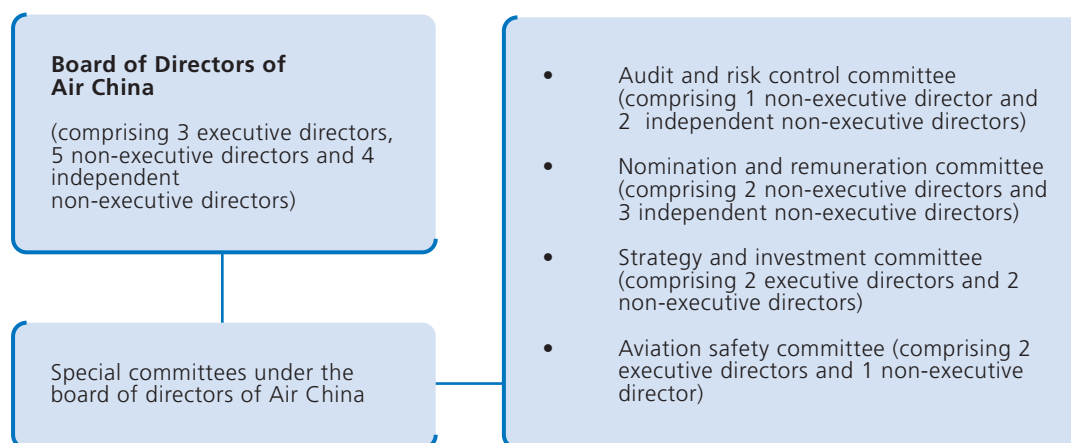


Corporate Governance Report

The Company has been maintaining and enhancing the level of its corporate governance so as to ensure greater accountability and transparency and bring long-term return to its shareholders. Except the deviations detailed below, the Company has complied with the principles and code provisions of the Code of Corporate Governance Practices (the "Code") under Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") in 2006. The Company's corporate governance practices and deviations from the Code in 2006 are summarised and discussed below.

GOVERNANCE STRUCTURE



MAJOR CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES OF THE COMPANY

A. Board of Directors (the "Board")

The power of the Board is balanced by comprising independent non-executive directors representing at least one-third of the Board

- The Board of the Company currently comprises twelve directors, out of which four are independent non-executive directors. The directors of the Company are elected in the shareholders' general meeting for a three-year term of office, and are eligible for re-election upon expiry of the term.
- Pursuant to the Listing Rules, each of the independent non-executive directors has confirmed his independence with the Stock Exchange. Each of the independent non-executive directors re-confirmed his independence on 31 December 2006. The Company considered that they were independent.

Deviation: Nil

The Board should have a balance of skills and experience appropriate for the requirements of the business of the Company

- With reference to the nature of the objectives of the Company's specialised operations, the Non-executive Directors' extensive expertise and experience in the fields of aviation, finance and financial management provide substantial support for the effective performance of the Board.
- The list of the Directors and their biographical details and their respective roles in the Board and Board committees are set out in this annual report and published on the Company's website.

Deviation: Nil

Distinguished roles of the Chairman and President

- The Chairman, Mr. Li Jiayang, a Non-executive Director, is responsible for leading the Board and ensuring the Board's efficient operation and that all major and relevant issues are discussed by the Board in a prompt and constructive manner.
- The Chairman shall be elected and dismissed by a majority of all Directors. The term of office of the Chairman shall be three years, and the Chairman is eligible for re-election upon expiry of the term.
- The Company has a President who shall be nominated, appointed or dismissed by the Board.
- The President is authorised to oversee the Group's business operations and implement its strategies to attain overall commercial goals.

Deviation: Nil

Non-executive Directors should be appointed for a specific term, and all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment

- The term of office of the existing Non-executive Directors is three years. Mr. Christopher Dale Pratt was appointed as an additional Non-executive Director at the 17th session of the first Board meeting of the Company on 18 April 2006, the resolution of which has been approved by the Company's shareholders at a general meeting.

