




**AIR CHINA**  
中國國際航空公司

## Annual Report 2008

Stock Code: 753 HongKong  
601111 Shanghai  
AIRC London





Air China is the only national flag carrier of China and a member of the Star Alliance, the world's largest airline alliance. It is also the exclusive airline partner of the 2008 Beijing Olympic Games.

Air China is headquartered in Beijing, the capital of China, with Shanghai and Chengdu as its two increasingly important hubs. As at 31 December 2008, through the Star Alliance, the routes network of Air China could cover 160 countries and regions as well as 961 destinations. Air China is dedicated to providing passengers with safe, convenient, comfortable and customised services.

The strategic objectives of Air China are to build up international competitive strength, continue to enhance development potentials, offer its customers unique and excellent experience and realise a sustainable growth so as to create value to all the relevant parties.

In addition, Air China also directly or indirectly holds interests in the following airlines: Air Macau Company Limited (51%), Air China Cargo Co., Ltd. (76%), Shandong Airlines Company Limited (22.8%), Shenzhen Airlines Company Limited (25%) and Cathay Pacific Airways Limited (17.5%).

# Contents

<b>2</b>	Corporate Information
<b>3</b>	Summary of Financial Information
<b>4</b>	Summary of Operating Data
<b>6</b>	Chairman’s Statement
<b>9</b>	Business Overview
<b>13</b>	Management’s Discussion and Analysis of Financial Position and Operating Results
<b>22</b>	Corporate Governance Report
<b>32</b>	Report of the Directors
<b>50</b>	Report of the Supervisory Committee
<b>51</b>	Profile of Directors, Supervisors and Senior Management
	Financial Statements prepared under International Financial Reporting Standards
<b>55</b>	– Independent Auditors’ Report
<b>57</b>	– Consolidated Income Statement
<b>58</b>	– Consolidated Balance Sheet
<b>60</b>	– Consolidated Statement of Changes in Equity
<b>61</b>	– Consolidated Cash Flow Statement
<b>63</b>	– Balance Sheet
<b>65</b>	– Notes to Financial Statements
	Financial Statements prepared under China Accounting Standards for Business Enterprises
<b>153</b>	– Consolidated Balance Sheet
<b>155</b>	– Consolidated Income Statement
<b>156</b>	Supplementary Information
<b>158</b>	Glossary of Technical Terms

# Corporate Information

## REGISTERED CHINESE NAME

中國國際航空股份有限公司

## ENGLISH NAME

Air China Limited

## REGISTERED OFFICE

9/F, Blue Sky Mansion  
28 Tianzhu Road  
Zone A, Tianzhu Airport Industrial Zone  
Shunyi District  
Beijing  
China

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG

5th Floor, CNAC House  
12 Tung Fai Road  
Hong Kong International Airport  
Hong Kong

## WEBSITE ADDRESS

[www.airchina.com.cn](http://www.airchina.com.cn)

## DIRECTORS

Kong Dong  
Wang Yinxiang  
Wang Shixiang  
Christopher Dale Pratt  
Chen Nan Lok, Philip  
Cai Jianjiang  
Fan Cheng  
Hu Hung Lick, Henry  
Wu Zhipan  
Zhang Ke  
Jia Kang

## SUPERVISORS

Sun Yude  
He Chaofan  
Zhou Guoyou  
Liu Feng  
Liu Guoqing

## LEGAL REPRESENTATIVE OF THE COMPANY

Kong Dong

## JOINT COMPANY SECRETARIES

Huang Bin  
Tam Shuit Mui (*HKICPA, AICPA*)

## AUTHORISED REPRESENTATIVES

Cai Jianjiang  
Tam Shuit Mui

## LEGAL ADVISER TO THE COMPANY

Haiwen & Partners (*as to PRC Law*)  
Freshfields Bruckhaus Deringer (*as to Hong Kong and  
English Law*)

## INTERNATIONAL AUDITORS

Ernst & Young

## H SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited  
Rooms 1712-1716, 17th Floor  
Hopewell Centre  
183 Queen's Road East  
Wanchai  
Hong Kong

## LISTING VENUES

Hong Kong, London and Shanghai

# Summary of Financial Information

	2008	2007*	2006*	2005*	2004*
		(restated)			
				<i>(in RMB'000)</i>	
Operating Revenue	<b>52,908,161</b>	51,081,667	44,936,606	38,290,966	33,520,757
Profit from operations	<b>(1,907,766)</b>	3,676,179	2,517,704	3,673,816	4,485,251
Profit before tax	<b>(10,977,680)</b>	5,448,165	3,929,221	3,374,254	3,559,559
Profit after tax (including profit attributable to minority shareholders)	<b>(9,367,030)</b>	3,935,552	3,305,097	2,470,380	2,548,695
Profit attributable to minority shareholders	<b>(111,208)</b>	(110,661)	617,256	64,124	162,731
Profit attributable to shareholders of the Company	<b>(9,255,822)</b>	4,046,213	2,687,841	2,406,256	2,385,964
EBITDA <sup>(1)</sup>	<b>4,457,509</b>	9,230,622	7,813,232	8,186,496	7,948,503
EBITDAR <sup>(2)</sup>	<b>7,305,975</b>	11,781,243	10,206,623	9,928,427	9,207,230
Earnings per share attributable to shareholders of the Company (RMB)	<b>(0.78)</b>	0.34	0.26	0.26	0.36
Return on shareholders' equity (%)	<b>(46.41%)</b>	13.22	9.04	11.98	14.42

(1) EBITDA represents earnings before finance revenue (including interest income, net exchange gains, net gain on derivative financial instrument and dividend income from available-for-sale investments), finance costs (including interest expenses, net loss on derivative financial instruments), enterprise income taxes, gain on disposal of subsidiaries and an associate, share of profits and losses of associates, depreciation and amortisation as computed under the International Financial Reporting Standards.

(2) EBITDAR represents EBITDA less operating lease expenses on aircraft and engines as well as other operating lease expenses.

	31 December 2008	31 December 2007*	31 December 2006*	31 December 2005*	31 December 2004*
		(restated)			
				<i>(in RMB'000)</i>	
Total assets	<b>100,401,224</b>	91,300,277	84,477,536	68,201,943	66,689,269
Total liabilities	<b>79,944,718</b>	60,548,027	52,741,843	46,651,337	48,660,727
Minority interests	<b>513,654</b>	138,050	2,011,435	1,458,365	1,480,287
Shareholders' equity (excluding minority interests)	<b>19,942,852</b>	30,614,200	29,724,258	20,092,241	16,548,255
Shareholders' equity per share (RMB)	<b>1.68</b>	2.58	2.43	2.13	1.83

\* The Group has adopted IFRIC 13 *Customer Loyalty Programme* ("IFRIC 13") in preparing the consolidated financial statements for the year ended 31 December 2008 and has restated the financial information for 2007 accordingly. The financial information for the period from 2004 to 2006 have not been restated as the Company's management is of the view that the adoption of IFRIC 13 has had no significant impact on the disclosure of such financial information.

# Summary of Operating Data

The following summary includes the operating data of Air China Limited (the “Company”), Air China Cargo Co., Ltd (“Air China Cargo”) and Air Macau Company Limited (“Air Macau”)

	2008	2007	Increase/(decrease)
<b>Traffic</b>			
<b>RPK (in millions)</b>	<b>68,747.1</b>	70,025.8	(1.8%)
International	27,896.5	29,025.2	(3.9%)
Mainland China	37,013.3	36,534.4	1.3%
Hong Kong, Macau and Taiwan	3,837.2	4,466.2	(14.1%)
<b>RFTK (in millions)</b>	<b>3,610.6</b>	3,875.5	(6.8%)
International	2,697.0	2,852.4	(5.4%)
Mainland China	758.8	776.3	(2.3%)
Hong Kong, Macau and Taiwan	154.8	246.7	(37.3%)
<b>Passengers (in thousands)</b>	<b>36,136.4</b>	37,256.2	(3.0%)
International	5,595.8	6,196.3	(9.7%)
Mainland China	28,039.0	27,931.2	0.4%
Hong Kong, Macau and Taiwan	2,501.7	3,128.8	(20.0%)
<b>Cargos and mails carried (tonnes)</b>	<b>980,105.4</b>	1,103,914.0	(11.2%)
<b>Kilometers flown (in millions)</b>	<b>521.6</b>	519.6	0.4%
<b>Block hours (in thousands)</b>	<b>829.3</b>	817.9	1.4%
<b>Number of flights</b>	<b>290,887</b>	294,905	(1.4%)
International	43,599	44,189	(1.3%)
Mainland China	222,726	219,237	1.6%
Hong Kong, Macau and Taiwan	24,562	31,479	(22.0%)
<b>RTK (in millions)</b>	<b>9,787.3</b>	10,170.3	(3.8%)
<b>Capacity</b>			
<b>ASK (in millions)</b>	<b>91,809.9</b>	89,233.7	2.9%
International	37,789.5	37,738.9	0.1%
Mainland China	48,560.5	45,558.7	6.6%
Hong Kong, Macau and Taiwan	5,459.9	5,936.1	(8.0%)
<b>AFTK (in millions)</b>	<b>6,355.9</b>	6,868.1	(7.5%)
International	4,464.4	4,972.2	(10.2%)
Mainland China	1,640.7	1,531.3	7.1%
Hong Kong, Macau and Taiwan	250.8	364.6	(31.2%)
<b>ATK (in millions)</b>	<b>14,655.9</b>	14,938.7	(1.9%)

