Supplementary Information

31 December 2006

(Prepared under PRC Accounting Standards and Regulations)

SOURCE OF FINANCIAL INFORMATION UNDER PRC ACCOUNTING STANDARDS AND REGULATIONS

The above consolidated balance sheet, consolidated income statement and consolidated profit appropriation statement prepared under the PRC Accounting Standards and Regulations and were extracted from the Group's financial statements for inclusion in the Company's A share annual report pursuant to the requirements of the Shanghai Stock Exchange (www.sse.com.cn). For a better understanding of the financial position of the Group as at 31 December 2006 and the financial performance of the Group for the year ended 31 December 2006 under PRC Accounting Standards and Regulations, the aforesaid financial statements should be read in conjunction with the Group's financial statements prepared in accordance with PRC Accounting Standards and Regulations from which the aforesaid financial statements were derived.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting regulations

The Group's financial statements are prepared under PRC Accounting Standards and Regulations, Accounting Method for Civil Aviation Enterprises and other relevant regulations issued by the Ministry of Finance ("MOF").

Accounting year

The Group adopts the Gregorian calendar year as its accounting year, commencing from 1 January to 31 December each year.

Reporting currency

The reporting currency of and the currency adopted for the preparation of these financial statements by the Group is Renminbi ("RMB").

Basis of preparation and principle of measurement

The Group's financial statements are prepared on an accrual basis except for subsidy income which is recognised when received. All assets are measured at historical cost when acquired.

Foreign currency transactions

The Group's reporting currency is RMB. Foreign currency transactions are translated into the reporting currency at the exchange rates quoted by the People's Bank of China at the transaction date. At the balance sheet date, monetary items denominated in foreign currencies are retranslated at the exchange rates ruling at that date. Any exchange differences arising from the retranslation are charged to the income statement as exchange gains or losses for that period. Exchange gains or losses arising from borrowings in association with the acquisition or construction of fixed assets are accounted for in accordance with the principle of capitalisation of borrowing costs.

Translation of financial statements denominated in foreign currencies

All assets and liabilities are translated into RMB at the exchange rates ruling at the balance sheet date. Shareholders' equity, other than retained profits, is translated into RMB at the exchange rates ruling at the date of transaction. Retained profits are recorded at the translated amounts as shown in the income statement and profit appropriation statement. The differences between translating the aggregate carrying amounts of assets and the aggregate carrying amounts of liabilities together with shareholders' equity are separately reported as exchange differences arising on retranslation of financial statements denominated in foreign currency. All items in the income statement and profit appropriation statement are translated into RMB at the average exchange rates. All items in the cash flow statement are translated into RMB at the exchange rates ruling at the balance sheet date. All the opening balances and the actual amounts for the prior year are reported as previously translated.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of preparation of consolidated financial statements

The consolidated financial statements of the Group are prepared in accordance with the requirements of document [1995] No.11 "Provisional regulations on consolidated financial statements" and "Accounting Regulations for Business Enterprises" issued by the MOF. Investees in which the Company has more than 50% interest with voting rights, or in which the Company has less than 50% interest with voting rights but in substance has dominant control over the investees, should be consolidated.

In the preparation of consolidated financial statements, the financial statements of subsidiaries are prepared for the same reporting year and by using the same accounting policies as the parent company. All significant inter company transactions and balances within the Group, including any unrealised profit, are eliminated on consolidation.

In the preparation of the Group's consolidated financial statements, the assets, liabilities, revenue, expenses and profits of joint ventures are included in the consolidated financial statements through proportionate consolidation. For those joint ventures which are not significant with reference to the Group's overall financial position and operating results, equity accounting method is adopted.

Subsidiaries are consolidated from the date on which control is obtained by the Company and cease to be consolidated from the date on which control is transferred out of the Group. Joint ventures are consolidated from the date on which joint control is obtained by the Company and cease to be consolidated from the date on which joint control is transferred out of the Group.

Cash equivalents

Cash equivalents held by the Group represent short-term and highly liquid investments which are readily convertible into known amounts of cash and are subject to an insignificant risk of change in value.

Provision for bad debts

Bad debts are recognised in the event that:

(1) the debtor is bankrupt or dead and the debts cannot be recovered from its liquidated assets or estates; or

(2) the debtor fails to fulfill its obligation to repay its debt when the debt becomes due and there is substantial evidence showing that the debt cannot be recovered.

