## 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"). The Company's H Shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited on 30th October 2003.

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.

The Company's directors regard AVIC II, a company established in the PRC, as being the ultimate holding company of the Company.

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 2nd April 2007.

## 2 BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") 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, as appropriate.

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 Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

In preparing these financial statements, the directors have taken into account all information that could reasonably be expected to be available and have ascertained that the Group has obtained adequate financial resources to support the Group to continue in operational existence for the foreseeable future. Under these circumstances, the directors consider that it is proper to prepare the financial statements on a going concern basis notwithstanding that at 31st December 2006, the Group's current liabilities exceeded its current assets by RMB899,352,000.

## 2 BASIS OF PREPARATION (continued)

The following amendments to standards and interpretations are mandatory for financial year ended 31st December 2006.

| | |
|---|---|
| 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; |
| IFRIC 4 | Determining whether an Arrangement contains a Lease; |
| IFRIC 5 | Rights to Interests arising from Decommissioning, arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and |
| IFRIC 6 | Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment. |

The adoption of the above amendments to standards and interpretation did not have any significant financial impact to the Group.

The Group has not early adopted the following new/revised standards or interpretations that have been issued but are not yet effective. The directors anticipate that the adoption of these Standards or interpretations in future periods will not result in substantial changes to the Group's accounting policies.

| | |
|---|---|
| IAS 1(Amendment) | Presentation of Financial Statements: Capital disclosures |
| IFRS 7 | Financial Instruments: Disclosures |
| IFRS 8 | Operating Segments, effective for accounting periods beginning on or after 1st January 2009 |
| IFRIC 7 | Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies; |
| IFRIC 8 | Scope of IFRS 2; |
| IFRIC 9 | Reassessment of embedded derivatives |
| IFRIC 10 | Interim Financial Reporting and Impairment |
| IFRIC 11 | IFRS 2 – Group and Treasury Share Transactions |
| IFRIC 12 | Service Concession Arrangements. |

## 3 PRINCIPAL ACCOUNTING POLICIES

### (a) Consolidation

The 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 equity owners of the Group. For purchases from minority interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is deducted from equity. Gains or losses on disposals to minority interests are also recorded in equity. For disposals to minority interests, differences between any proceeds received and the relevant share of minority interests are also recorded in equity.

## 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.

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 |

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

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

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 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. 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.

### (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 income statement.

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (e) Intangible assets (continued)

Technology know-how is initially recognised at cost. Technology know-how that has a definite useful life is carried at cost less accumulated amortisation and accumulated impairment losses, if any. Amortisation is calculated using the straight-line method to allocate the cost of technology know-how over their estimated useful lives of 6 years.

### (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.

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

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

*(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.

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (g) Financial assets (continued)

*(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 the income statement 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 the income statement, 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.

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.

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (g) Financial assets (continued)

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.

### (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).

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (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, deposits held at call with banks and term deposit with initial terms less than three months.

### (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 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 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.

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (n) Deferred income tax (continued)

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.

### (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 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.

## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (o) Employee benefits (continued)

*(iii) Housing benefits* (continued)

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

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 realiably 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 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 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 (continued)

*(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 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(i) above.

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

Revenue from the provision of 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 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 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, deferred income tax assets, investments in associates, inventories, operating receivables, deposits and cash and cash equivalents, and mainly exclude corporate assets. Segment liabilities comprise operating liabilities, current and deferred income tax liabilities, and exclude 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 deprecation/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 aircrafts.

### (a) 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 other aircrafts.

All segment revenues were made to external parties.

## 5 SEGMENT INFORMATION (continued)

**Primary reporting format - business segments**

| | As at and for the year ended 31st December 2006 | | |
|---|---|---|---|
| | Aviation RMB'000 | Automobiles RMB'000 | Total RMB'000 |
| **Operating results** | | | |
| Segment revenue | 4,427,598 | 12,682,910 | 17,110,508 |
| Segment results | 404,140 | (619,988) | (215,848) |
| Unallocated income | | | 6,591 |
| Unallocated costs | | | (36,775) |
| Operating loss | | | (246,032) |
| Finance costs, net | (81,951) | (190,331) | (272,282) |
| Share of results of associates | 42,540 | 2,511 | 45,051 |
| Loss before income tax | | | (473,263) |
| Income tax expense | | | (13,399) |
| Loss for the year | | | (486,662) |
| **Assets** | | | |
| Segment assets | 7,720,276 | 15,976,945 | 23,697,221 |
| Interests in associates | 192,339 | 55,628 | 247,967 |
| Unallocated assets | | | 865,338 |
| Total assets | | | 24,810,526 |
| **Liabilities** | | | |
| Segment liabilities | 5,119,222 | 11,051,521 | 16,170,743 |
| Unallocated liabilities | | | 517,671 |
| Total liabilities | | | 16,688,414 |
| **Other segment information** | | | |
| Capital expenditures | 157,655 | 1,045,909 | 1,203,564 |
| Depreciation | 70,266 | 857,847 | 928,113 |
| Amortisation | 1,277 | 125,572 | 126,849 |
| Provisions for impairment | 30,248 | 75,706 | 105,954 |

## 5 SEGMENT INFORMATION (continued)

| | As at and for the year ended 31st December 2005 | | |
|---|---|---|---|
| | Aviation | Automobiles | Total |
| | RMB'000 | RMB'000 | RMB'000 |
| **Operating results** | | | |
| Segment revenue | 3,550,166 | 10,715,942 | 14,266,108 |
| Segment results | 275,125 | 108,887 | 384,012 |
| 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 income tax | | | 239,674 |
| Income tax expense | | | (52,078) |
| Profit for the year | | | 187,596 |
| **Assets** | | | |
| 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 |
| **Liabilities** | | | |
| Segment liabilities | 3,715,239 | 9,653,737 | 13,368,976 |
| Unallocated liabilities | | | 633,320 |
| Total liabilities | | | 14,002,296 |
| **Other segment information** | | | |
| Capital expenditures | 256,714 | 2,307,396 | 2,564,110 |
| Depreciation | 117,521 | 546,568 | 664,089 |
| Amortisation | 656 | 98,836 | 99,492 |
| Provisions for impairment | 30,456 | 112,388 | 142,844 |

## 5 SEGMENT INFORMATION (continued)

### (b) 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 revenue from external customers and assets is attributable to markets not located in the PRC.

## 6 OTHER INCOME

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Interest income on bank balances and deposits | 78,256 | 73,968 |
| Profit from sale of scrap materials | 19,699 | 16,511 |
| Gain on disposal of other financial assets at fair value through profit or loss | 6,591 | 2,031 |
| Income from government grants | 66,223 | 96,634 |
| Refund of value-added tax and real estate tax | 1,878 | 4,706 |
| Rental income from plant and equipment | 2,012 | 5,069 |
| Income from rendering of other services, net | 8,599 | 9,838 |
| | 183,258 | 208,757 |

## 7 OPERATING (LOSS)/PROFIT

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

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Auditors' remuneration | **7,780** | 6,840 |
| Amortisation | | |
| - Land use rights | **2,983** | 4,904 |
| - Intangible assets | **123,866** | 94,588 |
| Amortisation of deferred income relating to government grants | **(18,396)** | (21,746) |
| Costs of inventories sold | **15,204,907** | 12,395,184 |
| Depreciation on property, plant and equipment (Note 15) | **928,113** | 664,089 |
| (Gain)/loss on disposal | | |
| - Property, plant and equipment | **(12,780)** | 9,513 |
| - A subsidiary (Note 18 (b)) | **3** | 1,918 |
| - Associates | **9,811** | — |
| Operating lease rentals | | |
| - Land and buildings | **41,029** | 38,515 |
| - Property, plant and equipment | **—** | 430 |
| Provision/(reversal of provision) for impairment | | |
| - Receivables | **22,126** | 33,877 |
| - Inventories | **121** | (13,941) |
| - Other non-current financial assets | **12,355** | 25,000 |
| - Property, plant and equipment (Note 15) | **642** | 1,305 |
| - Intangible assets (Note 17) | **70,710** | 96,603 |
| Repairs and maintenance expense on property, plant and equipment | **24,301** | 15,670 |
| Research expenditures and development costs charged to income statement directly | **230,712** | 86,714 |
| Staff costs, including directors' emoluments (Note 13) | **997,118** | 793,454 |
| Warranty expenses (Note 34) | **154,841** | 59,235 |

## 8 FINANCE COSTS, NET

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Interest expense on bank borrowings | | |
| - Wholly repayable within 5 years | **313,986** | 281,765 |
| - Not wholly repayable within 5 years | **15,618** | 854 |
| Interest expense on other borrowings | | |
| - Wholly repayable within 5 years | **9,707** | 661 |
| - Not wholly repayable within 5 years | **121** | 121 |
| | **339,432** | 283,401 |
| Less: Amount capitalised in property, plant and equipment (note) | **(59,252)** | (36,918) |
| Government interest subsidies | **(27,119)** | (37,100) |
| | **253,061** | 209,383 |
| Exchange losses/(gains), net | **14,487** | (57,993) |
| Other finance costs | **4,734** | 2,506 |
| | **272,282** | 153,896 |

Note:

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:

| | 2006 | 2005 |
|---|---|---|
| Interest rates per annum at which finance costs were capitalised | **3.74% - 5.81%** | 3.68% - 5.58% |

## 9 INCOME TAX EXPENSE

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| PRC enterprise income tax | **52,686** | 64,621 |
| Deferred income taxes | **(39,287)** | (12,543) |
| | **13,399** | 52,078 |

Notes:

(a) Except for certain subsidiaries which are taxed at preferential rates ranging from 7.5% to 33% (2005: 7.5% to 33%), in accordance with the relevant PRC enterprise income tax rules and regulations, provision for PRC enterprise income tax is calculated based on the statutory income tax rate of 33% of the assessable income of the Group as determined for the year (2005: 33%).