# Summary of Operating Data

	2008	2007	Increase/(decrease)
<b>Load factor</b>			
<b>Passenger load factor (RPK/ASK)</b>	<b>74.88%</b>	78.47%	(3.59 ppt)
International	<b>73.82%</b>	76.91%	(3.09 ppt)
Mainland China	<b>76.22%</b>	80.19%	(3.97 ppt)
Hong Kong, Macau and Taiwan	<b>70.28%</b>	75.24%	(4.96 ppt)
<b>Cargo and mail load factor (RFTK/AFTK)</b>	<b>56.81%</b>	56.43%	0.38 ppt
International	<b>60.41%</b>	57.37%	3.04 ppt
Mainland China	<b>46.25%</b>	50.70%	(4.45 ppt)
Hong Kong, Macau and Taiwan	<b>61.73%</b>	67.67%	(5.94 ppt)
<b>Yield</b>			
<b>Yield per RPK (RMB)</b>	<b>0.63</b>	0.62	1.75%
International	<b>0.61</b>	0.58	4.07%
Mainland China	<b>0.63</b>	0.64	(0.70%)
Hong Kong, Macau and Taiwan	<b>0.75</b>	0.69	9.12%
<b>Yield per RFTK (RMB)</b>	<b>1.99</b>	1.89	5.13%
International	<b>1.89</b>	1.80	4.83%
Mainland China	<b>1.85</b>	1.52	21.31%
Hong Kong, Macau and Taiwan	<b>4.44</b>	4.10	8.21%
<b>Fleet</b>			
Total number of aircraft in service at year end	<b>256</b>	234	22
Daily utilization (block hours per day per aircraft)	<b>9.48</b>	9.93	(0.45 hour)
<b>Unit cost</b>			
Operating expenses per ASK (RMB)	<b>0.59</b>	0.55	8.14%
Operating expenses per ATK (RMB)	<b>3.72</b>	3.28	13.41%

Note: Part of 2007 data has been adjusted accordingly for comparability due to the changes of statistics scope of 2008 data.

# Chairman's Statement



Kong Dong  
Chairman of the Board

Dear Shareholders:

2008 was the most challenging year for our Group since its establishment. Due to the impact of a number of adverse factors, which included the natural disasters such as the snow storms that ravaged southern China and the earthquake in Wenchuan, Sichuan, the security measures adopted during the Olympic Games and the global financial crisis that broke out and spread in the second half of 2008, both the air passenger and air cargo operations of the Group faced enormous pressure arising from the market slowdown and the high jet fuel price while the drastic plunge in the international fuel price since July 2008 led to fair value losses on the fuel hedging contracts entered into by the Company, which had also significantly affected the Group's 2008 operating results. In 2008, the Group incurred a loss of RMB9,256 million attributable to shareholder. In 2007, the profit attributable to shareholder was RMB4,046 million.

In 2008, the air passenger revenue of the Group was RMB43.352 billion, representing a slight decrease compared with 2007. The number of passengers carried reached 36.1364 million person-times and the passenger traffic was 68.747 billion RPKs, representing a decrease of 3% and 1.8% over the previous year respectively. The passenger load factor was 74.88%, representing a decrease of 3.59 percentage points from the previous year. While there was a slight growth in domestic route operation both in terms of the number of passengers carried and the passenger traffic, the international and regional route operations dropped 13.2% and 5.2% in the number of passengers carried and the passenger traffic respectively.



# Chairman's Statement

With respect to air cargo, while Air China Cargo achieved growth in both revenue and profits during the first half of 2008 by taking a number of measures such as improving the utilisation efficiency of cargo space to capitalise on opportunities in an expanding market, the rapid shrinkage in market demand in the second half of the year forced the Group to reduce its utilisation of its traffic capacity. Although the cargo and mail load factors and unit revenue increased during the year, the volume of cargo and mail carried, RFTK and revenue were reduced by 11.2%, 6.8% and 2.05% respectively compared with the previous year, with the reduction particularly significant for international and regional routes.

Despite a sharp fall in jet fuel price at the end of 2008, the average jet fuel price in 2008 was still significantly higher than in 2007, which led to a considerable increase in the cost of jet fuel compared with 2007. Meanwhile, the fair value losses arising from fuel hedging transactions for the period between 2009 and 2011 were relatively high. The fair value losses on the fuel hedging contracts and the operation loss incurred by Cathay Pacific Airways Limited ("Cathay Pacific"), an associate of the Company, also had a negative impact on the financial results of the Group.

In response to the extraordinary market condition, the Group continued to optimise its fleet. In 2008, 28 aircraft ranging from A-330/320 series to B737-800 series were introduced. Five aircraft which had been in operation for a very long period of time with high maintenance cost but low operational efficiency were retired. In addition, we are in the process of implementing a retirement plan involving two B737-300 series aircraft, two B767 series aircraft and three B747-200F series aircraft.

In accordance with market change, the Group continued with the implementation of its hub strategy and adjusted its air routes and utilisation of its traffic capacity in a timely



Earthquake rescue and aid efforts



Voluntary services provided during the Paralympic Games

manner to improve the operational efficiency of its flights. The Company increased the flight frequency serving the Australia route to meet the rising market demand, and adjusted the route structure of flights from Shanghai to Paris as well as flights from Shanghai to Rome to improve operational efficiency. The Company also cut some of the routes that had incurred considerable loss in order to allocate its traffic capacity to markets that can generate more stable revenue. The abovementioned measures ensure the overall stability of both the Group's air passenger operation and revenue.

Leveraging on the operation commencement of Terminal 3 at Beijing capital international airport, the Company launched an improvement plan for its entire suite of services by taking advantage of the comprehensive functions and facilities available in Terminal 3. By raising the service standards, streamlining the service process and improving the ways in which service is provided, the Company was able to satisfy the increasing service demand of the customers as well as enhance the competitiveness of the Company's products.

Despite being affected by the natural disasters and the drastic market volatility, the Group did not forsake its social responsibilities. After the ravage by the snow storms in southern China and the earthquake in Wenchuan, Sichuan, the Company arranged more than 1,000 flights to join in the rescue efforts on several occasions, making the Company the first airline to arrive at the affected areas after the earthquake and the airline that had transported the largest number of injured victims.

As the exclusive airline partner of the 2008 Beijing Olympic Games, the Group conscientiously fulfilled its commitment of providing transport services for the torch relay both within and outside China, the Olympic Games and the Paralympic Games in a satisfactory manner. The Company made contributions towards achieving the goal of "Two Olympics, Same Success".

# Chairman's Statement

The jet fuel hedging transactions of the Company had a material adverse impact on its 2008 operating results and such impact is expected to continue during the remaining term of the jet fuel hedging contracts as the jet fuel price continues to fluctuate. In particular, if the jet fuel price continues to drop, the fair value losses on the fuel hedging contracts may increase. The Company will proactively take the relevant measures in response to market changes in order to minimise the effect of the fuel hedging contracts.

In 2009, the Group will continue to firmly strive toward its current strategic goals, strengthen business cooperation with its strategic partner Cathay Pacific and further utilise the cooperation platform provided by Star Alliance. The Company believes that backed by the general prospect of the PRC's macro-economy and the relevant policies adopted by the PRC government, and with its continually improving capability to seize market opportunities and effectively control costs, the Company is well-positioned to overcome

the current difficulties, continue to offer quality services to its customers and create greater value for both the society and its shareholders.



*Chairman of the Board*  
**Kong Dong**

Beijing, the PRC,  
16 April 2009



# Business Overview

## BUSINESS REVIEW OF PASSENGER SERVICE OPERATION

In 2008, the Company's available seat kilometres reached 88,101 million, representing an increase of 3.32% from 2007 and its passenger traffic was 66,160 million RPKs, representing a decrease of 1.25% from 2007, among which the passenger traffic of Mainland China routes increased by 1.31%, the passenger traffic of international routes decreased by 4.14% and the passenger traffic of Hong Kong, Macau and Taiwan routes decreased by 7.01%. The number of passengers carried by the Company was 34.26 million person-times in 2008, representing a decrease of 1.68% from 2007. The Company recorded an average passenger load factor of 75.1% in 2008, representing a decrease of 3.48 percentage points from 2007.

Air Macau: for 2008, its available seat kilometres was 3,709 million, representing a decrease of 6.44% from 2007; its passenger traffic decreased by 14.52% from 2007 to 2,587 million RPKs; the number of passengers carried by it decreased by 22.17% from 2007 to 1.88 million person-times; and its passenger load factor was 69.75%, representing a decrease of 6.6 percentage points from 2007.

The Group's yield per RPK increased by 1.75% from 2007 to RMB0.63.

## BUSINESS REVIEW OF CARGO SERVICE OPERATION

In 2008, the available freight tonne kilometres of the Company's subsidiary Air China Cargo Co., Ltd ("Air China Cargo") (including its freighters and the bellyhold space of the Company's passenger aircraft) decreased by 6.07% from 2007 to 6,217 million and its cargo and mail traffic was 3,513 million RFTKs, representing a decrease of 4.82% from 2007, of which Mainland China routes, international routes, and Hong Kong, Macau and Taiwan routes decreased by 2.25%, 5.42% and 8.81% respectively. Air Cargo carried 899,800 tonnes of cargo and mail in 2008, representing a decrease of 3.67% from 2007 and its cargo and mail load factor increased by 0.74 percentage points from 2007 to 56.5%.