Bad debts are recognised by way of provision before approval is obtained and are written off against the relevant receivables balances (including accounts receivable and other receivables) when approved.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Provision for bad debts (Continued)

The Group accounts for the bad debts of accounts receivable and other receivables through provisions. Specific provision for bad debts is made when the bad debts in accounts receivable and other receivables are confirmed. General provision for accounts receivable and other receivables is made based on their aging analysis where the age and the recoverability of the receivables are considered, except for those accounts receivables and other receivables on which special provision for bad debts has been made. The percentage of general provision for bad debts applied by the Group, after considering the financial position and cash flow of the debtors, is as follows:

Age	Percentage of general provision for bad debts
Within one year	0.3%
Over one year and less than two years	5%
Over two years and less than three years	10%
Over three years and less than four years	30%
Over four years and less than five years	50%
Over five years	100%

Inventories

Inventories comprise expendables, work-in-progress, general equipment, flight supplies, raw materials acquired, low value consumables, materials for further processing by external parties and others. Expendables refer to spare parts, which are consumed when used, generally of lower value, in large quantity and cannot be repaired after use. However they may also comprise spare parts that are of lower value but can be repaired more than once. Inventories are measured at actual costs when acquired and are calculated on weighted-average basis.

The physical record of inventories is maintained by perpetual method.

The costs of work-in-progress include direct materials, direct labors and manufacturing overheads based on appropriate proportion.

Except for work-in-progress, inventories are charged to the income statement when consumed.

Impairment loss is recognised when the costs of inventories cannot be recovered due to damage or obsolescence or for the reason that the selling prices are lower than costs. Impairment loss is recognised for other inventories on the basis of the lower of costs and net realisable value. If the cost of the inventories is higher than its realisable value, impairment loss will be made on an individual item basis. Net realisable value is determined based on the estimated selling price offered in the normal course of operation less the costs of completion and the estimated costs necessary for the sales.

Long-term investments

Long-term equity investments, including investments in shares and other equity investments, and are measured at cost when acquired. When the Company does not exercise control, joint control or significant influence over a long-term equity investment, the investment is accounted for at cost. When the Company has the ability to exercise control, joint control or significant influence over a long-term equity investment, the investment is accounted for using equity accounting.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long-term investments (Continued)

When long-term equity investments are accounted for using equity accounting, the equity investment differences, which represent the excess of the initial investment costs over the Company's share of shareholders' equity in the investees, are amortised over the tenure of the investments as stipulated in the relevant contracts or over a period of no more than 10 years. When the initial investment costs are less than the Company's share of shareholders' equity in the investees, such differences are accounted for as capital reserve. If the investment was acquired prior to 17 March 2003, such differences are recognised as long-term differences on equity investments and are amortised on a straight-line basis over the investment period.

The carrying amounts of the long-term equity investments, which are accounted for using equity accounting, will be adjusted according to the Group's share of post-acquisition profit or loss of the investee to the extent that the Group's share of loss is based on the carrying value of the long-term equity investments and is limited to Nil.

When the cost method is adopted, profits or cash dividends declared to be distributed by the investee enterprise should be recognised as investment income for the year after the investment acquired by the Group. The excess should be treated as a recovery of investment cost.

The initial investment cost of long-term debt investment is measured at cost. The interest income of long-term debt investment, which is determined by the face value and interest rate, is accounted for as investment income for the year.

In the event that the market value decreases continuously or the recoverable amounts of the investees are lower than the carrying amounts of the investment under the circumstances that the operation of the investee deteriorates, such difference will be recognised in the income statement as impairment in long-term investments during the period when impairment arises.

Measurement of fixed assets and depreciation

Fixed assets are tangible assets which are of comparatively high unit value and are for use in the production of goods, provision of services, leasing or for administrative purposes. They are expected to have useful lives of more than one year.

Fixed assets are measured at cost when acquired. The cost of fixed assets which is purchased separately comprise its purchase price, value added tax, import duties and other related taxes, and any directly attributable expenditure for bringing the asset to its working condition for its intended use, such as transportation and installation costs. Interests on specific borrowing and exchange differences arising thereon in relation to the acquisition or construction of fixed assets and incurred before the assets are ready for their intended uses are capitalised. Any subsequent expenditure in relation to significant expansion and technical improvement will be capitalised as fixed assets when it is probable that future economic benefits in excess of the original estimation will flow to the enterprise. Repair and maintenance expenses are recognised in the period in which they are incurred. Net gains or losses on fixed assets arising from the stock take gain or loss, retirement, damages and disposal of fixed assets are accounted for as non-operating income or expenses for the year.