Deviation: Nil

The Board should assume responsibility for the leadership and control of the Company and be collectively responsible for promoting the success of the Company

- The Board is accountable to the shareholders' general meeting and determines the investment proposals of the Company and delimits the approval authority regarding disposal of the Company's fixed assets according to the authorisation of the shareholders' general meeting. The Company formulates the Rules and Procedures for Shareholders' General Meetings, Rules and Procedures for Board Meetings and Rules and Procedures for Senior Management Meetings.
- The President shall be authorised by the Board to implement various strategies and oversee the day-to-day operations of the Company.
- The Board shall have independent access to the senior management personnel for enquiries in relation to the Company's management.
- The Board shall have specialised committees, the chairmen of which shall report to the Board on a regular basis.

Deviation: Nil

The board should meet regularly to carry out its duties. The board and its committees shall be provided with adequate information in a timely manner

- Board meetings are held regularly throughout the year and will generally include annual meetings, half-year meetings and meetings for the first and third quarters. Board meetings will be convened by the Chairman and a 10-day notice will be served to all directors before each meeting. The meetings may be attended through personal participation or other electronic means of communication.

Corporate Governance Report

- The Secretary to the Board shall be responsible for the communications and liaison with all Directors from the time the notice is served to the commencement of the meeting, and will provide the necessary information to the Directors for facilitating their decision-making on matters set out in the agenda.
- For the purpose of considering resolutions or matters during Board meetings, the Directors may require presence of the persons in charge of the relevant departments to answer queries, so that the Directors can have a thorough understanding of the key issues and the general situation.
- During each Board meeting, the President or other relevant departments will report to the Board in writing in respect of the implementation of resolutions of the previous Board meeting. The Board shall review such implementation at the meeting.
- All Directors shall have access to the Board Secretary. Under the leadership of the Board and the Chairman, the Board Secretary shall take the initiative to acquaint himself with the implementation progress of Board resolutions, and report to and advise the Board and the Chairman in a timely manner on major issues arising in the course of implementation.
- Minutes of Board meetings shall be kept by the Board Secretary and available for inspection by any Director at anytime.
- All Directors have actively participated in the business operations of the Company. Attendance of all Directors at Board meetings in 2006 is as follows:

Attendance of individual Director at Board meetings in 2006		
No. of meetings	14	
Non-executive Director:		
Li Jiaxiang (<i>Chairman</i>)	13/14	93%
Kong Dong	13/14	93%
Wang Shixiang	11/14	79%
Yao Weiting	13/14	93%
Christopher Dale Pratt	3/8	38%
Executive Director:		
Ma Xulun (<i>President</i>)	13/14	93%
Cai Jianjiang	13/14	93%
Fan Cheng	14/14	100%
Independent Non-executive Director:		
Hu Hung Lick, Henry	7/14	50%
Wu Zhipan	14/14	100%
Zhang Ke	14/14	100%
Jia Kang	7/8	88%
Average attendance rate:	85%	

Deviation: A 10-day notice is served to all Directors before Board meetings are convened. However, the Code requires a notice of at least 14 days before each meeting. The reason for the Board's practice is that service of a 10-day notice to the Directors is deemed sufficient under the relevant PRC laws.

Remedy: Article 98 of the articles of association of the Company has been amended so that a notice of at least 14 days must be served to all Directors before a meeting of the Board, except for extraordinary meeting. The amendment to the articles of association of the Company was approved by the extraordinary general meeting held on 28 March 2006 and will become effective upon approval by the relevant authorities.

Each Director is required to keep abreast of his responsibilities as a Director of the company and of the operating manner, business activities and developments of the Company

- The management shall provide members of the Board and Board committees with proper and sufficient information in a timely manner so as to update them with the latest developments of the Company and facilitate their discharge of duties.
- Newly appointed Directors shall be given introduction in relation to the Company to ensure that they have a proper understanding of the management, business and governance practices of the Company.
- The Company also encourages its Directors to participate in seminars and courses conducted by eligible institutions so as to enable them to boost necessary skills and update them with the latest changes or developments in laws, the Listing Rules and the Code with which they are required to comply in discharging their duties.