(b) 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:

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| (Loss)/profit before income tax | **(473,263)** | 239,674 |
| Tax calculated at the statutory tax rate of 33% (2005: 33%) | **(156,177)** | 79,092 |
| Preferential tax rates on the income of certain subsidiaries | **(91,449)** | (47,049) |
| Non-taxable income | **(63,662)** | (47,894) |
| Expenses not deductible for tax purposes | **26,951** | 20,479 |
| Tax losses for which no deferred income tax asset was recognised | **314,119** | 69,856 |
| Utilisation of previously unrecognised tax losses | **—** | (25,280) |
| Others | **(16,383)** | 2,874 |
| Tax charge | **13,399** | 52,078 |

(c) Share of taxation attributable to associates for the year ended 31st December 2006 of RMB 772,000 (2005: RMB 2,202,000) is included in the consolidated income statement as share of results of associates.

## 10 LOSS ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The loss attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of RMB 166,985,000 (2005: profit of RMB 69,645,000).

## 11 DIVIDEND

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Final dividend, proposed, of RMB Nil (2005: RMB 0.0105) per share | **—** | 48,758 |

The board of directors do not recommend the payment of a dividend for the year ended 31st December 2006.

## 12 (LOSS)/EARNINGS PER SHARE

The calculation of basic (loss)/earnings per share is based on the Group's loss attributable to equity holders of the Company of RMB 331,079,000 (2005: profit of RMB118,072,000) and based on the weighted average number of 4,643,608,500 (2005: 4,643,608,500) shares in issue during the year.

There was no dilution effect on the basic (loss)/earnings per share for the years ended 31st December 2006 and 2005 as there were no potential dilutive shares outstanding during the years ended 31st December 2006 and 2005.

## 13 STAFF COSTS, INCLUDING DIRECTORS' EMOLUMENTS

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Wages, salaries and bonuses | **690,103** | 531,077 |
| Housing benefits | **55,305** | 26,408 |
| Contributions to pension plans | **128,072** | 122,398 |
| Welfare and other expenses | **123,638** | 113,571 |
| | **997,118** | 793,454 |

## 14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

### (a) Directors' emoluments

The emoluments of each of the directors of the Company for the years ended 31st December 2006 and 2005 are set out below.

| | Year ended 31st December 2006 | | | | |
|---|---|---|---|---|---|
| Name of director | Fees<br>RMB'000 | Basic salaries, housing allowances, other allowances and benefits in kind<br>RMB'000 | Bonuses<br>RMB'000 | Employer's contributions to retirement schemes<br>RMB'000 | Total<br>RMB'000 |
| **Executive directors** | | | | | |
| Zhang Hongbiao | — | 180 | — | — | 180 |
| Wu Xiandong | — | 160 | — | — | 160 |
| Tan Ruisong (note (i)) | — | 140 | — | — | 140 |
| **Non-executive directors** | | | | | |
| Liang Zhenhe | 120 | — | — | — | 120 |
| Song Jingang | 120 | — | — | — | 120 |
| Tian Min | 120 | — | — | — | 120 |
| Chen Huaiqiu | 120 | — | — | — | 120 |
| Wang Bin | 120 | — | — | — | 120 |
| Wang Yong | 35 | — | — | — | 35 |
| Maurice Savart | — | — | — | — | — |
| **Independent non-executive directors** | | | | | |
| Dr. The Hon. Li Kwok-Po, David (note (ii)) | 64 | — | — | — | 64 |
| Guo Chongqing | 62 | — | — | — | 62 |
| Li Xianzong | 62 | — | — | — | 62 |
| Lau Chungman (note (iii)) | 63 | — | — | — | 63 |
| | 886 | 480 | — | — | 1,366 |

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

### (a) Directors' emoluments (continued)

| | Year ended 31st December 2005 | | | | |
|---|---|---|---|---|---|
| Name of director | 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 |
| **Executive directors** | | | | | |
| Zhang Hongbiao | — | 180 | — | — | 180 |
| Wu Xiandong | — | 160 | — | — | 160 |
| **Non-executive directors** | | | | | |
| Liang Zhenhe | — | 120 | — | — | 120 |
| Song Jingang | — | 120 | — | — | 120 |
| Tan Ruisong (note (i)) | — | 60 | — | — | 60 |
| Tian Min | — | 120 | — | — | 120 |
| Wang Bin (note (iv)) | — | 60 | — | — | 60 |
| Chen Huaiqiu | — | 120 | — | — | 120 |
| Wang Yong (note (iv)) | — | 15 | — | — | 15 |
| Maurice Savart | — | — | — | — | — |
| Xu Tongxing (note (v)) | — | 60 | — | — | 60 |
| Cui Xuewen (note (v)) | — | 60 | — | — | 60 |
| Yang Jinhuai (note (v)) | — | 60 | — | — | 60 |
| Hu Jiarui (note (v)) | — | 15 | — | — | 15 |
| **Independent non-executive directors** | | | | | |
| Dr. The Hon. Li Kwok-Po, David | 106 | — | — | — | 106 |
| Guo Chongqing | 57 | — | — | — | 57 |
| Li Xianzong | 57 | — | — | — | 57 |
| | 220 | 1,150 | — | — | 1,370 |

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

### (a) Directors' emoluments (continued)

Notes:

(i) Mr Tan Ruisong was appointed as a non-executive director on 16th June 2005 and appointed as an executive director on 16th June 2006.

(ii) Dr. The Hon. Li Kwok-Po, David was resigned on 16th June 2006.

(iii) Mr Lau Chungman was appointed on 28th August 2006.

(iv) These directors were appointed on 16th June 2005.

(v) These directors were resigned on 16th June 2005.

### (b) Supervisors' emoluments

The emoluments of each of the supervisors of the Company for the years ended 31st December 2006 and 2005 are set out below.

| | Year ended 31st December 2006 | | | | |
|---|---|---|---|---|---|
| Name of supervisor | Fees | Basic salaries, housing allowances, other allowances and benefits in kind | Bonuses | Employer's contributions to retirement schemes | Total |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **Supervisors** | | | | | |
| Tang Jianguo | 140 | — | — | — | 140 |
| Wang Shouxin | 140 | — | — | — | 140 |
| Li Shentian | 120 | — | — | — | 120 |
| Bai Ping | 120 | — | — | — | 120 |
| Han Xiaoyang (note (i)) | 60 | — | — | — | 60 |
| Lu Liubao (note (ii)) | 60 | — | — | — | 60 |
| Liu Xianping (note (ii)) | 11 | — | — | — | 11 |
| Yu Yan | 24 | — | — | — | 24 |
| Li Deqing (note (i)) | 13 | — | — | — | 13 |
| **Independent supervisors** | | | | | |
| Zheng Li | 35 | — | — | — | 35 |
| Xie Zhihua | 35 | — | — | — | 35 |
| | 758 | — | — | — | 758 |

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

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

| | Year ended 31st December 2005 | | | | |
|---|---|---|---|---|---|
| Name of supervisor | 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 |
| **Supervisors** | | | | | |
| 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 |
| **Independent supervisors** | | | | | |
| Zheng Li | — | 30 | — | — | 30 |
| Xie Zhihua | — | 30 | — | — | 30 |
| | — | 740 | — | — | 740 |

Notes:

(i) These supervisors were appointed on 16th June 2006.

(ii) These supervisors were resigned on 16th June 2006.