Fixed assets acquired through finance leases are recognised as assets held under finance leases and are measured at the lower of the original book value of the leased assets upon commencement of the finance leases and the present value of minimum lease payments. Finance leases are accounted for as long-term payables which will be determined on the basis of the minimum lease payments. The differences between the carrying amounts of the leased assets and long-term payables are recognised as unrealised finance costs which will be amortised under actual interest rate method during the lease terms.

Pursuant to the document Cai Kuai Han [2004] No. 54 "Reply from MOF regarding the extension of Pilot Site for Fixed Assets Management of Rotables of Aviation Operation" issued by the MOF of the People's Republic of China, the Company accounts for rotables as fixed assets.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Measurement of fixed assets and depreciation (Continued)

Fixed assets (including fixed assets held under finance leases) are depreciated using the straight-line method and the annual depreciation rates for fixed assets, as determined by reference to their original costs, estimated economic useful lives or the estimated remaining useful lives at the time of acquisition and residual value, are as follows:

Category	Estimated useful life	Estimated residual value	Annual depreciation rate
Aircraft and engines	20 years	5%	4.75%
Buildings and construction	15-35 years	5%	2.71%-6.33%
Machinery and equipment	8-20 years	5%	4.75%-11.88%
Transportation equipment	6 years	5%	15.83%
Office equipment	4-10 years	5%	9.5%-23.75%
Rotables	10 years	–	10%

Depreciation on fixed assets is charged on a monthly basis. Depreciation of fixed assets is provided in the month following the month of acquisition and ceases to be provided in the month after the relevant fixed assets are disposed of.

Fixed assets are remeasured at the lower of their net book value and recoverable amounts at the balance sheet date and impairment loss will be recognised in the period in which the recoverable amounts fall below the net book value.

Construction in progress

Construction in progress represents necessary expenditure incurred before the assets are ready for their intended uses and includes direct materials, direct labour cost, equipment under installation, construction and installation fees, project management fees and net gains or losses arising from trial operation as well as borrowing costs which can be capitalised. Construction in progress is transferred to fixed assets when it is ready for its intended use.

For construction projects which have been suspended and will not be resumed within three years or which have become functionally or technically obsolete or the economic benefits to be brought to the enterprises are highly uncertain, impairment loss will be recognised and charged to the income statement in the year when incurred.

The Group will review the construction in progress on an individual basis at the balance sheet date and impairment of construction in progress, determined as the difference between the recoverable amount and the carrying amount, will be charged to the income statement in the period when the recoverable amount falls below the carrying amount.

Measurement and amortisation of intangible assets

The Group's intangible assets are stated at cost when acquired. The cost of intangible assets is amortised on a straight-line basis over the estimated useful lives commencing from the month of acquisition. If the estimated useful life is longer than the contracted beneficial period or the effective period as stipulated under the relevant law, the intangible asset will be amortised on a straight-line basis over the contracted beneficial period or the effective period as stipulated under the relevant law, whichever is shorter. When the useful life of an intangible asset is not stipulated by the contract or law, it is amortised over a period of five years.

The Group will review the economic benefits that are expected to be brought to the Group by the intangible assets on an individual basis at the balance sheet date and impairment, determined as the difference between the recoverable amount and the carrying amount, will be charged to the income statement in the year when the recoverable amount falls below the carrying amount.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Maintenance and overhaul expenses

The regular maintenance and overhaul expenses incurred for aircraft owned or under finance leases are charged to the income statement as incurred. For aircraft under operating leases which require overhauls to be undertaken before the return of aircraft to lessors, the estimated cost of overhaul is calculated on a straight-line basis or by reference to the flown hours of the aircraft under the relevant operating leases and is charged to the income statement during the lease terms.

Borrowing costs

Borrowing costs comprise interest incurred, amortisation of discounts or premiums, ancillary costs and exchange differences in connection with the Group's borrowings. Specific borrowing refers to funds borrowed specifically for the acquisition or construction of fixed assets and the costs of specific borrowings are capitalised as part of the cost of the fixed assets if:

(1) the capital expenditure has been incurred;

(2) the borrowing costs have been incurred; and

(3) the acquisition or construction activities that are necessary to bring the asset into its intended use have commenced.

If the acquisition and construction activities pertaining to the fixed assets are suspended abnormally, and have been suspended for more than three consecutive months, the borrowing costs will cease to be capitalised and be recognised as expenses for the period until the resumption of such acquisition and construction activities.

Capitalisation of borrowing costs ceases when the fixed assets have reached their expected usable condition. Borrowing costs incurred thereafter are recognised as expenses in the year in which they are incurred.