Air Macau: for 2008, its available freight tonne kilometres was 139 million, representing a decrease of 44.30% from 2007; its cargo and mail traffic decreased by 47% from 2007 to 98 million RFTKs; the amount of cargo and mail carried by it decreased by 52.7% from 2007 to 80,300 tonnes; and its freight and mail load factor for 2008 was 70.66%, representing a decrease of 3.7 percentage points from 2007.

The Group's yield per RFTK in 2008 increased by 5.13% from 2007 to RMB1.99.



# Business Overview

## BUSINESS REVIEW OF ASSOCIATED AIRLINES

### Shandong Airlines Company Limited (“Shandong Airlines”)

The Company holds 22.8% of the share capital of Shandong Airlines, and 49.4% of the share capital of Shandong Aviation Group Corporation, which in turn holds 42.0% of the share capital of Shandong Airlines. In 2008, the total traffic turnover of Shandong Airlines increased by 4.7% from 2007 to 630 million tonne kilometres, while the number of passengers carried by it increased by 1.10% from 2007 to 5.42 million person-times.

### Shenzhen Airlines Company Limited (“Shenzhen Airlines”)

The Company holds 25% of the share capital of Shenzhen Airlines. In 2008, the total traffic turnover of Shenzhen Airlines increased by 25.4% from 2007 to 1,780 million tonne kilometres, while the number of passengers carried by it increased by 25.5% from 2007 to 11.95 million person-times.

## FLEET

In 2008, the Company continued to optimise and update the structure of its fleet in order to improve the operation efficiency of the fleet and promote energy efficiency and the reduction of emissions.

In 2008, the Company and Air China Cargo introduced 28 aircraft, including nine B737-800 series aircraft, seven A330-200 series aircraft, ten A321-200 series aircraft, one TU204 freighter and one business jet. Five aircraft was retired, including two B737-300 series aircraft, two B737-600 series aircraft, one A330-300 series aircraft. There was a net increase of 23 aircraft.

As at 31 December 2008, the Company and Air China Cargo operated a fleet of 243 aircraft in total, with the average age of aircraft being 7.4 years (compared to 7.3 years in 2007). Details of the fleet are set out in the table below:

Type of Aircraft	Owned	Number of Aircraft		Total
		Finance leased	Operating leased	
<b>Passenger Aircraft</b>	<b>98</b>	<b>76</b>	<b>57</b>	<b>231</b>
Airbus	27	42	7	<b>76</b>
Boeing	71	34	50	<b>155</b>
<b>Freighters</b>	<b>9</b>	<b>–</b>	<b>2</b>	<b>11</b>
<b>Business Jet</b>	<b>–</b>	<b>–</b>	<b>1</b>	<b>1</b>
<b>Total</b>	<b>107</b>	<b>76</b>	<b>60</b>	<b>243</b>

As at 31 December 2008, Air Macau operated a fleet of 13 aircraft, of which 11 were passenger aircraft and the remaining two were freighters.

# Business Overview

## HUB NETWORK BUILDING

During 2008, the Company continued to implement its hub network strategy, and the construction of Beijing hub developed smoothly. The Company, in response to market changes, continued its expansion of transportation capacity in the Beijing hub. There are currently 136 aircraft serving the Beijing routes, an increase of 17 aircraft from 2007. The Company's share of the number of flights and passenger kilometres of the Beijing hub was 45.5% and 54.6% respectively, representing an increase of 1.9 and 0.7 percentage points as compared to 2007. Through adjusting flights schedule, the status of Beijing as a hub was further strengthened with 22,863 connecting flights per week, an increase of 60.5% compared with 2007. With flights of 10 routes (such as from Beijing to Pyongyang, Beijing to Wuxi) recently added by Capital Airports, the flight frequency from Beijing to various provincial capitals and coastal cities was increased with at least three flights per day from Beijing to the main provinces and cities. As a result, the coverage of route network of the Beijing hub was expanded and flight frequency of the Beijing hub network was further increased.

The construction progress of the Chengdu hub was slowed down due to the Sichuan earthquake. However, through optimising flight schedules, the number of connecting flights serving between the Northwest China and Southern China and other strategic locations increased significantly. The Shanghai market maintained its relatively high yield and the proportion of passenger kilometres remained stable as compared to 2007. Leveraging on the code sharing arrangement with Shanghai Airlines, the inadequacy of the domestic routes network in Shanghai was supplemented and strong support was provided for international route operation.

As at 31 December 2008, the Company operated 259 routes (including 70 international routes, 12 regional routes and 177 domestic routes), covering 30 countries and regions and 129 cities.

## MARKETING AND CO-OPERATION

Faced with intense market changes, the Company emphasised on making use of strategic marketing channels and focusing on key clients. There was an increase of 2,310,000 new members to the frequent-flyer programme, bringing its total number of members to 8,580,000. Revenues from key clients, first and business class sales and the e-commerce business increased by 32.7%, 3.7% and 210% respectively as compared to 2007.

In response to domestic and international market changes, the Company promoted its domestic sales and the sales made to individual clients, and also strengthened its regional business linkages. The Company also explored

markets not open to its navigation and increased its offline sales. Revenue therefore increased by 8.5% as compared to 2007.

The Company made great efforts in releasing its fare rates in order to develop its global sales capability. By improving the pricing system for Europe and US routes and formulating new fare rates for Asia-Pacific routes, the Company preliminarily established its carrier's fare rate system. The Company also completed setting up the system for automated ticket issuance and calculation of agreed fare rates, released its fare rates for 19 new routes and readjusted its base rates for 13 domestic routes.

The Company strengthened the bilateral co-operation with Star Alliance by leveraging on the Star Alliance platforms. Through the Star Alliance, the Company developed route networks and new customer bases, resulting in revenue increasing by 42.1 % compared to 2007. The new joint operation with Cathay Pacific on routes between Chengdu and Hong Kong and between Chongqing and Hong Kong further expanded the scope of co-operation.

## SERVICE AND PRODUCTS

The Company launched the "Gold-Standard Service for the Olympics" and the "Olympics Safety, Punctuality, Quality Service Year" campaigns. The Company has used its best efforts to provide services to the Olympic Games and achieved a remarkable record of receiving no complaints in respect of the support service as well as offering the highest number of chartered flights and flight frequency, which effectively improved the brand image of Air China.

The Company has improved the quality of its service from various aspects such as baggage handling. During the year 2008, supervision and control over baggage handling was carried out for the entire journey for the first time between domestic airports with high flight density and in airports in



# Business Overview



Guangzhou and Shenzhen, thereby effectively decreasing the incidents of lost baggage. By using a global tracking system, baggage reclaim rate reached 97%, two percentage points higher than the industry average.

In order to improve the services provided in the circumstances of flight delay and cancellation, the Company streamlined the information communication process for flight delay and cancellation and issued a "Service Handbook relating to Flight Delay and Cancellation", thus increasing the quality of services in the event of flight delay and cancellation.

At the beginning of 2008, the Company successfully completed its relocation from Terminal 2 to Terminal 3 of the Beijing Capital International Airport. Through its strong support capabilities and advanced service facilities, Terminal 3 enables the Company to provide competitive services and products. At the same time, excellent operation environment ensures the normality of flights. Furthermore, in accordance with the new operation environment requirements, the Company has optimised the transit process in Terminal 3 and continues to increase the transit connection products, thereby extending the service platform of Beijing as a transit point. Currently, the Minimum Connection Time (MCT) from a domestic flight to an international flight is as short as 90 minutes, making the Company one of the leaders in the domestic airline industry. The one-stop boarding service is also made available in 25 cities.

In 2008, the Company continued to develop its e-commerce business. The Company developed the information hotline services, seat reservations and online check-in and other value-added services. The online check-in time for domestic flights has also been brought forward to 36 hours before the scheduled take-off. To date, a total of 1,646,000 passengers have used the CUSS self-service check-in system and a total 398,000 passengers have used the online check-

in facility. Both CUSS and online check-in show signs of increased usage.

The Company has completed its three-year brand promotion plan, and developed the "Express Beijing" sub-brand project. The Company has developed the Beijing-Shanghai Express Line, the Forbidden Pavilion and Capital Pavilion cabins and has also launched the Beijing-Chengdu Express Line. The Company has emphasised on designing services for the entire journey for high-end passengers.

## POST BALANCE SHEET EVENTS

In accordance with the amendments to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") which came into effect on 1 January 2009, the Company no longer has a qualified accountant within the meaning of the Listing Rules.

On 26 February 2009, the Company issued its first tranche of medium-term notes for the year 2009 with a total offering size of RMB3,000 million. The first-tranche notes with a coupon rate of 3.32% will mature in 3 years. The second tranche of medium-term notes for the year 2009 was issued on 19 March 2009 with a total offering size of RMB3,000 million. The second-tranche notes with a coupon rate of 3.48% will mature in 5 years.

On 2 April 2009, the Company entered into an agreement with Capital Airports Holding Company to acquire in cash from Capital Airports Holding Company its 24% equity interest in Air China Cargo. Pursuant to such agreement, the aggregate consideration payable by the Company is RMB718,004,045. Upon completion of the transaction, the Company's equity interest in Air China Cargo (including indirect interest held through China National Aviation Company Limited ("CNAC")) shall increase from 76% to 100%.