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

### (c) Five highest paid individuals

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

| | Number of individuals | |
|---|---|---|
| | **2006** | 2005 |
| In the capacity as: | | |
| Director | **3** | 2 |
| Supervisor | **1** | 1 |
| Senior management | **1** | 2 |
| | **5** | 5 |

The five individuals whose emoluments were highest in the Group for the year included three (2005: two) directors and one (2005: one) supervisor whose emoluments are reflected in the analyses presented above. The emoluments payable to the remaining one (2005: two) individual(s) during the year are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Basic salaries, housing allowances, other allowances and benefits in kind | **241** | 395 |
| Contributions to retirement schemes | **—** | — |
| | **241** | 395 |

The emoluments fell within the following band:

| | Number of individual(s) | |
|---|---|---|
| | **2006** | 2005 |
| Nil – RMB1,005,000 (equivalent to HKD 1,000,000) | **1** | 2 |

(d) No directors or supervisors of the Company waived any emoluments during the years ended 31st December 2005 and 2006. 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 (2005: Nil).

## 15 PROPERTY, PLANT AND EQUIPMENT

| | Group | | | | |
|---|---|---|---|---|---|
| | 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 |
| **Cost** | | | | | |
| As at 1st January 2006 | 1,629,663 | 2,103,442 | 8,255,149 | 639,642 | 12,627,896 |
| Additions | 931,725 | 15,439 | 113,992 | 50,056 | 1,111,212 |
| Transfer upon completion | (1,822,114) | 104,886 | 1,638,230 | 78,998 | — |
| Disposals/write off | (1,305) | (29,489) | (184,707) | (33,432) | (248,933) |
| As at 31st December 2006 | 737,969 | 2,194,278 | 9,822,664 | 735,264 | 13,490,175 |
| **Accumulated depreciation and impairment** | | | | | |
| As at 1st January 2006 | 1,305 | 573,489 | 2,793,784 | 286,240 | 3,654,818 |
| Depreciation | — | 79,437 | 771,605 | 77,071 | 928,113 |
| Impairment charge | — | — | 642 | — | 642 |
| Disposals/write off | (1,305) | (13,962) | (101,935) | (25,734) | (142,936) |
| As at 31st December 2006 | — | 638,964 | 3,464,096 | 337,577 | 4,440,637 |
| **Net book value** | | | | | |
| As at 31st December 2006 | 737,969 | 1,555,314 | 6,358,568 | 397,687 | 9,049,538 |

## 15 PROPERTY, PLANT AND EQUIPMENT (continued)

| | Group | | | | |
|---|---|---|---|---|---|
| | 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 |
| **Cost** | | | | | |
| 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 | 1,629,663 | 2,103,442 | 8,255,149 | 639,642 | 12,627,896 |
| **Accumulated depreciation and impairment** | | | | | |
| As at 1st January 2005 | — | 484,632 | 2,394,866 | 242,965 | 3,122,463 |
| Depreciation | — | 124,888 | 479,775 | 59,426 | 664,089 |
| Impairment charge | 1,305 | — | — | — | 1,305 |
| Disposals | — | (36,031) | (80,857) | (16,151) | (133,039) |
| As at 31st December 2005 | 1,305 | 573,489 | 2,793,784 | 286,240 | 3,654,818 |
| **Net book value** | | | | | |
| As at 31st December 2005 | 1,628,358 | 1,529,953 | 5,461,365 | 353,402 | 8,973,078 |

## 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 |
| **Cost** | | | |
| As at 1st January 2006 | **6,637** | **8,364** | **15,001** |
| Additions | **—** | **290** | **290** |
| As at 31st December 2006 | **6,637** | **8,654** | **15,291** |
| **Accumulated depreciation and impairment** | | | |
| As at 1st January 2006 | **3,094** | **2,991** | **6,085** |
| Depreciation | **246** | **755** | **1,001** |
| As at 31st December 2006 | **3,340** | **3,746** | **7,086** |
| **Net book value** | | | |
| As at 31st December 2006 | **3,297** | **4,908** | **8,205** |
| **Cost** | | | |
| As at 1st January 2005 | 6,637 | 7,861 | 14,498 |
| Additions | — | 503 | 503 |
| As at 31st December 2005 | 6,637 | 8,364 | 15,001 |
| **Accumulated depreciation and impairment** | | | |
| As at 1st January 2005 | 2,890 | 2,362 | 5,252 |
| Depreciation | 204 | 629 | 833 |
| As at 31st December 2005 | 3,094 | 2,991 | 6,085 |
| **Net book value** | | | |
| As at 31st December 2005 | 3,543 | 5,373 | 8,916 |

## 15 PROPERTY, PLANT AND EQUIPMENT (continued)

Notes:

(a) Carrying value of the Group's property, plant and equipment pledged as securities for bank borrowings were set out as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Property, plant and equipment pledged (Note 35(h)) | **209,539** | 406,563 |

(b) As at 31st December 2006, certain of the Group's property, plant and equipment with carrying value of approximately RMB 900,034,000 (2005: RMB 1,036,780,000) 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 leasehold land as at 31st December 2006 are ranging from 16 to 43 years (2005: 17 to 44 years).

## 16 LAND USE RIGHTS

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| **Cost** | | |
| As at 1st January | **125,286** | 111,466 |
| Additions | **—** | 13,820 |
| As at 31st December | **125,286** | 125,286 |
| **Accumulated amortisation** | | |
| As at 1st January | **25,972** | 21,068 |
| Amortisation | **2,983** | 4,904 |
| As at 31st December | **28,955** | 25,972 |
| **Net book amount** | | |
| As at 31st December | **96,331** | 99,314 |

## 17 INTANGIBLE ASSETS

| | Group | | | |
|---|---|---|---|---|
| | Development costs RMB'000 (note (i)) | Technology know-how RMB'000 (note (iii)) | Electricity use rights RMB'000 | Total RMB'000 |
| **Cost** | | | | |
| As at 1st January 2006 | **865,847** | **—** | **37,760** | **903,607** |
| Additions | **50,642** | **41,710** | **—** | **92,352** |
| Write off | **(67,538)** | **—** | **(37,760)** | **(105,298)** |
| As at 31st December 2006 | **848,951** | **41,710** | **—** | **890,661** |
| **Accumulated amortisation and impairment** | | | | |
| As at 1st January 2006 | **312,969** | **—** | **37,760** | **350,729** |
| Impairment charge (note (ii)) | **70,710** | **—** | **—** | **70,710** |
| Amortisation | **121,697** | **2,169** | **—** | **123,866** |
| Write off | **(67,538)** | **—** | **(37,760)** | **(105,298)** |
| As at 31st December 2006 | **437,838** | **2,169** | **—** | **440,007** |
| **Net book amount** | | | | |
| As at 31st December 2006 | **411,113** | **39,541** | **—** | **450,654** |
| **Cost** | | | | |
| As at 1st January 2005 | 688,824 | — | 37,760 | 726,584 |
| Additions | 177,023 | — | — | 177,023 |
| As at 31st December 2005 | 865,847 | — | 37,760 | 903,607 |
| **Accumulated amortisation and impairment** | | | | |
| As at 1st January 2005 | 152,023 | — | 7,515 | 159,538 |
| Impairment charge (note (ii)) | 67,538 | — | 29,065 | 96,603 |
| Amortisation | 93,408 | — | 1,180 | 94,588 |
| As at 31st December 2005 | 312,969 | — | 37,760 | 350,729 |
| **Net book amount** | | | | |
| As at 31st December 2005 | 552,878 | — | — | 552,878 |

## 17 INTANGIBLE ASSETS (continued)

Notes:

(i) In 2005, the Group entered into a jointly controlled asset arrangement with a fellow subsidiary to develop a new model of aircraft in which the Group has a 60.56% participating interest. As at 31st December 2006, the aggregate amounts of development costs incurred by the Group amounted to RMB175,957,000 (2005: RMB134,988,000).

(ii) Impairment losses on intangible assets are mainly in relation to certain development costs for which management estimated that the carrying amounts of these assets have exceeded their recoverable amounts as determined based on value-in-use calculations.

(iii) Technology know-how represents one-off upfront license fees paid to a minority shareholder of a subsidiary for acquiring technical details in connection with certain new automobile and engine models.

## 18 INTERESTS IN SUBSIDIARIES

| | Company | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Investments, at cost | | |
| - Listed in the PRC | **2,219,793** | 1,044,117 |
| - Unlisted | **1,295,171** | 2,411,254 |
| | **3,514,964** | 3,455,371 |
| Amounts due from subsidiaries (note (a)) | **505,000** | 955,188 |
| | **4,019,964** | 4,410,559 |
| Market value of listed shares (also see Note 37(f)) | **4,865,390** | 1,281,060 |

Particulars of the principal subsidiaries of the Group as at 31 st December 2006 are set out in Note 43.