The amount of interest costs capitalised for the period, including the amortisation of premiums or discounts, is determined based on the weighted average of cumulative expenditures incurred for the acquisition or construction of a fixed asset and the weighted average interest rate, and is limited to the actual amount of interest incurred and the amortisation of premiums or discounts on the specific borrowings during the year. Exchange differences on borrowings denominated in foreign currencies and ancillary costs arising from specific borrowings are capitalised to the extent of the amount actually incurred.

Borrowing costs incurred from other borrowings are recognised directly as financial expenses in the period when incurred.

Corporate bonds

Corporate bonds issued are recorded at face value. Difference between the issue price and the face value is accounted for as the premium or discount of the bonds, and is amortised on a straight-line basis over the term of the bonds when the relevant interest is accrued.

Principles of revenue recognition

When air passenger, cargo and mail services are provided by the Group, revenue from passenger, cargo and mail transportation is recognised as air traffic revenue upon the rendering of the relevant transportation services. Ticket sales for transportation services not yet provided are included in current liabilities as "domestic air traffic liabilities" or "international air traffic liabilities"; ticket sales for carriage undertaken but not sold by the Group and tickets sold but not carried by the Group must be settled through Accounting Centre of China Aviation or International Air Transport Association (IATA). Transportation revenue should be recognised based on flight coupons upon the rendering of the relevant transportation services.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of revenue recognition (Continued)

Agency commission income is recognised when invoices are issued by other carriers i.e. when the sales offices of the Group sell air tickets on behalf of other carriers and when such carriers received the flight coupons after the transportation services have been provided, settlement will be performed through the domestic clearing network of civil aviation (for domestic airlines) or IATA (for foreign airlines) for the collection of proceeds from ticket sales from the Group. Upon recognition, the Group will deduct the amount of agency commission it is entitled to from the proceedings of those ticket sales and recognise it as income of the Group.

For the rendering of other services, revenue is recognised when the relevant services are rendered and completed within the same accounting year. For services rendered and completed in more than one accounting year, when the outcome of the transaction involving the rendering of services can be estimated reliably, the relevant revenue from the rendering of services is recognised by the percentage of completion method.

Revenue from the sales of goods is recognised when the significant risks and rewards of ownership of the goods have been passed to the buyers such that the Group no longer maintain neither managerial rights nor control over the goods.

Revenue from other operations is stated at the net invoiced amount of the goods sold (net of the amount of output value added tax) and sales return is deducted from the revenue during the period when sales return occurred. Return of goods sold on or before the balance sheet date after the balance sheet date and before the date of approval of the financial statements are treated as adjusting events; cash discount is recognised as expenses during the period as and when incurred; and sales rebate is set off against revenue during the period when incurred.

Interest income is recognised according to the principal outstanding and the accrued interest at the applicable rate.

Dividend income is recognised as revenue when a shareholder's right to receive the dividend is established.

Rental income is recognised on a straight-line basis over the term of the leases.

Operating revenue included in the consolidated financial statements does not include intra-group transactions.

Operating leases

Leases where the lessors retain substantially all the risks and rewards of ownership of the assets are classified as operating leases. Rental charges under operating leases are recorded as expenses on a straight-line basis over the lease terms.

Accounting treatment of income tax

The Group accounts for enterprise income tax by using the tax payable method.

Frequent flyer programme

The Group currently maintains a frequent flyer programme, namely Air China Companion Club Incentive Programme, which provides travel awards to members based on accumulated mileage. The estimated incremental cost to provide free travel is recognised as an expense and accrued as a current liability when mileage accumulates. When members redeem their travel awards or when their entitlements expire, the relevant liability is reversed accordingly.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control, or jointly control the other party or exercise significant influence over the other party in making financial and operation decisions; or where two or more parties are subject to common control, these parties are also considered as related parties.

Accounting policies, changes in accounting estimates and correction of significant accounting errors

The Group's financial statements were prepared based on consistent accounting policies and accounting estimates, and no adjustment in significant accounting errors existed.

EFFECTS OF SIGNIFICANT DIFFERENCES BETWEEN IFRS AND PRC ACCOUNTING STANDARDS AND REGULATIONS

Effects of significant differences between the net profit under PRC Accounting Standards and Regulations and the profit attributable to the equity holders of the Company under IFRS are analysed as follows:

