade receivables, notes receivable and other receivables; and current financial liabilities including trade and other payables and current borrowings, approximate their fair values. The fair value of non-current borrowings are disclosed in Note 33 to the financial statements.



## Notes to the Financial Statements

### 40 FINANCIAL RISK MANAGEMENT (continued)

#### (b) Fair value estimation (continued)

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 20 to the financial statements, there are no quoted market price in an active market for the Group's other non-current financial assets in the PRC and for which the range of other methods of reasonably estimating fair value is significant and the probabilities of the various estimates cannot be reasonably assessed without incurring excessive costs. Accordingly, these investments are carried at cost less accumulated impairment losses.

### 41 SUBSEQUENT EVENT

Subsequent to the year end, the Company announced an initial share reform plan for the conversion of all unlisted domestic shares ("Domestic shares") of each of Harbin Dongan Auto Engine Co., Ltd ("Dongan") and Jiangxi Changhe Automobile Co., Ltd ("Changhe") into listed shares ("A Shares"). Dongan and Changhe are subsidiaries of the Company, the existing A Shares of which are listed on The Shanghai Stock Exchange. Pursuant to the above initial plan, the Company proposed to offer 3 and 2.8 Domestic shares of Dongan and Changhe respectively to each shareholder holding every 10 listed A Shares of the relevant company as a consideration for the agreement to the conversion of all Domestic shares into listed A Shares of the relevant companies. Should the conversion be completed as proposed, the Group's interests in Dongan and Changhe will be reduced from 70.01% and 71.57% to 61.01% and 65.05% respectively. Up to the date of this report, as the above proposal has not yet been finalised and details of the terms are still subject to changes, the directors are of the opinion that it would not be possible to estimate the financial impact to the Company and the Group. However, as the above share reform plan would result in dilution of the Group's interests in the abovementioned companies, the directors expect the completion of such plan would result in a reduction of the Group's share of net assets in these companies.

### 42 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.

### 43 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 4th April 2006.



#### 44 PARTICULARS OF PRINCIPAL 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	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
<b>Subsidiaries</b>				
<b>Directly held:</b>				
哈爾濱航空工業集團有限責任公司 (Harbin Aviation Industry Group Ltd)	RMB775,832,000	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)	RMB1,131,700,000	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.)	RMB725,647,000	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.)	RMB462,080,000	70.01%	Joint stock company (listed on the Shanghai Stock Exchange)	Manufacture and sale of automobile engine
北京維思韋爾航空電子技術有限公司 (Beijing WiseWell Avionics Technology Co., Ltd.)	RMB10,000,000	51%	Limited liability company	Development, production and sale of avionics and IT products
<b>Indirectly held:</b>				
哈飛航空工業股份有限公司 (Hafei Aviation Industry Co., Ltd.)	RMB337,350,000	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.)	RMB210,000,000	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.)	RMB410,000,000	72.25%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of mini-sized vehicles



## Notes to the Financial Statements

### 44 PARTICULARS OF PRINCIPAL SUBSIDIARIES AND ASSOCIATES (continued)

Name	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
<b>Subsidiaries</b> (continued)				
<b>Indirectly held:</b> (continued)				
江西昌河鈴木汽車有限責任公司 (Jiangxi Changhe Suzuki Automobile Co., Ltd.)	USD251,800,000	39.63%	Equity joint venture	Manufacture and sale of min-sized vehicles
九江昌河汽車有限責任公司 (Jiujiang Changhe Automobile Co., Ltd.)	RMB161,250,000	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.)	RMB500,000,000	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.)	RMB1,013,280,000	74.81%	Joint stock company	Manufacture and sale of automobile products
<b>Associates</b>				
<b>Indirectly held:</b>				
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.)	RMB74,080,000	18.9%	Limited liability company	Mining, concentrating and smelting of rare earth material, processing and sale of rare earth products
哈爾濱萬向汽車底盤系統有限責任公司 (Harbin Wanxiang Hafei Motor Chassis System Co., Ltd.)	RMB60,000,000	35%	Limited liability company	Manufacture and sales of motor chassis system
哈爾濱安博威飛機工業有限公司 (Harbin Embraer Aircraft Industry Co., Ltd.)	USD25,000,000	38.17%	Limited liability company	Production of regional jets and provision of relevant sales and after-sale services
哈爾濱哈飛汽車模具製造有限責任公司 (Harbin Hafei Motor Mould Manufacturing Co., Ltd.)	RMB70,370,000	21.67%	Limited liability company	Design, manufacture and sale of press dies

All the above subsidiaries and associates are established and operating in the PRC.