Notes:

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

(b) Pursuant to an agreement entered into between AVIC II and the Company on 28th April 2006, the Company disposed of its entire 51% interest in Beijing Wisewell Avionics Technology Co., Ltd. (北京維思韋爾航空電子科技開發有限公司) for a consideration of RMB 1,479,000 resulting in a loss of RMB 3,000.

(c) During the year, the Group acquired a further 54.95% equity interest in a 45% owned associate, Harbin Lingfei Auto Welding Parts Co., Ltd. (哈爾濱凌飛汽車焊裝件有限公司) for a consideration of RMB 11,994,000. Accordingly, this associate becomes a 99.95% owned subsidiary of the Group.

## 19 SHARE OF RESULTS OF/INTERESTS IN ASSOCIATES

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Share of net assets, as at 1st January | **252,863** | 224,192 |
| Share of results of associates | | |
| - Profit before income tax | **45,823** | 47,569 |
| - Income tax expense | **(772)** | (2,202) |
| | **45,051** | 45,367 |
| | **297,914** | 269,559 |
| Dividends received from associates | **(31,777)** | (39) |
| Acquisition | **15,000** | 6,902 |
| Disposals | **(23,375)** | (23,559) |
| Acquired as a subsidiary (Note 18(c)) | **(9,795)** | — |
| Share of net assets, as at 31st December | **247,967** | 252,863 |

Particulars of the principal associates of the Group as at 31 st December 2006 are set out in Note 43.

## 20 OTHER NON-CURRENT FINANCIAL ASSETS

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Investments in promoter shares, unlisted | **62,177** | 62,177 |
| Other equity investments, unlisted | **81,425** | 103,709 |
| Less: Provision for impairment | **(12,355)** | (50,000) |
| | **69,070** | 53,709 |
| | **131,247** | 115,886 |

The Group's other non-current financial assets principally represent investments in promoter shares of certain companies listed in the PRC which are only 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 | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| As at 1st January | **49,489** | 38,713 |
| Credited to consolidated income statement | **25,816** | 10,776 |
| As at 31st December | **75,305** | 49,489 |

Deferred income tax liabilities:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| As at 1st January | **(49,343)** | (51,110) |
| Credited to consolidated income statement | **13,471** | 1,767 |
| As at 31st December | **(35,872)** | (49,343) |

## 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 | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Deferred income tax assets: | | |
| Provision for impairment of receivables | **54,672** | 58,355 |
| Provision for impairment of inventories | **14,417** | 13,562 |
| Provision for impairment of investments | **1,853** | 375 |
| Provision for impairment of property, plant and equipment | **2,812** | 2,676 |
| Provision for warranty expense | **30,926** | 14,778 |
| Other temporary differences | **12,433** | 8,391 |
| | **117,113** | 98,137 |
| Deferred income tax liabilities: | | |
| Interest income | **—** | 396 |
| Development costs | **72,590** | 97,595 |
| Other temporary differences | **5,090** | — |
| | **77,680** | 97,991 |
| Total deferred income tax assets less total deferred income tax liabilities | **39,433** | 146 |

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 | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Representing: | | |
| Deferred income tax assets | **75,305** | 49,489 |
| Deferred income tax liabilities | **(35,872)** | (49,343) |
| Total deferred income tax assets less total deferred income tax liabilities | **39,433** | 146 |

## 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 RMB403,387,000 (2005: RMB89,268,000) in respect of tax losses amounting to RMB1,222,386,000 (2005: RMB270,510,000) that can be carried forward against future taxable income. These unrecognised tax losses are expiring within 5 years.

## 22 ACCOUNTS RECEIVABLE

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Trade receivables, gross (note (a)) | | |
| - Fellow subsidiaries (note (b)) | **1,701,901** | 1,116,620 |
| - Other related parties (note (b)) | **152,778** | 165,317 |
| - Others | **1,206,085** | 994,502 |
| | **3,060,764** | 2,276,439 |
| Less: Provision for impairment of receivables | **(222,108)** | (252,719) |
| | **2,838,656** | 2,023,720 |
| Notes receivable (note (c)) | | |
| - Fellow subsidiaries | **37,263** | 70,400 |
| - Others | **841,005** | 834,979 |
| | **878,268** | 905,379 |
| | **3,716,924** | 2,929,099 |

## 22 ACCOUNTS RECEIVABLE (continued)

Notes:

(a) Certain of the Group's sales were on advance payment or documents against payment. Sales to small, new or short-term customers are normally expected to be settled shortly after delivery. A credit period of up to six months may be granted in respect of sales to customers with good credit history and long-established relationship with the Group. Terms offered to related parties are similar to those offered to third parties. Ageing analysis of trade receivables is as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Current to 1 year | **2,820,466** | 1,987,199 |
| 1 year to 2 years | **63,532** | 88,181 |
| 2 years to 3 years | **5,449** | 28,868 |
| Over 3 years | **171,317** | 172,191 |
| | **3,060,764** | 2,276,439 |

(b) Trade receivables from fellow subsidiaries and other related parties are unsecured and non-interest bearing.

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

(d) The carrying amounts of accounts receivable approximate their fair values.

(e) Certain notes receivable were pledged as security for a bank loan (Note 35 (h))

## 23 ADVANCES TO SUPPLIERS

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Advances to suppliers | | |
| - Fellow subsidiaries | **38,824** | 60,202 |
| - Other related parties | **2,254** | 235,299 |
| - Others | **587,305** | 330,260 |
| | **628,383** | 625,761 |

In the ordinary course of business, the Group is required to make advance payments to certain suppliers according to the terms of respective agreements. The advance payments made to these parties are unsecured, non-interest bearing and will be settled or utilised in accordance with the terms of relevant agreements.

## 24 OTHER RECEIVABLES AND PREPAYMENTS

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Advances for purchase of property, plant and equipment | **30,386** | 33,312 | **—** | — |
| Amount due from customers for contract work (Note 26) | **—** | 136,167 | **—** | — |
| Dividends receivable from subsidiaries | **—** | — | **137,195** | 32,350 |
| Other advances (note) | | | | |
| - Ultimate holding company | **57,293** | 58,090 | **—** | — |
| - Fellow subsidiaries | **38,696** | 343,987 | **—** | — |
| - Other related parties | **16,058** | 1,148 | **—** | — |
| Other receivables | **390,526** | 58,967 | **—** | — |
| Prepayments and deposits | **101,652** | 98,226 | **72** | 1,320 |
| Value-added tax recoverable | **—** | 24,822 | **—** | — |
| Other current assets | **73,607** | 37,617 | **—** | — |
| | **708,218** | 792,336 | **137,267** | 33,670 |

Note:

Other advances mainly represent current account balances with the respective related parties which are unsecured, non-interest bearing and are repayable on demand.

## 25 INVENTORIES

| | Group 2006 RMB'000 | Group 2005 RMB'000 |
|---|---|---|
| Raw materials | **2,081,314** | 1,978,068 |
| Work in progress | **673,204** | 640,449 |
| Finished goods | **1,990,662** | 1,487,906 |
| Consumables | **138,385** | 93,189 |
| | **4,883,565** | 4,199,612 |
| Less: Provision for impairment losses | **(78,652)** | (72,994) |
| | **4,804,913** | 4,126,618 |

## 26 CONTRACTS IN PROGRESS

| | Group 2006 RMB'000 | Group 2005 RMB'000 |
|---|---|---|
| Contracts in progress at balance sheet date: | | |
| Amount due from customers for contract work (Note 24) | **—** | 136,167 |
| Amount due to customers for contract work (Note 32) | **(40,409)** | — |
| | **(40,409)** | 136,167 |
| Contract costs incurred and recognised profits to date | **4,408,458** | 1,984,293 |

At 31st December 2006, no retentions were held by customers for contract work (2005: Nil) and advances of RMB 83,088,000 (2005: Nil) which were included in advances from customers (Note 31), were received on construction contracts.

## 27 OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Other financial assets at fair value through profit or loss of the Group represented investments in shares and government bonds listed in the PRC and are stated at fair value at the close of business at year end date. Fair value was estimated by reference to the quoted bid prices. During the year, the Group disposed of all other financial assets at fair value through profit or loss at a profit of approximately RMB 6,591,000.

## 28 PLEDGED DEPOSITS

(a) Pledged deposits are denominated in the following currencies:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| Currency | **RMB'000** | RMB'000 |
| Renminbi * | **694,391** | 405,574 |

* The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(b) Pledged deposits earn interest at rates ranging from 0.72% to 1.98% (2005: 0.72% to 2.07%).

(c) As at 31st December 2006, the trade finance facilities utilised by the Group for issuing notes payable to the Group's suppliers were amounting to RMB 1,365,285,000 (2005: RMB 943,472,000), which were secured by these pledged deposits.