# Management's Discussion and Analysis of Financial Position and Operating Results

The following discussion and analysis are based on the Group's consolidated financial statements and its notes prepared in accordance with International Financial Reporting Standards ("IFRS"), and are designed to assist the readers in understanding the information provided in this report further so as to better understand the financial performance of the Group as a whole.

## ANALYSIS OF THE PROFITABILITY

In 2008, the Group incurred a loss from operations of RMB1.908 billion and the loss attributable to equity holders of the Company was RMB9.256 billion with a loss per share of RMB0.78. In 2007, the restated profit from operations was RMB3.676 billion and the profit attributable to equity holders of the Company was RMB4.046 billion with earnings per share of RMB0.34.

## TURNOVER

In 2008, the Group's total turnover (net of business taxes and surcharges) was RMB52.908 billion, an increase of RMB1.826 billion or 3.58% compared with 2007. As the Group acquired an additional 25% shareholding in Air China Cargo in 2008, Air China Cargo, which was previously a joint venture of the Group, became the Group's subsidiary after the acquisition and was therefore fully consolidated into the Group's consolidated financial statements for the year ended 31 December 2008. If the Group's comparative information in 2007 was restated on the basis that Air China Cargo had been consolidated into the Group's consolidated financial statements for the year ended 31 December 2007, the Group's total turnover in 2008 would have only increased by RMB74 million compared with 2007, such increase is mainly constituted of the significant increase of the revenue from the engineering services provided by the Group's joint venture Aircraft Maintenance and Engineering Corporation, Beijing compared with 2007.

## REVENUE CONTRIBUTION BY GEOGRAPHICAL SEGMENT

(in RMB'000)	2008		2007 (restated)		Change
	Amount	Percentage	Amount	Percentage	
Mainland China	27,272,415	51.55%	27,558,480	53.95%	(1.04%)
Hong Kong and Macau	3,559,564	6.73%	3,930,462	7.69%	(9.44%)
Europe	8,971,139	16.96%	7,581,769	14.84%	18.33%
North America	5,708,150	10.79%	4,658,495	9.12%	22.53%
Japan and Korea	4,205,811	7.95%	4,583,332	8.97%	(8.24%)
Asia Pacific and others	3,191,082	6.02%	2,769,129	5.43%	15.24%
<b>Total</b>	<b>52,908,161</b>	<b>100.00%</b>	<b>51,081,667</b>	<b>100.00%</b>	<b>3.58%</b>

## REVENUE CONTRIBUTION BY BUSINESS SEGMENT

(in RMB'000)	2008		2007 (restated)		Change
	Amount	Percentage	Amount	Percentage	
Air passenger	43,352,020	81.94%	43,398,754	84.96%	(0.11%)
Air cargo	7,184,675	13.58%	4,085,456	8.00%	75.86%
Engineering Services	613,784	1.16%	487,710	0.95%	25.85%
Airport terminal services	547,571	1.03%	509,450	1.00%	7.48%
Others	1,210,111	2.29%	2,600,297	5.09%	(53.46%)
<b>Total</b>	<b>52,908,161</b>	<b>100.00%</b>	<b>51,081,667</b>	<b>100.00%</b>	<b>3.58%</b>

# Management's Discussion and Analysis of Financial Position and Operating Results

## AIR PASSENGER REVENUE

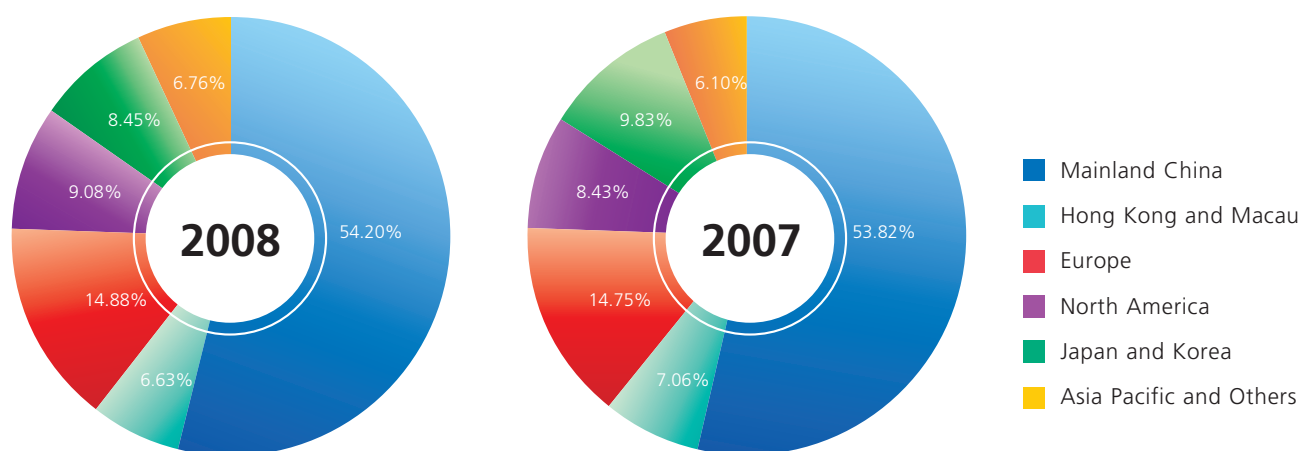
In 2008, the Group's air passenger revenue was RMB43.352 billion, representing a slight decrease compared with RMB43.399 billion in 2007. The traffic capacity, passenger load factor and revenue per seat kilometre in 2008 are as follows:

	2008	2007 (restated)	Change
Available seat kilometres ( <i>million</i> )	<b>91,809.88</b>	89,233.74	2.89%
Passenger load factor (%)	<b>74.88</b>	78.47	(3.59ppt)
Yield per PRK ( <i>RMB</i> )	<b>0.63</b>	0.62	1.75%

Compared with 2007, the increase in traffic capacity and yield per RPK contributed to an increase in revenue of RMB1.253 billion and RMB0.746 billion respectively while the decrease in passenger load factor caused a decrease in revenue of RMB2.045 billion in 2008.

## AIR PASSENGER REVENUE CONTRIBUTED BY GEOGRAPHICAL SEGMENT

<i>(in RMB'000)</i>	2008		2007 (restated)		Change
	Amount	Percentage	Amount	Percentage	
Mainland China	<b>23,498,230</b>	<b>54.20%</b>	23,357,973	53.82%	0.60%
Hong Kong and Macau	<b>2,872,176</b>	<b>6.63%</b>	3,063,467	7.06%	(6.24%)
Europe	<b>6,450,513</b>	<b>14.88%</b>	6,403,212	14.75%	0.74%
North America	<b>3,934,709</b>	<b>9.08%</b>	3,660,605	8.43%	7.49%
Japan and Korea	<b>3,664,419</b>	<b>8.45%</b>	4,266,923	9.83%	(14.12%)
Asia Pacific and others	<b>2,931,973</b>	<b>6.76%</b>	2,646,574	6.10%	10.78%
<b>Total</b>	<b>43,352,020</b>	<b>100.00%</b>	43,398,754	100%	(0.11%)





# Management's Discussion and Analysis of Financial Position and Operating Results

## AIR CARGO REVENUE

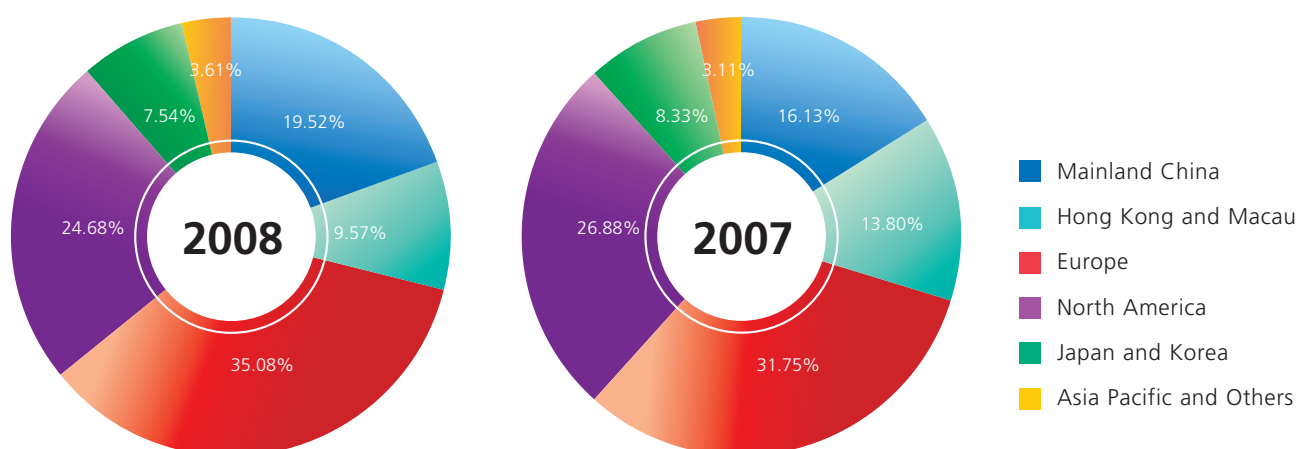
In 2008, the Group's air cargo and mail revenue was RMB7.185 billion, a decrease of RMB0.15 billion compared with 2007, which was mainly due to the sudden deterioration of the air cargo market conditions caused by the global financial crisis in the second half of 2008, and especially in the 4th quarter of 2008.