Deviation: Nil

The Company should arrange appropriate insurance in respect of potential legal actions against its Directors

- The Company has purchased liability insurance for its directors and senior management.

Deviation: Nil

Compliance with the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code")

- After making specific enquiries, the Company confirmed that each Director and each Supervisor have complied with the required standards of the Model Code as set out in Appendix 10 of the Listing Rules throughout 2006.
- The Model Code contained in Appendix 10 of the Listing Rules requires the Board to adopt written guidelines regarding transactions of securities of the issuer by its employees on terms no less exacting than the required standard of the Model Code.
- On 5 September 2005, the Company adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standards of the Model Code. The code of conduct of the Company also applies to Supervisors and the relevant employees.

Deviation: Nil

B. Remuneration of Directors and Senior Management

Issuers should establish a remuneration committee with certain authorities and obligations under specific written terms. A majority of the members of the remuneration committee should be Independent Non-executive Directors

- The Company has established a nomination and remuneration committee to recommend to our Board regarding the compensation of other Executive Directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management.
- A majority of the members of the nomination and remuneration committee are Independent Non-executive Directors. The current members of the nomination and remuneration committee are Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.

Corporate Governance Report

- Attendance at the meetings of the nomination and remuneration committee in 2006 is as follows:

Attendance at the meetings of the nomination and remuneration committee in 2006		
No. of meeting	2	
Wu Zhipan	1/2	50%
Li Jiayang	2/2	100%
Kong Dong	1/2	50%
Hu Hung Lick, Henry	1/2	50%
Zhang Ke	2/2	100%
Average attendance rate:	70%	

- The articles of association of the Company provides that a shareholder holding 5% or more of the total shares of the Company is entitled to nominate a director through the nomination and remuneration committee, which will scrutinize the candidates for directorship and senior management according to the standards set out in the articles of association of the Company and report to the Board.
- At a meeting of the nomination and remuneration committee held on 29 August 2006, according to the requirement of the Company's business development and the relevant provisions of the articles of association, the nomination and remuneration committee under the Board proposed to consider and agreed that the Board should establish an aviation safety committee and appointed Mr. Wang Shixiang as the Chairman of this committee and Mr. Ma Xulun and Mr. Cai Jianjiang as committee members. It also proposed to consider and agreed that all special committees of the Board should be allowed to engage both internal or external experts to provide professional advice for their decision-making. The term of such engagement should expire upon the expiration of the current Board session.
- Pursuant to the Shareholders' Agreement entered into between the Company and Cathay, as proposed by the nomination and remuneration committee and considered by the Board and approved by the shareholders' general meeting of the Company, Mr. Chen Nan Lok Philip was elected as a director of the Company and his term of office should commence from the date on which the amendment of Article 93 of the articles of association concerning the number of directors being approved by the relevant competent authority of the state and should expire upon the expiration of the current Board session.
- As nominated by the President of the Company and considered by the nomination and remuneration committee under the Board, Mr. Song Zhiyong, Mr. He Li, Mr. Fan Cheng (also as an Executive Director and the Chief Accountant) and Ms. Zhang Lan were appointed as the Vice President of the Company, Mr. Cheng Yiru no longer served as a Vice President of the Company and was redesignated as a researcher and Mr. Ma Kuiliang retired from the post of Vice President of the Company. It was proposed that Mr. Song Zhiyong and Mr. He Li should replace Mr. Cheng Yiru and Mr. Ma Kuiliang to serve as experts of the aviation safety committee and their terms of office should expire upon the expiration of the current Board session.
- Remuneration payable to directors shall be determined according to the terms of their respective employment contract, if any, and recommendation of the nomination and remuneration committee. Details of the remuneration of the Directors are set out in the financial statements.