	Notes	2006 RMB'000	2005 RMB'000
Net profit under PRC Accounting Standards and Regulations		**3,191,381**	1,709,287
Additional depreciation from restatement of costs of fixed assets	*(i)*	**(159,746)**	(164,391)
Reversal of depreciation and amortisation arising on revaluation	*(ii)*	**490,369**	535,663
Effect of component accounting	*(iii)*	**234,344**	311,058
Reversal of amortisation of equity investment differences	*(iv)*	**105,141**	80,266
Share of profits and losses of associates	*(v)*	**24,495**	53,409
Gain on disposal of an associate	*(vi)*	**(964,366)**	–
Unrealised gain/(loss) on fuel derivatives	*(vii)*	**(268,041)**	125,868
Provision for early retirement benefit obligations	*(viii)*	**(12,056)**	6,047
Government grant	*(ix)*	**(10,987)**	6,417
Deferred tax	*(xi)*	**51,851**	(277,713)
Others		**5,456**	20,343
Profit attributable to equity holders of the Company under IFRS		**2,687,841**	2,406,254

Effects of significant differences between the shareholders' equity under PRC Accounting Standards and Regulations and the equity attributable to equity holders of the Company under IFRS are analysed as follows:

	Notes	2006 RMB'000	2005 RMB'000
Shareholders' Equity under PRC Accounting Standards and Regulations		**31,239,980**	19,840,022
Restatement of costs of fixed assets	*(i)*	**892,828**	1,052,574
Reversal of revaluation surplus	*(ii)*	**(1,419,784)**	(1,910,153)
Effect of component accounting	*(iii)*	**545,403**	311,058
Reversal of equity investment differences	*(iv)*	**(11,327)**	737,071
Share of net assets of associates	*(v)*	**183,801**	122,559
Unrealised gain on disposal of an associate	*(vi)*	**(218,721)**	–
Recognition of financial assets/(liabilities), net	*(vii)*	**(142,173)**	125,868
Provision for early retirement benefit obligations	*(viii)*	**(201,198)**	(189,141)
Government grant	*(ix)*	**(427,141)**	(416,155)
Elimination of reciprocal interest in an associate	*(x)*	**(1,246,955)**	–
Deferred tax	*(xi)*	**550,222**	498,371
Others		**(20,677)**	(79,833)
Equity attributable to equity holders of the Company under IFRS		**29,724,258**	20,092,241

EFFECTS OF SIGNIFICANT DIFFERENCES BETWEEN IFRS AND PRC ACCOUNTING STANDARDS AND REGULATIONS (Continued)

Notes:

i. Differences in the costs of fixed assets mainly relate to fixed assets acquired in foreign currencies prior to 1 January 1994 and are stated at the equivalent amount of RMB translated at the then prevailing exchange rates prescribed by the government (i.e. the government-prescribed rates). Under IFRS, such difference is stated at the equivalent amount of RMB translated at the then prevailing market rate (i.e. the swap rate), resulting in differences in the costs of fixed assets between the financial statements prepared under IFRS and under PRC Accounting Standards and Regulations.

ii. In accordance with the accounting policies under IFRS, all assets are recorded at historical costs. Accordingly, the revaluation of assets and its amortisation recorded under PRC Accounting Standards and Regulations is reversed in the financial statements prepared under IFRS.

iii. In accordance with the requirements of IFRS, the costs of major overhauls in respect of owned or finance-leased aircraft and engines are capitalised and depreciated over the respective overhaul cycles.

iv. In accordance with IFRS, the amortisation of equity investment differences arising on the acquisition of long term equity investments should be reversed.

v. Adjustments to financial statements of associates in accordance with IFRS.

vi. The unrealised profit arising from the disposal of an associate, Dragonair, to Cathay has been adjusted in accordance with IFRS.

vii. In accordance with IFRS, financial assets and financial liabilities from fuel derivatives contracts should be carried at their fair value at the balance sheet date; while there is no relevant requirement under PRC Accounting Standards and Regulations.

viii. In accordance with IFRS, when staff applies for early retirement, the employee compensation costs to be accrued up to the staff's official retirement age should be provided for on a one-off basis whereas there was no such requirement under PRC Accounting Standards and Regulations.

ix. In accordance with IFRS, government-granted assets or government subsidies should be debited to government grant receivable or asset and at the same time credited to deferred income in the balance sheet, which is amortised on a straight-line basis to the income statement. In accordance with PRC Accounting Standards and Regulations, when government granted assets are received, they should be debited to the relevant assets and credited to the capital reserve; when government subsidies are received, they should be debited to cash at bank and included in the income statement as subsidies income.

x. During the year, Cathay and the Company became associates of each other. In accordance with IFRS, the investment under cross-holding should be eliminated.

xi. In accordance with PRC Accounting Standards and Regulations, the Company has adopted the tax payable method to account for enterprise income tax. Therefore, no provision for deferred tax has been made in the financial statements prepared under PRC Accounting Standards and Regulations. In accordance with IFRS, provision for deferred tax is required.