In order to provide an objective description of the actual change of the Group's business results, the comparative data of the Group for 2007 in the following analysis on the Group's air cargo revenue has included the total revenue of Air China Cargo for 2007 (adjustments were made to the data set out in the consolidated financial statements and its explanatory notes of the Group for the year ended 31 December 2008).

	2008	2007	Change
Available freight tonne kilometres ( <i>million</i> )	<b>6,355.89</b>	6,868.07	(7.46%)
Load factor (%)	<b>56.81</b>	56.43	0.38ppt
Cargo yield per tonne kilometre ( <i>RMB</i> )	<b>1.99</b>	1.89	5.13%

## AIR CARGO REVENUE CONTRIBUTED BY GEOGRAPHICAL SEGMENT

<i>(in RMB'000)</i>	2008		2007		Change
	Amount	Percentage	Amount	Percentage	
Mainland China	<b>1,402,720</b>	<b>19.52%</b>	1,183,014	16.13%	18.57%
Hong Kong and Macau	<b>687,388</b>	<b>9.57%</b>	1,012,321	13.8%	(32.10%)
Europe	<b>2,520,626</b>	<b>35.08%</b>	2,328,636	31.75%	8.24%
North America	<b>1,773,441</b>	<b>24.68%</b>	1,971,669	26.88%	(10.05%)
Japan and Korea	<b>541,392</b>	<b>7.54%</b>	611,206	8.33%	(11.42%)
Asia Pacific and others	<b>259,108</b>	<b>3.61%</b>	228,453	3.11%	13.42%
<b>Total</b>	<b>7,184,675</b>	<b>100%</b>	7,335,298	100%	(2.05%)

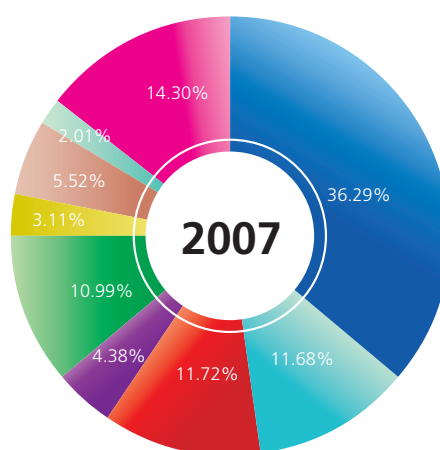
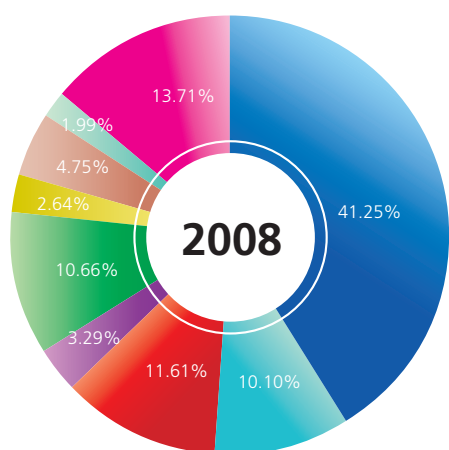


# Management's Discussion and Analysis of Financial Position and Operating Results

## OPERATING EXPENSES

In 2008, the Group's aggregate operating expenses amounted to RMB54.816 billion, representing an increase of 15.63% compared with RMB47.405 billion in 2007. The breakdown of the operating expenses are set out below:

(in RMB'000)	2008		2007 (restated)		Change
	Amount	Percentage	Amount	Percentage	
Jet fuel costs	22,613,935	41.25%	17,201,143	36.29%	31.47%
Take-off, landing and depot charges	5,538,092	10.10%	5,537,907	11.68%	0.00%
Depreciation	6,365,275	11.61%	5,554,443	11.72%	14.10%
Aircraft maintenance, repair and overhaul costs	1,804,416	3.29%	2,076,119	4.38%	(13.09%)
Employee compensation costs	5,843,887	10.66%	5,209,766	10.99%	12.17%
Air catering charges	1,443,855	2.64%	1,473,543	3.11%	(2.01%)
Selling expenses	2,602,904	4.75%	2,617,843	5.52%	(0.57%)
Administration management expenses	1,089,467	1.99%	951,377	2.01%	14.52%
Other	7,514,096	13.71%	6,783,347	14.30%	11.18%
<b>Total</b>	<b>54,815,927</b>	<b>100%</b>	<b>47,405,488</b>	<b>100%</b>	<b>15.63%</b>



- Jet fuel costs
- Take-off, landing and depot charges
- Depreciation
- Aircraft maintenance, repair and overhaul costs
- Employee compensation costs
- Air catering charges
- Selling expenses
- Administration management expenses
- Other

# Management's Discussion and Analysis of Financial Position and Operating Results

- Jet fuel costs increased by 31.47% to RMB22.614 billion in 2008 compared with RMB17.201 billion in 2007, which accounted for 41.25% of total operating expenses in 2008 compared with 36.29% in 2007. If the jet fuel costs of the Group for the year 2007 were restated on the basis that the jet fuel cost incurred by Air China Cargo had been fully consolidated in the Group's cost, the jet fuel cost incurred by the Group in 2008 would have increased by 24.98% compared with 2007. The significant increase in the Group's jet fuel costs was mainly due to the rapid rise of the jet fuel price in the first half of 2007. Although the jet fuel price in the international market dropped rapidly after July, the average jet fuel price in 2008 still increased by 29% compared with 2007.
- Take-off, landing and depot charges was approximately the same as that in 2007, which decreased from constituting 11.68% of the operating expenses in 2007 to constituting 10.10% of the operating expenses in 2008.
- The depreciation expenses increased in 2008 due to an increase in the number of the self-owned aircrafts and those under finance leases.
- The aircraft maintenance, repair and overhaul costs amounted to RMB1.804 billion and accounted for 3.3% of the total operating expenses in 2008, a decrease of RMB0.272 billion compared with 2007. The decrease was mainly due to some of the operating leased aircrafts were surrendered in 2008, which resulted in a decrease in the provision made for their overhauls for 2008. In addition, the repair price decreased after the Group's further negotiation with its supplier of repair services.
- Employee compensation costs increased due to the increase in the number of employees and employees' basic income.
- The decrease in the air catering charges was primarily due to a decrease in the number of passengers carried.
- Selling expenses and general and administrative expenses were approximately the same as that incurred in 2007.
- Other operating expenses mainly included the aircraft and engines operating lease expenses, civil aviation infrastructure construction fund and the daily expenses arising from core air traffic business not included in the aforesaid items.

## PROFIT CONTRIBUTION BY BUSINESS SEGMENT

(in RMB'000)

	2008	2007 (restated)	Change
Air businesses	<b>(1,815,873)</b>	3,642,044	(149.86%)
Engineering services	<b>9,512</b>	12,478	(23.77%)
Airport terminal services	<b>(128,709)</b>	7,238	(1,878.24%)
Others	<b>27,304</b>	14,419	89.36%
<b>Total</b>	<b>(1,907,766)</b>	3,676,179	(151.90%)

# Management's Discussion and Analysis of Financial Position and Operating Results

## FINANCIAL REVENUE AND FINANCIAL COSTS

In 2008, the financial derivative operations of the Group were affected by the global financial crisis and incurred a loss arising from the contracts entered into for fuel hedging activities, which included unrealised fair value losses relating to fuel hedging activities of RMB7.472 billion and realized losses after settlement of RMB0.427 billion. In 2008, the fair value losses on interest rate swap transactions entered into by the Group was RMB0.249 billion and the actual gain after settlement was RMB0.6274 million. The fair value gain and the realized gain after settlement recorded by the Group from its financial derivative transactions amounted to RMB236 million in total in 2007.

In 2008, primarily due to the continued appreciation of Renminbi against US dollars, the Group recorded a net exchange gain of RMB1.487 billion, a decrease of RMB0.543 billion or 26.78% compared with 2007, and interest expenses of RMB2.111 billion, which was slightly less than the RMB2.224 billion in 2007.

## SHARE OF PROFITS AND LOSSES OF THE GROUP'S ASSOCIATES AND GAIN ON DISPOSAL OF ASSOCIATES AND SUBSIDIARIES

In 2008, the Group's share of losses of the Group's associates was RMB1.183 billion, compared with its share of profits of RMB1.365 billion in 2007, which was mainly attributable by sharing the RMB1.188 billion loss suffered by Cathay Pacific.

In 2008, the Group recorded a gain on disposal of its subsidiaries and associates of RMB0.477 billion, primarily due to the gain from the premium generated from the disposal of the equity interests in Beijing Air Catering Co., Ltd. (北京航食) and Southwest Air Catering Co., Ltd. (西南航食) by China National Aviation Company Limited (中航興業), a subsidiary of the Company.

## ANALYSIS OF ASSETS STRUCTURE

As of 31 December 2008, the total assets of the Group amounted to RMB100.401 billion, an increase of 9.97% compared with 31 December 2007, among which the current assets were RMB10.418 billion and accounted for 10.38% of the total assets, while non-current assets were RMB89.984 billion and accounted for 89.62% of the total assets.