Deviation: Nil

C. Accountability and Audit

The Board should present a balanced, clear and comprehensible assessment of the company's performance, position and prospects

- The Company has established an audit and risk control committee to review the financial information of the Company and the relevant disclosure, and review the internal control systems of the Company.
- The Company has published its annual and interim results, in accordance with the requirements of the Listing Rules and other relevant regulations, in a timely manner within four months and three months respectively after the end of the relevant periods.
- The Company has set up an investor relation webpage, on which figures of operating results are published monthly in order to improve transparency of the Company's performance and provide the latest developments of the Company in a timely manner.
- The Company has good environment for the implementation of internal controls. The Company has set up an effective electronic information system to support business development. The electronic information system comprises various operation systems, settlement system and a core accounting and audit platform, i.e. the Oracle financial information system. For treasury management, the Company implemented a global online banking management system. An effective accounting information system was also established.

Deviation: Nil

The Board should ensure that the issuer maintains a sound and effective internal control system to safeguard the shareholders' investments and the Company's assets

- The Board takes ultimate responsibility for the internal controls of the Company, and will review the effectiveness of the system through the audit and risk control committee. The audit and risk control committee has conducted a review of the effectiveness of the internal control system of the Company.

Deviation: Nil

The Board should establish formal and transparent arrangements for how to apply the financial reporting and internal control principles and for how to maintain an appropriate relationship with the Company's auditors

- The audit and risk control committee comprises 1 non-executive director and 2 independent non-executive directors, who are proficient in financial matters. The audit and risk control committee is primarily responsible for:
 1. making recommendations to the Board on the appointment and replacement of the external auditors;
 2. reviewing and monitoring the internal audit system of the Company and its implementation;
 3. liaison between the internal auditors and external auditors;
 4. reviewing the financial information of the Company and the relevant disclosure;
 5. reviewing the internal control system of the Company;
 6. other matters designated by the Board of the Company.

Corporate Governance Report

- The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as chairman of the committee.
- Attendance at the meetings of the audit and risk control committee in 2006 is set out as follows:

Attendance at meetings of the audit and risk control committee in 2006		
No. of meetings		2
Zhang Ke	2/2	100%
Yao Weiting	2/2	100%
Wu Zhipan	2/2	100%
Average attendance rate:		100%

- The audit and risk control committee passed the following resolution at its third meeting convened by way of circulation for signature on 28 March 2006: the audited reporting financial statements of Air China Limited for the three financial years ended 31 December 2005 were considered and approved.
- At the fourth meeting of the audit and risk control committee held on 6 April 2006, the meeting considered and approved and proposed to the Board to consider and approve the audited financial statements of the Company for the year 2005; the profit appropriation policy of the Company for the year 2005; and the reappointment of Ernst & Young as the Company's international auditors and Ernst & Young Hua Ming as domestic auditors for the year ended 31 December 2006.
- At the fifth meeting of the audit and risk control committee held on 29 August 2006, the 2006 interim financial report of the Company was approved.

Deviation: Nil

The responsibility of the Directors in relation to the financial statements

The Company prepares annual reports and interim reports each year and has started to prepare and publish quarterly reports since the third quarter of 2006. The responsibilities of the Directors in relation to the financial statements are set out below and shall be read together with the Report of the Independent Auditors set out on page 53 to page 54.

- *Annual reports and accounts*

The Directors acknowledged that they are responsible for preparing the financial statements for each financial year so as to present a true and fair view of the financial position of the Company and the Group, and of the financial performance and cash flows of the Group.

- *Accounting policy*

When preparing the financial statements of the Company and the Group, the Directors have consistently applied appropriate accounting policies under the relevant accounting standards.

- *Accounting records*

The Directors are responsible for keeping accounting records of the Company, which will reflect the financial position of the Company with reasonable accuracy, enabling the Group to prepare the financial statements in accordance with the requirements of the Listing Rules, Hong Kong Companies Ordinance and the relevant accounting standards.