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

(a) Term deposits with initial term of over three months are denominated in the following currencies.

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Currency | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Renminbi * | **950,658** | 701,187 | **665,000** | 534,000 |
| Hong Kong Dollar | **100,470** | 104,030 | **100,470** | 104,030 |
| | **1,051,128** | 805,217 | **765,470** | 638,030 |

* The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(b) The weighted average effective interest rates of the Group and the Company on term deposits with initial term of over three months were 2.31% (2005: 2.33%) and 2.47% (2005: 2.39%) per annum respectively.

## 30 ACCOUNTS PAYABLE

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Trade payables (note (a)) | | |
| - Ultimate holding company (note (b)) | **6,487** | — |
| - Fellow subsidiaries (note (b)) | **336,891** | 277,370 |
| - Other related parties (note (b)) | **300,957** | 529,391 |
| - Others | **4,587,023** | 3,476,023 |
| | **5,231,358** | 4,282,784 |
| Notes payable (note (c)) | | |
| - Fellow subsidiaries | **176,131** | 210,904 |
| - Other related parties | **756** | — |
| - Others | **1,628,999** | 1,320,873 |
| | **1,805,886** | 1,531,777 |
| | **7,037,244** | 5,814,561 |

Notes:

(a) The normal credit period for trade payables generally ranges from 0 to 6 months. Ageing analysis of trade payables is as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Current to 1 year | **4,953,475** | 4,072,192 |
| 1 year to 2 years | **215,827** | 191,612 |
| 2 years to 3 years | **46,806** | 13,581 |
| Over 3 years | **15,250** | 5,399 |
| | **5,231,358** | 4,282,784 |

(b) Trade payables to ultimate holding company, fellow subsidiaries and other related parties are unsecured and non-interest bearing.

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

(d) The carrying amounts of accounts payable approximate their fair values.

## 31 ADVANCES FROM CUSTOMERS

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Advances from customers | | |
| - Fellow subsidiaries | **21,381** | 37,777 |
| - Other related parties | **43,664** | 14,467 |
| - Other | **395,425** | 349,506 |
| | **460,470** | 401,750 |

In the ordinary course of the Group's business, certain of the Group's customers are required to pay advance deposits according to terms of the respective agreements. The advances from fellow subsidiaries and other related parties are unsecured, non-interest bearing and will be settled or utilised in accordance with the terms of relevant agreements.

## 32 OTHER PAYABLES AND ACCRUALS

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Payable for property, plant and equipment | | | | |
| - Fellow subsidiaries (note (i)) | **55** | 3,621 | **—** | — |
| - Others | **212,886** | 417,601 | **—** | — |
| Wages, salaries and bonuses payables | **190,350** | 158,355 | **—** | — |
| Welfare payables | **192,510** | 167,419 | **156** | 135 |
| Accrued expenses | **385,901** | 279,429 | **3,546** | 3,807 |
| Deferred income from government grants | **43,441** | 25,442 | **—** | — |
| Consumption tax, business tax and other taxes payable | **60,212** | 56,334 | **3** | — |
| Amount due to customers for contract work (Note 26) | **40,409** | — | **—** | — |
| Other advances (note (ii)) | | | | |
| - Ultimate holding company (note (i)) | **45,997** | 24,082 | **37,431** | 10,845 |
| - Fellow subsidiaries (note (i)) | **205,674** | 130,800 | **12,237** | 12,071 |
| - Other related parties (note (i)) | **22,362** | 26,214 | **—** | — |
| Payable relating to share reform | **96,029** | — | **—** | — |
| Other current liabilities | **172,058** | 133,862 | **—** | — |
| | **1,667,884** | 1,423,159 | **53,373** | 26,858 |

## 32 OTHER PAYABLES AND ACCRUALS (continued)

Notes:

(i) Balances with related parties are unsecured and non-interest bearing.

(ii) Other advances mainly represent current account balances with respective related parties which are unsecured, non-interest bearing and are repayable on demand.

## 33 AMOUNTS PAYABLE TO ULTIMATE HOLDING COMPANY

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Supplementary pension subsidies (note (a)) | **464,298** | 532,298 | **464,298** | 532,298 |
| One-off housing benefit (note (b)) | **56,226** | — | **—** | — |
| | **520,524** | 532,298 | **464,298** | 532,298 |

Notes:

(a) 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 retired 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. The balance is unsecured and non-interest bearing.

(b) This represents provision made by a subsidiary in connection with one-off housing subsidies for its eligible employees as at 31st December 2000 as detailed in Note 3(o)(iii). AVIC II has undertaken to bear any final actual cash settlement to those eligible employees in excess of RMB 56,226,000. During 2006, it was agreed that such one-off housing subsidies and future settlements shall be handled by AVIC II and accordingly the balance payable was transferred to AVIC II.

## 34 PROVISIONS

| | Group | | |
|---|---|---|---|
| | One-off housing subsidies RMB'000 | Warranty RMB'000 (note) | Total RMB'000 |
| As at 1st January 2006 | **56,226** | **81,636** | **137,862** |
| Additional provisions | **—** | **154,841** | **154,841** |
| Utilised during the year | **—** | **(133,193)** | **(133,193)** |
| Transfer (Note 33(b)) | **(56,226)** | **—** | **(56,226)** |
| As at 31st December 2006 | **—** | **103,284** | **103,284** |
| Analysis of total provisions: | | | |
| Current | **—** | **103,284** | **103,284** |
| As at 1st January 2005 | 56,226 | 68,902 | 125,128 |
| Additional provisions | — | 59,235 | 59,235 |
| Utilised during the year | — | (46,501) | (46,501) |
| As at 31st December 2005 | 56,226 | 81,636 | 137,862 |
| Analysis of total provisions: | | | |
| Non-current | 56,226 | — | 56,226 |
| Current | — | 81,636 | 81,636 |
| | 56,226 | 81,636 | 137,862 |

Note:

The Group provides warranties to its customers on certain automobile and aviation products and undertakes to repair or replace items that fail to perform up to certain specified standard. Provision for expected warranty claims has been determined based on historical warranty information after taking into account of the Group's recent claim experience.

## 35 BORROWINGS

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| **Short-term borrowings** | | |
| Bank borrowings | | |
| - Secured (note (h)) | **3,608,111** | 3,060,370 |
| - Unsecured | **1,398,689** | 1,036,917 |
| | **5,006,800** | 4,097,287 |
| Other short-term borrowings, unsecured (note (c)) | **394,798** | — |
| | **5,401,598** | 4,097,287 |
| Current portion of long-term borrowings | **433,695** | 399,994 |
| | **5,835,293** | 4,497,281 |
| **Long-term borrowings** | | |
| Bank borrowings | | |
| - Secured (note (h)) | **1,032,760** | 1,073,940 |
| - Unsecured | **59,800** | 170,699 |
| | **1,092,560** | 1,244,639 |
| Other long-term borrowings | | |
| - Secured (note (h)) | **12,067** | 12,067 |
| - Unsecured (note (d)) | **165,772** | 175,301 |
| | **177,839** | 187,368 |
| | **1,270,399** | 1,432,007 |
| Less: Current portion of long-term borrowings | **(433,695)** | (399,994) |
| | **836,704** | 1,032,013 |
| **Total borrowings** | **6,671,997** | 5,529,294 |

## 35 BORROWINGS (continued)

Notes:

(a) The long-term borrowings are analysed as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Wholly repayable within five years | | |
| - Bank borrowings | **820,670** | 1,182,639 |
| - Other borrowings | **165,772** | 175,301 |
| | **986,442** | 1,357,940 |
| Not wholly repayable within five years | | |
| - Bank borrowings | **271,890** | 62,000 |
| - Other borrowings | **12,067** | 12,067 |
| | **283,957** | 74,067 |
| | **1,270,399** | 1,432,007 |

(b) The long-term borrowings are repayable as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Bank borrowings | | |
| - Within one year | **400,670** | 366,969 |
| - In the second year | **100,000** | 535,670 |
| - In the third to fifth year | **366,000** | 280,000 |
| - After the fifth year | **225,890** | 62,000 |
| | **1,092,560** | 1,244,639 |
| Other borrowings | | |
| - Within one year | **33,025** | 33,025 |
| - In the third to fifth year | **132,747** | 142,276 |
| - After the fifth year | **12,067** | 12,067 |
| | **177,839** | 187,368 |
| | **1,270,399** | 1,432,007 |

(c) Other short-term borrowings represent a zero coupon debenture issued by a subsidiary of the Group during the year with an aggregate face value of RMB 400,000,000 for a term of one year. The debenture was issued at RMB 96.68 for par value of RMB 100 each. The debenture is initially recognised at fair value and subsequently carried at amortised cost.