Of the current assets, cash and cash equivalents amounted to RMB2.987 billion, a decrease of 23.53% compared with 31 December 2007, while accounts receivable decreased by 33.78% to RMB1.85 billion compared with 31 December 2007. Of the non-current assets, the net book value of property, plant and equipment as of 31 December 2008 was RMB71.821 billion, an increase of 16.42% compared with the net book value of property, plant and equipment as of 31 December 2007.

## ASSETS MORTGAGE

As of 31 December 2008, the Group mortgaged certain aircraft and premises with an aggregate net book value of approximately RMB35.336 billion (compared with RMB34.203 billion as of 31 December 2007), certain number of shares in the associated companies with an aggregate market value of RMB3.071 billion (compared with approximately RMB7.609 billion as of 31 December 2007), and the land use rights with an aggregate net book value of approximately RMB36 million (compared with approximately RMB37 million as of 31 December 2007) pursuant to certain bank loans and finance lease agreements. In addition, certain bank deposits of the Group of approximately RMB1.75 billion (compared with approximately RMB119 million as of 31 December 2007) were pledged against the obligations in respect of certain bank loans, operating leases and financial derivatives of the Group.

## CAPITAL EXPENDITURE

In 2008, the capital expenditure of the Company amounted to RMB12.876 billion in total, of which the total investment in aircraft and engines was RMB9.726 billion, including prepayment of RMB3.654 billion for the purchases of aircrafts for 2009 and for the years afterwards.

Other capital expenditure amounted to RMB3.15 billion, which was mainly applied towards the parts and components for aircraft, flight stimulators, improvement of first class and business class cabins of certain aircraft, investment in the ancillary project in Terminal 3 of the Beijing Capital International Airport, the 11th Five Years Plan regarding the ground handling facilities as well as certain long-term investment projects.

# Management's Discussion and Analysis of Financial Position and Operating Results

## EQUITY INVESTMENT

As of 31 December 2008, the aggregate amount of equity investment in the Group's associates was RMB6.272 billion, a decrease of 34.28% compared with 31 December 2007, of which the equity investment in Cathay Pacific, Shandong Airlines and Shenzhen Airlines was approximately RMB4.181 billion, RMB64 million and RMB171 million, respectively. Due to the extraordinary market conditions in 2008, Cathay Pacific and Shenzhen Airlines recorded a loss of RMB6.79 billion and RMB0.445 billion respectively, while Shandong Airlines achieved a profit of RMB15 million.

As of 31 December 2008, the attributable equity interests of the Group in its subsidiaries Air China Cargo (76%) and Air Macau (51%) were RMB1.951 billion and RMB0.139 billion respectively. The Air China Cargo recorded a net profit of RMB26 million and Air Macau Company Limited recorded a net loss of RMB367 million for the year ended 31 December 2008.

The Group plans to further consolidate and optimize the businesses of the companies it has invested and make more improvements on these companies' financial status and business results.

## DEBT STRUCTURE ANALYSIS

As of 31 December 2008, the total liabilities of the Group amounted to RMB79.945 billion, an increase of 32.04% compared with 31 December 2007. The total current liabilities were RMB42.725 billion, which accounted for 53.44% of the total liabilities and the total non-current liabilities were RMB37.219 billion, which accounted for 46.56% of the total liabilities.

Of the current liabilities, the derivative financial instruments payable amounted to RMB7.728 billion, an increase of RMB7.713 billion compared with 31 December 2007. The interests-bearing debt (including bank and other loans, obligations under finance leases and bills payable) amounted to RMB20.815 billion, an increase of 57.74% compared with 31 December 2007. Other payables and advances amounted to RMB14.182 billion, an increase of 2.07% compared with 31 December 2007.

Of the non-current liabilities, the interests-bearing debt (including bank and other loans, obligations under finance leases and corporate bonds) amounted to RMB33.824 billion, an increase of 12.96% compared with 31 December 2007.

(RMB'000)	Bank loans, other loans bills payable and corporate bonds		Obligations under finance leases	
	31 December 2008	31 December 2007	31 December 2008	31 December 2007
Within one year	<b>16,751,275</b>	10,978,835	<b>4,064,038</b>	2,216,680
In the second year	<b>8,001,444</b>	4,039,529	<b>3,599,513</b>	2,821,518
In the third to fifth years (inclusive)	<b>5,432,584</b>	8,181,988	<b>5,109,696</b>	5,484,352
After five years	<b>3,908,840</b>	4,393,774	<b>7,771,575</b>	5,022,323
<b>Total</b>	<b>34,094,143</b>	27,594,126	<b>20,544,822</b>	15,544,873

# Management's Discussion and Analysis of Financial Position and Operating Results

## COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2008, capital commitments of the Group increased substantially from RMB58.878 billion in 2007 to approximately RMB70.279 billion, which was primarily used for the purchase of certain aircrafts and relevant flight equipments to be delivered in the coming years and the construction of certain properties. The Group had operating lease commitments of RMB13.578 billion, an increase of 6% compared with 2007, which was primarily used to lease office premises, aircrafts and related equipments. The Group had investment commitments of RMB51 million, a decrease of 5.56% compared with 2007.

As of 31 December 2008, the Group's contingent liabilities in respect of guarantees of bank loans provided to its associates was RMB106 million. Details of contingent liabilities of the Group are set out in note 50 to the Group's consolidated financial statements for the year ended 31 December 2008.

## GEARING RATIO

As of 31 December 2008, the Group's gearing ratio (total liabilities divided by total assets) was 79.63%, an increase of 13.31 percentage points compared with 66.32% as of 31 December 2007, which was primarily due to the introduction of additional aircrafts and the increase of debt financing activities. In the meanwhile, due to the loss recorded by the Group in 2008, the equity interests of the Group attributable to its shareholders decreased from RMB30.752 billion as of 31 December 2007 to RMB20.457 billion as of 31 December 2008. Considering the prevailing gearing ratios of other air carriers in the same industry stood at a relatively high level, the Group's gearing ratio remains comparatively ideal and the long-term insolvency risks are within its control.

## WORKING CAPITAL AND ITS SOURCES

As of 31 December 2008, the net current liabilities of the Group (i.e. the current liabilities minus the current assets) was RMB32.308 billion, an increase of RMB15.032 billion compared with 31 December 2007. The Group's current ratio, which represents current assets divided by current liabilities, was 0.24, a decrease of 0.12 percentage point from 0.36 as of 31 December 2007. The increase of the net current liabilities was mainly due to the significant increase of the Group's current liabilities.

The Group mainly meets its working capital needs through its operating activities and external financing activities. In 2008, the Group's net cash inflow from operating activities decreased by 30.70% to RMB5.060 billion from RMB7.302 billion in 2007, which was primarily due to the fast increase of the jet fuel cost and a corresponding increase of the Group's cash outflow for the purpose of purchasing jet fuel. Net cash outflow from investment activities in 2008 decreased by 28.82% to RMB7.269 billion from RMB10.212 billion in 2007, primarily due to the Group's acquisition of the minority interests in China National Aviation Company Limited in 2007 by cash in the amount of RMB3.033 billion. The Group recorded a net cash inflow from financing activities of RMB2.870 billion, an increase of RMB1.031 billion from RMB1.839 billion in 2007, primarily due to less debt repayments made by the Group in 2008. The Group's cash and cash equivalent increased by RMB472 million in 2008 (in 2007 the Group's cash and cash equivalent decreased by RMB1.111 billion). The Group had already obtained bank facilities with an aggregate amount of up to RMB108.4 billion from a number of banks in the PRC of which an amount of approximately RMB40.0 billion was utilised and was therefore well positioned to fully meet its own demand on working capital and its future capital commitments.

## OBJECTIVES AND POLICIES OF FINANCIAL RISKS MANAGEMENT

The Group is exposed to the fluctuations in jet fuel price in its daily operation. International jet fuel prices have historically, and will continue to be, subject to market volatility and fluctuation in supply and demand. The Group's strategy for managing its jet fuel price risk aims to protect itself against sudden and significant price increases. The Group has been engaging in fuel hedging transactions since March 2001. The hedging instruments used were mainly derivatives of Singapore Kerosene together with Brent crude oil and New York crude oil, which are closely linked to the price of jet fuel. Due to the extreme price volatility of fuel prices in 2008, the fuel hedging contracts entered into by the Group had large fair value losses, part of which was actually settled. Considering the high volatility of the international fuel prices and the Company's high cost sensitivity, the Company will continue to utilise the hedging instruments to manage and control the risk in relation to rising fuel prices.