- *Ongoing operation*

After making appropriate enquiries, the Directors believe that the Group has sufficient resources for operation in the foreseeable future. Accordingly, the Group's financial statements should be prepared on a going concern basis.

The statement of reporting responsibility of the auditors is set out in the Report of the Independent Auditors on page 53 to page 54.

Auditors' Remuneration

The international and domestic auditors of the Company are Ernst & Young and Ernst & Young Hua Ming respectively. Breakdown of the remuneration to the Company's external auditors for audit service provided and other non-audit service assignments for the year ended 31 December 2006 are as follows:

- *Audit Services*

An amount of RMB8,354,000 was charged for the audit of the Group's financial statements for the year ended 31 December 2006.

An amount of RMB4,008,000 was charged for the audit services provided in relation to the listing of the Company's A shares.

- *Non-Audit Service Assignments*

An amount of RMB2,500,000 was charged for an agreed-upon procedure engagement performed on the Group's financial statements for the six months ended 30 June 2006.

An amount of RMB1,500,000 was charged mainly for the provision of professional services in relation to the restructuring of the Group's shareholding in Dragonair and Cathay and the issue of new H shares to Cathay.

An amount of RMB750,000 was charged mainly for reviewing the Group's indebtedness and working capital sufficiency in relation to the Company's major transactions.

D. Delegation by the Board

The Company should formalise the functions reserved to the Board and those delegated to management. There shall be division of responsibility between the board committees, and each committee should be formed with certain authorities under specific terms.

- To regulate the operations of the Board of the Company, the Company has formulated and revised the Rules and Procedures for Board Meetings (the "Meeting Rules"), setting out the authorities and authorisations of the Board. The terms of reference of the President, who shall be accountable to the Board, are set out in the articles of association of the Company. The revised Meeting Rules stipulate the following limits on the Board's power to approve an investment. The Meeting Rules will come into effect upon the approval to the amendment of the articles of association by the relevant state authorities.
- General transactions (including investment and acquisition). The Board is entitled to approve transactions if the following conditions are fulfilled:
 1. None of the ratios of a transaction shown on the test to its assets ratio, profits ratio, revenue ratio, consideration ratio and equity capital ratio conducted in accordance with the requirements of the Listing Rules exceed 25%; and

Corporate Governance Report

2. As shown in the test, all five ratios of a transaction, namely, the ratio of the total assets involved (the higher of the carrying amount and the valuation amount, if both available) to the total net assets of the Company as shown in its latest published audited accounts, the ratio of the consideration of the transaction (including the debt and expenses assumed thereof) to the net assets of the Company as shown in its latest published audited accounts, the ratio of the profit arising from the transaction to the net profit of the Company as shown in its latest published audited year report, the ratio of the revenue from the principal business of the transaction subject (such as equity interest) to the revenues from the Company's principal business as shown in its latest published audited year report and the ratio of the net profit of the transaction subject (such as equity interest) to the net profit of the Company as shown in its latest published audited year report, are lower than 50%, and the aggregated amount of the purchase and disposal of material assets (including connected transactions) within one year, taking the transaction into account, is lower than 30% of the total assets of the Company. In case any figure related to the above indexes is negative, an absolute value should be adopted for calculation.
- Connected transactions. The Board is entitled to approve the connected transactions if the following conditions are fulfilled:
 1. None of the transaction's assets ratio, revenue ratio, consideration ratio and equity capital ratio tested in accordance with the Listing Rules exceed 2.5%; and
 2. The consideration of the transaction is lower than 5% of the absolute value of the audited net assets of the Company as shown in its latest published report, and the aggregated amount of the purchase and disposal of material assets (including general transactions) within one year, taking the transaction into account, is lower than 30% of the total assets of the Company.
 - Risk investment (i.e. fuel derivatives or other derivative financial instruments). Without prejudice to the provisions of Article 11(1) of the Meeting Rules, the Board is entitled to approve any investment valued not exceeding 15% of the net assets of the Company as shown in its latest published audited accounts; however, for those investments that exceed the foresaid threshold, they shall be subject to approval at the general meeting.
 - External Guarantees. The Board is entitled to approve any external guarantee not subject to approval at the general meeting in accordance with the requirements of the applicable domestic and overseas laws and regulations, regulatory documents and the articles of association.
 - In respect of the fixed assets of the Company, if the expected value of fixed assets proposed to be disposed, together with the amount received from the disposal of fixed assets within four months preceding the proposed disposal, does not exceed 33% of the net book value of the fixed assets as set out in the latest balance sheet approved by the general meeting, such proposed disposal may be approved by the Board. Otherwise, the Board may not dispose of or agree to dispose of such fixed assets prior to obtaining approval at the general meeting. If the above percentage is lower than 0.2%, the general meeting may authorise the Senior Management Meeting to approve the disposal of such fixed assets, but the Senior Management Meeting is not allowed to approve the disposal of aircraft, engines and infrastructures.
 - The Company has established an audit and risk control committee in compliance with the Code. The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as the chairman of such committee.