## 35 BORROWINGS (continued)

Notes: (continued)

(d) Other long-term borrowings

Included in unsecured other long-term borrowings was a loan grant by Shenzhen Finance Bureau of RMB 150,000,000 to a subsidiary of the Group. The loan is unsecured, non-interest bearing and is repayable in full in 2009.

(e) The exposure of the total borrowings of the Group to interest rate changes is as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Bank borrowings | | |
| - Fixed rates | **5,889,470** | 4,989,611 |
| - Floating rates | **209,890** | 352,315 |
| | **6,099,360** | 5,341,926 |
| Other borrowings | | |
| - Fixed rates | **572,637** | 187,368 |
| - Floating rates | **—** | — |
| | **572,637** | 187,368 |
| | **6,671,997** | 5,529,294 |

The annual effective interest rates of long-term and short-term borrowings at balance sheet date were as follows:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Weighted average effective interest rates | | |
| - Bank borrowings | **5.29%** | 4.80% |
| - Other borrowings | **1.42%** | 0.42% |

(f) The carrying amounts of long-term and short-term borrowings are denominated in the following currencies:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| Currency | **RMB'000** | RMB'000 |
| Renminbi * | **5,867,581** | 4,887,068 |
| United States Dollar | **470,755** | 330,886 |
| Euro | **333,661** | 311,340 |
| | **6,671,997** | 5,529,294 |

* The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

## 35 BORROWINGS (continued)

Notes: (continued)

(g) The carrying amount and fair value of non-current portion of long-term borrowings are as follows:

| | Group | | | |
|---|---|---|---|---|
| | Carrying amount | | Fair value | |
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Bank borrowings | **691,890** | 877,670 | **661,237** | 880,486 |
| Other borrowings | **144,814** | 154,343 | **137,656** | 147,482 |
| | **836,704** | 1,032,013 | **798,893** | 1,027,968 |

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 6.30% to 6.84% as at 31st December 2006 (2005: 5.76% to 6.12%), depending on the type of the debt. The carrying amounts of current borrowings approximate their fair values.

(h) The Group's long-term and short-term borrowings are secured by the following:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Securities over the Group's assets, at carrying value | | |
| - Property, plant and equipment, at net book value (Note 15(a)) | **209,539** | 406,563 |
| - Notes receivable (Note 22(e)) | **33,561** | 41,000 |
| - Pledged deposits (Note 28) | **694,391** | 405,574 |
| Guarantees provided by | | |
| - Ultimate holding company (Note 40(d)) | **289,890** | 80,000 |
| - Fellow subsidiaries (Note 40(d)) | **540,729** | 563,408 |
| - Subsidiaries within the Group (cross guarantees) | **3,567,320** | 3,118,969 |
| - Third parties | **145,000** | 153,000 |

(i) As at 31st December 2006, the Group had the following undrawn committed borrowing facilities.

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Expiring beyond one year at fixed rates | **824,000** | 919,172 |

## 36 SHARE CAPITAL

| | Company | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Registered: | **4,643,609** | 4,643,609 |
| Issued and fully paid: | | |
| 2,963,808,000 Domestic Shares of RMB 1 each | **2,963,808** | 2,963,808 |
| 1,679,800,500 H Shares of RMB 1 each | **1,679,801** | 1,679,801 |
| | **4,643,609** | 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 HKD1.21 (equivalent to RMB1.28) per H Share in cash for an aggregate consideration of HKD2,033 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.

## 37 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 |
| As at 1st January 2006 | **(2,073)** | **17,809** | **8,903** | **52,322** | **76,961** |
| Loss for the year | **—** | **—** | **—** | **(166,985)** | **(166,985)** |
| 2005 dividend | **—** | **—** | **—** | **(48,758)** | **(48,758)** |
| Transfer to reserves | **—** | **8,903** | **(8,903)** | **—** | **—** |
| As at 31st December 2006 | **(2,073)** | **26,712** | **—** | **(163,421)** | **(138,782)** |
| Representing: | | | | | |
| Reserves | **(2,073)** | **26,712** | **—** | **(163,421)** | **(138,782)** |
| As at 1st January 2005 | (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 | (2,073) | 17,809 | 8,903 | 52,322 | 76,961 |
| Representing: | | | | | |
| Reserves | (2,073) | 17,809 | 8,903 | 3,564 | 28,203 |
| 2005 proposed dividend | — | — | — | 48,758 | 48,758 |
| | (2,073) | 17,809 | 8,903 | 52,322 | 76,961 |

Notes:

(a) Movements in the reserves of the Group are set out in the consolidated statement of changes in equity on pages 62 to 63.

(b) Capital reserve

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.

## 37 RESERVES (continued)

Note: (continued)

(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 prior years, the Company is required to transfer between 5% and 10% of the profit after taxation determined in accordance with the PRC accounting standards to a statutory public welfare fund every year pursuant to the relevant PRC regulations and the Articles of Association of the Company. 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 the 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.

During the year, as a result of the issurance of certain revised PRC regulations which is effective from 1st January 2006, the Company is no longer required to provide for statutory public welfare fund. Consequently, the balance of statutory public welfare fund as at 31st December 2005 is converted into statutory surplus reserve.

(e) Retained earnings available for distribution

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 2006, there was no retained earning available for distribution.

(f) Share reform

During the year, the Group's four subsidiaries whose A shares are listed on the Shanghai Stock Exchange have completed their respective share reform schemes (collectively "Share Reform"). Consequently, the Group's interests in the domestic shares ("Domestic Shares") in each of Harbin Dongan Auto Engine Co., Ltd ("Dongan") and Jiangxi Changhe Automobile Co., Ltd ("Changhe"), Jiangxi Hongdu Aviation Industry Co., Ltd. ("Hongdu") and Hafei Aviation Industry Co., Ltd. ("Hafei") have been converted into A shares and become tradable on the Shanghai Stock Exchange subject to certain specified conditions.

As result of the Share Reform, the Group's equity interests in Dongan, Changhe, Hongdu and Hafei have been reduced from 70.01%, 72.53% (among which 0.96% was held by Dongan), 54.75% and 55.73% to 59.51%, 63.22% (among which 0.83% was held by Dongan), 55.29% and 50.05% respectively.

In accordance with the Group's accounting policy, transactions with minority shareholders are dealt with in reserves. Accordingly, the aggregate effect on the reduction of equity interests in these subsidiaries of approximately RMB507,746,000 was accounted for as a reduction of the Group's reserves in the consolidated financial statements for the year ended 31st December 2006.

In the Company's financial statements, the effect of reduction in the equity interests in the Company's directly owned subsidiaries, namely, Dongan, Changhe and Hongdu totalling approximately RMB 328,993,000 is charged to the income statement directly.

## 38 CONSOLIDATED CASH FLOW STATEMENT

(a) Cash generated from operations

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| (Loss)/profit before taxation | **(473,263)** | 239,674 |
| Adjustments for: | | |
| Share of results of associates | **(45,051)** | (45,367) |
| (Gain)/loss on disposal of | | |
| - Property, plant and equipment | **(12,780)** | 9,513 |
| - A subsidiary | **3** | 1,918 |
| - Associates | **9,811** | — |
| Gain on disposal of other financial assets at fair value through profit or loss | **(6,591)** | (2,031) |
| Amortisation | | |
| - Land use rights | **2,983** | 4,904 |
| - Intangible assets | **123,866** | 94,588 |
| Amortisation of deferred income relating to government grants | **(18,396)** | (21,746) |
| Depreciation on property, plant and equipment | **928,113** | 664,089 |
| Provision/(reversal of provision) for impairment | | |
| - Property, plant and equipment | **642** | 1,305 |
| - Intangible assets | **70,710** | 96,603 |
| - Other non-current financial assets | **12,355** | 25,000 |
| - Receivables | **22,126** | 33,877 |
| - Inventories | **121** | (13,941) |
| Interest income | **(78,256)** | (73,968) |
| Interest expense | **253,061** | 209,383 |
| | **789,454** | 1,223,801 |
| Changes in working capital (excluding the effects of acquisitions and disposals of subsidiaries): | | |
| - Increase in accounts receivable | **(817,032)** | (1,093,229) |
| - Decrease/(increase) in advances to suppliers, other receivables and prepayments | **178,710** | (214,423) |
| - Increase in inventories | **(680,764)** | (437,425) |
| - Decrease in other financial assets at fair value through profit or loss | **47,618** | 207,805 |
| - Increase in accounts payable | **1,223,373** | 2,087,994 |
| - Increase/(decrease) in advances from customers, other payables and accruals | **383,081** | (88,748) |
| - (Decrease)/increase in provisions | **(34,578)** | 12,734 |
| - Decrease in amounts payable to ultimate holding company | **(11,774)** | (40,946) |
| - Increase in deferred income from government grants | **115,079** | 122,068 |
| Net cash generated from operations | **1,193,167** | 1,779,631 |