# Management's Discussion and Analysis of Financial Position and Operating Results

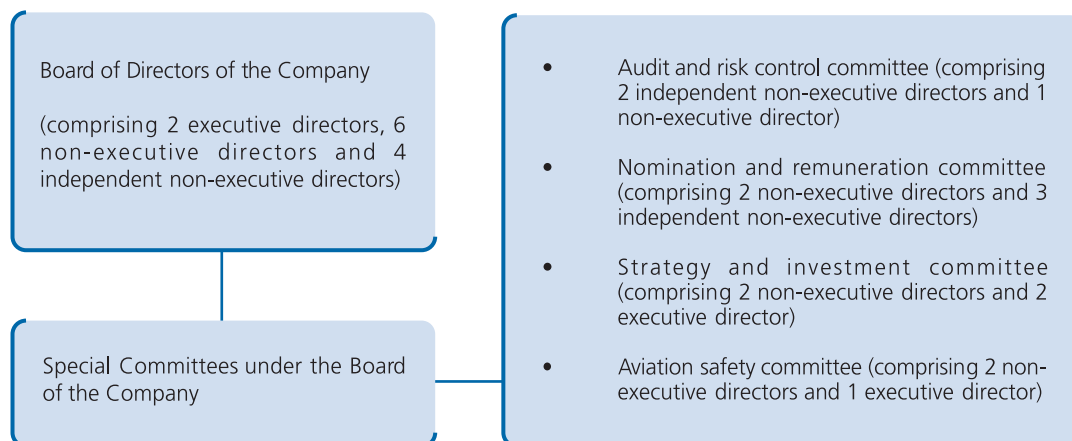
A large percentage of the Group's liabilities are interest-bearing debts and most of these debts are foreign debt. As of 31 December 2008 the total amount of interest-bearing debt of the Group was RMB54.639 billion, which accounted for 68.35% of the Group's total liabilities. Among these, the loans denominated in US dollars was RMB38.829 billion, the loans denominated in Hong Kong dollars was RMB2.346 billion and the loans denominated in Japanese Yen was RMB2.795 billion. In addition, the Group also has sales revenues and expenses denominated in foreign currencies. The Group endeavoured to minimize any risks relating to foreign exchange rate and interest rate by adjusting the structure of the interest rates and denominating currencies of its debt and by making use of the financial derivatives.

Information on financial risk management objectives and policies in other aspects of the Group's operations are set out in note 54 to the Group's 2008 annual consolidated financial statements.

# Corporate Governance Report

The Company has been maintaining and enhancing the level of its corporate governance so as to ensure greater accountability and transparency and bring long-term return to its shareholders. The Company has complied in all respects with the principles and code provisions of the Code on Corporate Governance Practices (the “Code”) under Appendix 14 of the Listing Rules in 2008. The Company’s corporate governance practices in 2008 are summarised and discussed below.

## GOVERNANCE STRUCTURE



## MAJOR CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES OF THE COMPANY

### A. Board of Directors (the “Board”)

#### ***The Board must include at least three independent non-executive directors***

- As at 31 December 2008, the Board of the Company comprises eleven directors, out of which four are independent non-executive directors. The directors of the Company are elected at the shareholders’ general meeting for a three-year term of office, and are eligible for re-election upon expiry of the term.
- Pursuant to the Listing Rules, each of the independent non-executive directors has confirmed his independence with the Hong Kong Stock Exchange. As at 31 December 2008, the Company has already received from all independent non-executive directors the annual statements concerning their independence in which each of the independent non-executive directors re-confirmed his independence. The Company believes that all independent non-executive directors have complied with the qualification of independence within the meaning of Rule 3.13 of the Listing Rules.

Deviation: Nil

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

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

Deviation: Nil



# Corporate Governance Report

## ***Distinguished roles of the Chairman and President***

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

Deviation: Nil

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

- The term of office of the existing non-executive directors is three years.

Deviation: Nil

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

- The Board is accountable to the shareholders' general meeting and determines the investment proposals of the Company and its approval authority regarding any disposal of the Company's fixed assets is delimited according to the authorisation of the shareholders' general meeting. The Company formulates the Rules and Procedures for Shareholders' General Meetings, Rules and Procedures for Board Meetings and Rules and Procedures for Senior Management Meetings. Pursuant to the articles of association of the Company, the main responsibilities of the Board are: to decide on the Company's business policies and investment plans; to formulate the Company's annual budget and final accounts; to formulate the Company's profit distribution proposals and loss recovery proposals; to decide on the establishment of the Company's internal management bodies; to appoint or dismiss the president of the Company, secretary to the Board of Directors of the Company, and, with reference to the nomination by the president, the vice president; and to exercise other functions and powers as stipulated the articles of association and granted by the shareholders' general meeting.
- The President shall be authorised by the Board to implement various strategies and oversee the day-to-day operations of the Company.
- The Board shall have independent access to the senior management personnel for enquiries in relation to the Company's management.
- The Board shall have specialised committees to provide support to the Board in its decision-making.

Deviation: Nil

## ***Besides the working relationships in the Company, there was no financial, business, family relationship or other material relationships among the directors, supervisors and senior management.***

Deviation: Nil

# Corporate Governance Report

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

- Board meetings are held regularly throughout the year and will generally include annual meetings, interim meetings and meetings for the first and third quarters. Board meetings will be convened by the Chairman and a 14-day notice will be served to all directors before each meeting. The meetings may be attended through personal participation or other electronic means of communication.
- The Secretary to the Board shall be responsible for the communications and liaison with all directors from the time the notice is served to the commencement of the meeting, and will provide in a timely manner the necessary information to the directors for facilitating their decision-making on matters set out in the agenda.
- For the purpose of considering resolutions or matters during Board meetings, the directors may require the presence of the persons-in-charge of the relevant departments at the Board meetings to answer queries, so that the directors can have a thorough understanding of the key issues and the general situation.
- All directors shall have access to the Board Secretary. Under the leadership of the Board and the Chairman, the Board Secretary shall take the initiative to acquaint himself with the implementation progress of the Board resolutions, and report to and advise the Board and the Chairman in a timely manner on major issues arising in the course of implementation.
- Minutes of Board meetings shall be kept by the Board Secretary and made available for inspection by any director at any time.
- All directors have actively participated in the business operations of the Company. Attendance of all directors at the Board meetings in 2008 is as follows:

<b>Attendance of Directors at the Board meetings in 2008</b>		
<b>No. of meetings</b>	<b>18</b>	
<b>Non-Executive Directors</b>		
Kong Dong ( <i>Chairman</i> )	18/18	100%
Wang Yinxiang	6/6	100%
Wang Shixiang	18/18	100%
Yao Weiting	6/10	60%
Ma Xulun	16/18	88.9%
Christopher Dale Pratt	18/18	100%
Chen Nan Lok Philip	17/18	94.4%
<b>Executive Directors</b>		
Cai Jianjiang ( <i>President</i> )	18/18	100%
Fan Cheng	18/18	100%
<b>Independent Non-Executive Directors</b>		
Hu Hung Lick, Henry	18/18	100%
Wu Zhipan	18/18	100%
Zhang Ke	18/18	100%
Jia Kang	18/18	100%
<b>Average attendance rate:</b>	<b>95.6%</b>	

# Corporate Governance Report

For the year ended 31 December 2008, the number of Board meetings held and the convening procedures, minutes and record, rules of procedure and other relevant matters in connection with such meetings were in compliance with the relevant code provisions. It can be shown from the attendance rate that all directors of the Company have discharged their duty of diligence and are dedicated to making contribution for the interest of the Company and its shareholders as a whole.

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

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

Deviation: Nil

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

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

Deviation: Nil

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

- After making specific enquiries, the Company confirmed that each director and each supervisor have complied with the required standards of the Model Code as set out in Appendix 10 of the Listing Rules throughout 2008.
- The Model Code contained in Appendix 10 of the Listing Rules requires the Board to adopt written guidelines regarding transactions of securities of the issuer by its employees on terms no less exacting than the required standard of the Model Code. On 5 September 2005, the Company adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standards of the Model Code. The code of conduct of the Company also applies to supervisors and the relevant employees.

Deviation: Nil

# Corporate Governance Report

## B. Remuneration of Directors and Senior Management

**Issuers should establish a remuneration committee with certain authorities and obligations under specific written terms. A majority of the members of the remuneration committee should be independent non-executive directors**

- The Company has established a nomination and remuneration committee to recommend to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management.
- The majority of the members of the nomination and remuneration committee are independent non-executive directors. As at 31 December 2008, the members of the nomination and remuneration committee were Mr. Kong Dong, Ms. Wang Yinxiang, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.
- Attendance at the meetings of the nomination and remuneration committee in 2008 and particulars of the meetings are as follows:

Attendance at the meetings of the nomination and remuneration committee in 2008		
<b>No. of meetings</b>		<b>2</b>
Wu Zhipan	2/2	100%
Kong Dong	2/2	100%
Hu Hung Lick, Henry	1/2	50%
Zhang Ke	2/2	100%
<b>Average attendance rate:</b>		<b>87.5%</b>

- The articles of association of the Company provides that a shareholder holding 5% or more of the total shares of the Company is entitled to nominate a director through the nomination and remuneration committee, which will evaluate the candidates for directorship and senior management according to the standards set out in the articles of association of the Company and report to the Board.
- At the first meeting of the nomination and remuneration committee of 2008 held on 29 July 2008, it was proposed that the annual remuneration of independent directors be increased from RMB50,000 to RMB60,000 and agreed the same be submitted to the fifteenth meeting of the second session of the Board for consideration and approval.
- At the second meeting of the nomination and remuneration committee of 2008 held on 11 August 2008, it was proposed that Ms. Wang Yinxiang be nominated as the candidate for the non-executive director of the second session of the Board of the Company and agreed the same be submitted to the sixteenth meeting of the second Board for consideration and approval.
- Remuneration payable to directors shall be determined according to the terms of their respective employment contracts, if any, and the recommendation of the nomination and remuneration committee. Details of the remuneration of the directors are set out in the financial statements.