- The Company has established a nomination and remuneration committee to recommend to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management. The current members of the nomination and remuneration committee are Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.
- The Company has established a strategy and investment committee to analyse and identify our development strategy and to decide on matters related to our investment as authorised by the Board. The current members of the strategy and investment committee are Mr. Kong Dong, Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang, with Mr. Ma Xulun as the chairman of such committee.
- The Company has established an aviation safety committee with Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang as its current members and Mr. Wang Shixiang as the chairman of such committee.

The Supervisory Committee is responsible for monitoring our financial matters and supervising the conduct of our Board and the management. The functions and authority of the Supervisory Committee include: reviewing the financial reports and other financial information prepared by the Board and proposed to be tabled before the shareholders' general meeting, as well as supervise the work of the Directors, President, Vice President and other senior personnel so as to prevent abuse of power or actions detrimental to the Company's interests. The current members of the Supervisory Committee are Mr. Zhang Xianlin, Mr. Liao Wei, Ms. Zhang Huilan and Mr. Liu Feng, with Mr. Zhang Xianlin acting as the chairman. In the event that any director has conflict of interests with the Company, the Supervisors may negotiate with the directors concerned or bring the case to court on behalf of the Company. Resolution of meetings of the Supervisory Committee will be passed by at least two-thirds of all Supervisors.

Deviation: Nil

E. Communications of the Company

The Board should endeavour to maintain an on-going dialogue with shareholders and in particular, use general meetings to communicate with shareholders.

- The Company has established and maintains various communication channels with the shareholders such as the publication of annual reports, interim reports and quarterly reports, press releases and announcements on the Company's website. The Company has also implemented the Investors Relation Management System.
- The annual general meetings represent an effective means for the shareholders to exchange views with the Board. The Chairman of the Board, as well as the respective chairman of the audit and risk control committee, nomination and remuneration committee, strategy and investment committee and aviation safety committee will attend the general meetings to answer queries raised by shareholders.
- At the annual general meetings, the Board will report to the shareholders and make announcements in respect of the implementation of resolutions which have been passed on the previous annual general meetings and shall be carried out by the Board.
- Resolutions in respect of independent matters, including the election and replacement of the directors of the Company, shall be separately tabled before the annual general meeting.

Deviation: Mr. Li Jiaxiang, being the Chairman of the Company, was unable to attend the annual general meeting of the Company on 12 June 2006 as required by the Code.

Reason for deviation: Mr. Li Jiaxiang, the Chairman of the Company, is a member of the Chinese government delegation. As he had to attend the signing ceremony for the Framework Agreement with Boeing and was therefore unable to attend the annual general meeting of the Company on 12 June 2006.