## 38 CONSOLIDATED CASH FLOW STATEMENT (continued)

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

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Net book amount (Note 15) | **105,997** | 121,432 |
| Gain/(loss) on sale of property, plant and equipment | **12,780** | (9,513) |
| Receivables from sale of property, plant and equipment | **(97,690)** | (11,964) |
| Proceeds from sale of property, plant and equipment | **21,087** | 99,955 |

(c) Analysis of changes in financing during the year:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| Total borrowings | **RMB'000** | RMB'000 |
| As at 1st January | **5,529,294** | 5,355,859 |
| Proceeds from borrowings | **6,525,514** | 5,039,483 |
| Repayments of borrowings | **(5,382,811)** | (4,866,048) |
| As at 31st December | **6,671,997** | 5,529,294 |

## 38 CONSOLIDATED CASH FLOW STATEMENT (continued)

(d) Disposal of a subsidiary

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Property, plant and equipment | **233** | 59,803 |
| Current assets | **12,102** | 273,163 |
| Total assets | **12,335** | 332,966 |
| Total liabilities | **(9,429)** | (296,006) |
| Minority interests | **(1,424)** | (7,150) |
| Net assets at the date of disposal | **1,482** | 29,810 |
| Less: Amount retained as investments in associates | **—** | (3,431) |
| Net assets sold | **1,482** | 26,379 |
| Proceeds from sales | | |
| - Received | **1,479** | 4,930 |
| - Receivable | **—** | 19,531 |
| Total consideration | **1,479** | 24,461 |
| Loss on disposal of a subsidiary | **3** | 1,918 |
| Net cash outflow from sale is determined as follows: | | |
| Proceeds received from sale of a subsidiary | **1,479** | 4,930 |
| Less: Cash and cash equivalents in a subsidiary sold | **(2,365)** | (134,605) |
| Net cash outflow from sale of a subsidiary | **(886)** | (129,675) |

## 38 CONSOLIDATED CASH FLOW STATEMENT (continued)

(e) Acquisition of a subsidiary

Details of net assets acquired are as follows:

| | As at 1st January 2006 RMB'000 |
|---|---|
| Purchase consideration: | |
| - cash paid | 11,994 |
| Fair value of net assets acquired (shown as below) | (11,994) |
| | — |

The assets and liabilities arising from the acquisition are as follows:

| | Fair value RMB'000 | Acquiree's carrying amount RMB'000 |
|---|---|---|
| Property, plant and equipment | 9,734 | 9,734 |
| Receivables | 19,198 | 19,198 |
| Cash and cash equivalents | 3,598 | 3,598 |
| Payables | (10,730) | (10,730) |
| Net assets | 21,800 | 21,800 |
| Minority interests (0.05%) | (11) | |
| Interests held as an associate (Note 19) | (9,795) | |
| Net assets acquired | 11,994 | |
| Purchase consideration settled in cash | | 11,994 |
| Cash and cash equivalents in a subsidiary acquired | | (3,598) |
| Cash outflow on acquisition | | 8,396 |

The acquired subsidiary's contributions to the Group's revenue and operating results for the period from the date of acquisition to 31st December 2006 were not material.

## 38 CONSOLIDATED CASH FLOW STATEMENT (continued)

(f) Analysis of cash and cash equivalents

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Bank balances and cash | **3,155,527** | 2,614,562 | **91,592** | 10,751 |
| Term deposits with initial term of less than three months | **—** | 327,800 | **—** | 177,800 |
| | **3,155,527** | 2,942,362 | **91,592** | 188,551 |

(i) The cash and cash equivalents are denominated in the following currencies.

| | Group | | Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Currency | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Renminbi * | **3,030,648** | 2,686,755 | **87,181** | 183,937 |
| Other currencies | **124,879** | 255,607 | **4,411** | 4,614 |
| | **3,155,527** | 2,942,362 | **91,592** | 188,551 |

* The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

(ii) In 2005, 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% per annum.

(iii) Bank balances earn interest at floating rates based on daily bank deposit rates.

## 39 COMMITMENTS

(a) Capital commitments

The Group has the following capital commitments not provided for as at 31st December 2006:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Acquisition of property, plant and equipment | | |
| - Authorised but not contracted for | **161,012** | 296,700 |
| - Contracted but not provided for | **148,446** | 521,904 |
| | **309,458** | 818,604 |
| Construction commitments | | |
| - Authorised but not contracted for | **—** | 60,000 |
| - Contracted but not provided for | **6,050** | 33,234 |
| | **6,050** | 93,234 |
| Investment in a jointly controlled asset | | |
| - Contracted but not provided for | **66,292** | 107,261 |
| Investment in an associate | | |
| - Contracted but not provided for | **48,000** | 14,600 |
| | **429,800** | 1,033,699 |

(b) Operating lease commitments

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases as at 31st December 2006:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Land and buildings | | |
| - Not later than one year | **26,132** | 29,765 |
| - Later than one year and not later than five years | **66,904** | 103,569 |
| - Later than five years | **101,004** | 69,559 |
| | **194,040** | 202,893 |

Generally, the Group's operating leases are for terms of 1 to 20 years.

(c) The Company did not have any significant commitment as at 31st December 2006 (2005: Nil).

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS

The Group is controlled by AVIC II, which owns 61.06% of the Company's shares as at 31st December 2006. 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 ultimate 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, "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 meaningful information relating to related party disclosures has been adequately disclosed.

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(a) The directors of the Company has identified the following principal related parties, which had significant related party transactions or balances with the Group during the year:

| **Principal related parties** | **Relationship with the Group** |
|---|---|
| **Ultimate holding company** | |
| - AVIC II | Ultimate holding company of the Group |
| **Fellow subsidiaries** | |
| - Jiangxi Hongdu Aviation Industrial Group Corporation | A wholly-owned subsidiary of AVIC II |
| - Changhe Aircraft Industries (Group) Ltd. | A wholly-owned subsidiary of AVIC II |
| - Harbin Dongan Engine (Group) Co., Ltd. | A wholly-owned subsidiary of AVIC II |
| - Harbin Aircraft Industry (Group) Co., Ltd. | A wholly-owned subsidiary of AVIC II |
| - Hefei Changhe Automobile Co., Ltd. | A wholly-owned subsidiary of AVIC II |
| **Other related parties** | |
| - China National Aero-Technology Import & Export Corporation | An associate of AVIC II |
| - CATIC International Industry and Trade Company | An associate of AVIC II |
| - Shenzhen Shenhang Avionics Co., Ltd. | An associate of Group |
| - Mitsubishi Motor Corporation | A shareholder of Harbin Dongan Automotive Engine Manufacturing Co., Ltd., a subsidiary of the Group |
| - Suzuki Motor Corporation | A shareholder of Jiangxi Changhe Suzuki Automobile Co., Ltd., a subsidiary of Group |

**Other state-owned enterprises**

Other state-owned enterprises represent the entities and their subsidiaries, directly or indirectly, controlled by the PRC government, other that those, directly or indirectly, controlled or significantly influenced by AVIC II.

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(b) Below is a summary of significant transactions with related parties:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| **Revenues** | | |
| Revenue from sale of goods and materials | | |
| - Fellow subsidiaries | **3,599,256** | 2,706,927 |
| - Other related parties | **235,875** | 384,720 |
| - Other state-owned enterprises | **1,237,965** | 1,580,885 |
| Revenue from rendering of service | | |
| - Fellow subsidiaries | **159,689** | 145,449 |
| Rental income | | |
| - Fellow subsidiaries | **539** | 10,218 |
| **Expenses** | | |
| Purchases of goods and raw materials | | |
| - Fellow subsidiaries | **1,666,825** | 1,796,846 |
| - Other related parties | **1,012,790** | 595,178 |
| - Other state-owned enterprises | **2,440,136** | 1,685,165 |
| Service fees payable | | |
| - Fellow subsidiaries (note (ii)) | **423,203** | 383,444 |
| - Other related parties | **30,743** | 20,075 |
| - Other state-owned enterprises | **76,221** | 97,139 |
| Rental expenses for property, plant and equipment | | |
| - Fellow subsidiaries | **37,841** | 32,838 |
| Interest expense | | |
| - Other state-owned enterprises | **162,141** | 166,947 |
| Key management compensations | | |
| - Salaries, bonuses and other welfares | **2,814** | 2,854 |

Notes:

(i) In the opinion of the directors of the Company, the above transactions were carried out in the ordinary course of the Group's business and were determined based on mutually agreed terms.

(ii) Included in service fees to fellow subsidiaries for the year ended 31st December 2006 was an amount of RMB 80,095,000 representing compensation paid to a fellow subsidiary of the Group in connection with its logistic services provided to the Group for the years ended 31st December 2004 and 2005. The amount was determined based on mutually agreed terms.

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(c) Below is a summary of significant balances with related parties:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| **Assets** | | |
| Accounts receivable | | |
| - Fellow subsidiaries | **1,701,901** | 1,116,620 |
| - Other related parties | **152,778** | 165,317 |
| - Other state-owned enterprises | **86,849** | 127,636 |
| Notes receivable | | |
| - Fellow subsidiaries | **37,263** | 70,400 |
| Advance to suppliers | | |
| - Fellow subsidiaries | **38,824** | 60,202 |
| - Other related parties | **2,254** | 235,299 |
| - Other state-owned enterprises | **134,045** | 144,174 |
| Other receivables and prepayments | | |
| - Ultimate holding company | **57,293** | 58,090 |
| - Fellow subsidiaries | **38,696** | 343,987 |
| - Other related parties | **16,058** | 1,148 |
| - Other state-owned enterprises | **69,902** | 2 |
| Pledged deposits | | |
| - Other state-owned enterprises | **656,643** | 405,574 |
| Term deposits with initial term of over three months | | |
| - Other state-owned enterprises | **1,051,128** | 805,217 |
| Cash and cash equivalents deposited with | | |
| - Other state-owned enterprises | **3,005,885** | 2,728,331 |

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(c) Below is a summary of significant balances with related parties: (continued)

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| **Liabilities** | | |
| Accounts payable | | |
| - Ultimate holding company | **6,487** | — |
| - Fellow subsidiaries | **336,891** | 277,370 |
| - Other related parties | **300,957** | 529,391 |
| - Other state-owned enterprises | **1,035,050** | 1,040,048 |
| Notes payable | | |
| - Fellow subsidiaries | **176,131** | 210,904 |
| - Other related parties | **756** | — |
| Advance from customers | | |
| - Fellow subsidiaries | **21,381** | 37,777 |
| - Other related parties | **43,664** | 14,467 |
| - Other state-owned enterprises | **77,468** | 106,614 |
| Other payables and accruals | | |
| - Ultimate holding company | **45,997** | 24,082 |
| - Fellow subsidiaries | **205,729** | 134,421 |
| - Other related parties | **22,362** | 26,214 |
| - Other state-owned enterprises | **19,104** | 62,964 |
| Bank borrowings | | |
| - Other state-owned enterprises | **6,099,360** | 3,844,319 |

Details of the balances with ultimate holding company, fellow subsidiaries and other related parties are disclosed in Notes 22, 23, 24, 30, 31, 32 and 33 to the financial statements.

## 40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(d) Below is a summary of other matters with related parties:

| | Group | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Guarantees on bank loans granted to the Group from | | |
| - Ultimate holding company | **289,890** | 80,000 |
| - Fellow subsidiaries | **540,729** | 563,408 |

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).

(e) 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 businesses. Details of these balances are included under Notes 28, 29, 35 and 38(e) to the financial statements.

## 41 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 and Hong Kong Dollar ("HKD"). The Group has not used any forward contracts to hedge its exposure as foreign currency risk is considered minimal.

As at 31st December 2006, the Group had certain borrowings (Note 35) and deposits in banks (Notes 28 and 38(f)) denominated in foreign currencies. RMB against USD and HKD 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 financial statements.

## 41 FINANCIAL RISK MANAGEMENT (continued)

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

*(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.

*(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 2006, the net current liabilities of the Group amounted to RMB 899,352,000. The directors believe that cash from operations and bank borrowings will be sufficient to meet the Group's operating cashflows. Due to the dynamic nature of the underlying businesses, it is the Group's policy to maintain sufficient cash and cash equivalents or have available funding through credit facilities to meet its working capital requirements. The amount of undrawn committed credit facilities at the balance sheet date are disclosed in Note 35 to the financial statements. The directors believe that the Group's current operating cash flows and credit facilities from PRC banks are sufficient for financing its 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 28, 29 and 38(f). The Group's exposure to changes in interest rates is mainly attributable to its borrowings, details of which have been disclosed in Note 35 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 2006, 100% (2005:93%) 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.

## 41 FINANCIAL RISK MANAGEMENT (continued)

### (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. 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.

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 35 to the financial statements.

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.

## 42 SUBSEQUENT EVENT

On 16th March 2007, the National People's Congress approved the Corporate Income Tax Law of the People's Republic of China (the new "CIT Law"). The new CIT Law reduces (increases) the corporate income tax rate for domestic enterprises (foreign invested enterprises) from 33% (15% or 24%) to 25% with effect from 1st January 2008. The new CIT Law also provides for preferential tax rates, tax incentives for prescribed industries and activities, grandfathering provisions as well as determination of taxable profit. As at the date that these financial statements are approved for issue, detailed measures concerning these items has yet to be issued by the State Council. Consequently, the Group is not in a position to assess the impact, if any, to the carrying value of deferred tax assets and liabilities as at 31st December 2006. The Group will continue to evaluate the impact as more detailed regulations are announced.

## 43 PARTICULARS OF PRINCIPAL SUBSIDIARIES AND ASSOCIATES

| Name | Registered and paid up capital | Attributable equity interest | Type of legal entity | Principal activities |
|---|---|---|---|---|
| **Subsidiaries** | | | | |
| **Directly held** | | | | |
| Harbin Aviation Industry Group Ltd (哈爾濱航空工業（集團）有限公司) | RMB775,832,000 | 100% | Limited liability company | Manufacture and sale of general-purpose aeroplane and automobile |
| Jiangxi Changhe Aviation Industry Company Limited (江西昌河航空工業有限公司) | RMB381,317,754 | 100% | Limited liability company | Manufacture and sale of general-purpose aeroplane, automobile and automobile parts and components |
| Jiangxi Hongdu Aviation Industry Co., Ltd. (江西洪都航空工業股份有限公司) | RMB252,000,000 | 55.29% | 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 |
| Harbin Dongan Auto Engine Co., Ltd. (哈爾濱東安汽車動力股份有限公司) | RMB462,080,000 | 59.51% | Joint stock company (listed on the Shanghai Stock Exchange) | Manufacture and sale of automobile engine |
| Jiangxi Changhe Automobile Co., Ltd. (江西昌河汽車股份有限公司) | RMB410,000,000 | 62.88% | Joint stock company (listed on the Shanghai Stock Exchange) | Design, development, manufacture and sale of mini-sized vehicles |
| **Indirectly held** | | | | |
| Hafei Aviation Industry Co., Ltd. (哈飛航空工業股份有限公司) | RMB337,350,000 | 50.05% | Joint stock company (listed on the Shanghai Stock Exchange) | Research, development, design, manufacture and sale of aero products, including parts and components |
| Jiangxi Changhe Suzuki Automobile Co., Ltd. (江西昌河鈴本汽車有限責任公司) | USD311,800,000 (paid up capital USD251,800,000) | 35.78% | Equity joint venture | Manufacture and sale of mini-sized vehicles |

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

| Name | Registered and paid up capital | Attributable equity interest | Type of legal entity | Principal activities |
|---|---|---|---|---|
| Jiujiang Changhe Automobile Co., Ltd. (九江昌河汽車有限責任公司) | RMB161,250,000 | 72.89% | Limited liability company | Development, manufacture and sale of parts and components for mini-sized vehicles |
| Harbin Dongan Automotive Engine Manufacturing Co., Ltd. (哈爾濱東安汽車發動機製造有限公司) | RMB500,000,000 | 36.42% | Equity joint venture | Manufacture and assembly of 4G1 series petrol engines |
| Hafei Motor Co., Ltd. (哈飛汽車股份有限公司) | RMB1,013,280,000 | 74.81% | Joint stock company | Manufacture and sale of automobile products |
| **Associates** | | | | |
| **Indirectly held** | | | | |
| Harbin Wanxiang Hafei Motor Chassis System Co., Ltd. (哈爾濱萬向汽車底盤系統有限責任公司) | RMB60,000,000 | 35.00% | Limited liability company | Manufacture and sales of motor chassis system |
| Harbin Embraer Aircraft Industry Co., Ltd. (哈爾濱安博飛機工業有限公司) | USD25,000,000 | 36.76% | Limited liability company | Production of regional jets and provision of relevant sales and after-sale services |

Notes:

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

(ii) The English name of certain subsidiaries and associated companies referred to herein represent management is best effort at translating the Chinese names of there companies as no English names been registered.