Deviation: Nil

# Corporate Governance Report

## C. Accountability and Audit

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

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

Deviation: Nil

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

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

Deviation: Nil

### ***The Board should establish formal and transparent arrangements in relation to the application of financial reporting and internal control principles and the maintenance of an appropriate relationship with the Company's auditors***

- Through the audit and risk control committee, the Board reviews and supervises the Company's financial reporting process and communicates with the external auditors, reviews periodic financial reports so as to make sure the financial reporting and internal control principles are formal and transparent.
- As at 31 December 2008, the audit and risk control committee comprised two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke. Mr. Ma Xulun, a previous member on the audit and risk control committee and a non-executive director, resigned on 22 December 2008 and Mr. Cao Jianxiong, a director candidate, will be the replacement when his proposed appointment is approved by the shareholders' meeting. Mr. Zhang Ke acts as chairman of the audit and risk control committee.

# Corporate Governance Report

- Attendance at the meetings of the audit and risk control committee in 2008 and particulars of the meeting are set out as follows:

Attendance at meetings of the audit and risk control committee in 2008		
No. of meetings	6	
Zhang Ke	6/6	100%
Wu Zhipan	6/6	100%
Yao Weiting	3/4	75%
Ma Xulun	1/2	50%
<b>Average attendance rate:</b>	<b>81.25%</b>	

- At the second meeting of the second session of the audit and risk control committee held on 17 January 2008, the members were briefed by the secretary of the Board on the overall schedule and arrangement of 2007 annual report and briefed by Ernst & Young on the work arrangement and matters related to the audit of 2007 financial report.
- At the third meeting of the second session of the audit and risk control committee held on 17 March 2008, the following were considered and approved: the audited financial report and annual report of the Company for the year 2007 and status of implementation of connected transactions for the year 2007; the profit distribution proposal of the Company for the year 2007; the summary report on 2007 audit by Ernst & Young; the reappointment of Ernst & Young as the Company's international auditors and Ernst & Young Hua Ming as domestic auditors for the year of 2008; the self-assessment report on internal control for 2007; the resolutions regarding adjustments to certain items under the balance sheet at the beginning of 2007; the amendments to the Rules and Procedure for the Audit and Risk Control Committee of the Company; the work report of the audit and risk control committee for the year 2007.
- At the fourth meeting of the second session of the audit and risk control committee held on 24 April 2008, the first quarterly report of 2008 was considered and approved.
- At the fifth meeting of the second session of the audit and risk control committee held on 21 August 2008, the interim report and interim financial report for the year 2008 were considered and approved. The medium-term adjustment to the financial plan and capital expenditure plan of the Company were also considered and approved during the meeting.
- At the sixth meeting of the second session of the audit and risk control committee held on 28 October 2008, the third quarterly report for the year 2008 was considered and approved.
- At the seventh meeting of the second session of the audit and risk control committee held on 3 December 2008, a resolution in respect of the relevant matters relating to fuel hedging was considered and approved.
- The annual report as of 31 December 2008 of the Company was reviewed by the audit and risk control committee.

Deviation: Nil

# Corporate Governance Report

## ***The responsibility of the directors in relation to the financial statements***

The Company prepares and publishes annual reports, interim reports and quarterly reports each year. The responsibilities of the directors in relation to the financial statements are set out below and shall be read together with the Independent Auditors' Report set out on page 55 to page 56.

- *Annual reports and accounts*

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

- *Accounting policy*

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

- *Accounting records*

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

- *Ongoing operation*

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

The statement of reporting responsibility of the auditors is set out in the Independent Auditors' Report on page 55 to page 56.

## ***Auditors' Remuneration***

The international and domestic auditors of the Company are Ernst & Young and Ernst & Young Hua Ming respectively. Breakdown of the remuneration to the Company's external auditors for audit service provided and non-audit service assignments for the year ended 31 December 2008 are as follows:

- *Audit Services*

An aggregate amount of approximately RMB13,789,120 was mainly charged for the review of the Group's consolidated financial statements for the six months ended 30 June 2008, the audit of the Group's consolidated financial statements for the year ended 31 December 2008 and the audits of the financial statements of certain subsidiaries of the Group for the year ended 31 December 2008.

- *Non-audit Service Assignments*

An aggregate amount of approximately RMB1,654,890 was mainly charged for the agreed-upon procedures performed on the Group's internal control.

# Corporate Governance Report

## D. Delegation by the Board

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

- The articles of association of the Company has provided for the authorities and authorisations of the Board and the president, details of which are set out in the Rules and Procedure for Board Meetings and Rules and Procedures for Senior Management Meetings.
- The primary duties of the audit and risk control committee are to propose the engagement or change of external auditors, review and supervise our internal auditing system and its implementation, be responsible for the communication between the internal auditors and external auditors, review the Company's financial information and the relevant disclosure, review the Company's internal control system, and other duties authorized by the Board.
- The primary duties of the nomination and remuneration committee are to nominate candidates for director vacancies, recommend to our Board regarding the compensation of directors. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management.
- The primary duties of the strategy and investment committee are to analyse and identify our development strategy and to decide on matters related to our investment as authorised by the Board. As at 31 December 2008, the current members of the strategy and investment committee were Mr. Kong Dong, Mr. Wang Shixiang and Mr. Cai Jianjiang, with Mr. Cai Jianjiang as the chairman of such committee.
- The Company has established an aviation safety committee with Mr. Wang Shixiang and Mr. Cai Jianjiang as its members and Mr. Wang Shixiang as the chairman of such committee as at 31 December 2008.

The supervisory committee is responsible for monitoring our financial matters and supervising the conduct of our Board and the management. The functions and authority of the supervisory committee include: reviewing the financial reports and other financial information prepared by the Board and proposed to be tabled before the shareholders' general meeting, as well as supervising the work of the directors, President, Vice President and other senior personnel so as to prevent the abuse of power or conduct detrimental to the Company's interests. The current members of the supervisory committee are Mr. Sun Yude, Mr. He Chaofan, Mr. Zhou Guoyou, Mr. Liu Feng and Mr. Liu Guoqing, with Mr. Sun Yude acting as the chairman. In the event that any director has conflict of interests with the Company, a supervisor may negotiate with the director concerned or bring the case to court on behalf of the Company. Resolution of meetings of the supervisory committee will be passed by at least two-thirds of all supervisors.

Deviation: Nil



# Corporate Governance Report

## E. Communications of the Company

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

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

Deviation: Nil

# Report of the Directors

The Board of the Company hereby presents this report and the audited consolidated financial statements of the Company and the Group for the year ended 31 December 2008 to all the shareholders.

## GROUP ACTIVITIES AND RESULTS

The Group is a provider of air passenger, air cargo and airline-related services. The results of the Group for the year ended 31 December 2008 and the financial positions of the Company and the Group as at the same date are set out in the audited financial statements on pages 57 to 152 of this annual report.

## FIVE-YEAR FINANCIAL HIGHLIGHTS

The summary of the Group's published results, assets, liabilities and minority interest under International Financial Reporting Standards for the five years ended 31 December 2008 are set out under the section headed "Summary of Financial Information" on page 3 of this annual report.

## SHARE CAPITAL

As at 31 December 2008, the total share capital of the Company was RMB12,251,362,273, divided into 12,251,362,273 shares with a par value of RMB1.00 each. The following table sets out the share capital structure of the Company as at 31 December 2008:

Category of Shares	Number of shares	Percentage of the total share capital
A Shares	7,845,678,909	64.04%
H shares	4,405,683,364	35.96%
Total	12,251,362,273	100%

# Report of the Directors

## SIGNIFICANT INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 31 December 2008, to the knowledge of the Directors, Supervisors and Chief Executives of the Company, the interests and short positions of the following persons (other than a Director, Supervisor or Chief Executive of the Company) who have an interest or short position in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company pursuant to the Securities and Futures Ordinance (the "SFO"), or who are, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any members of the Group are as follows:

Name	Type of interests	Type and number of shares of the Company concerned	Percentage of the total issued shares of the Company	Percentage of the total issued A shares of the Company	Percentage of the total issued H shares of the Company	Short position
China National Aviation Holding Company ("CNAHC")	Beneficial owner	4,949,066,567 A shares	40.40%	63.08%	–	–
CNAHC <sup>(1)</sup>	Attributable interests	1,380,482,920 A shares	11.26%	17.60%	–	–
CNAHC <sup>(1)</sup>	Attributable interests	66,852,000 H shares	0.55%	–	1.52%	–
China National Aviation Corporation (Group) Limited ("CNACG")	Beneficial owner	1,380,482,920 A shares	11.26%	17.60%	–	–
CNACG	Beneficial owner	66,852,000 H shares	0.55%	–	1.52%	–
Cathay Pacific	Beneficial owner	2,217,617,455 H shares	18.10%	–	50.34%	–
Swire Pacific Limited <sup>(2)</sup>	Attributable interests	2,217,617,455 H shares	18.10%	–	50.34%	–
John Swire & Sons Limited <sup>(2)</sup>	Attributable interests	2,217,617,455 H shares	18.10%	–	50.34%	–
John Swire & Sons (H.K.) Limited <sup>(2)</sup>	Attributable interests	2,217,617,455 H shares	18.10%	–	50.34%	–

### Notes:

Based on the information available to the Directors, chief executive and Supervisors of the Company (including such information as was available on the website of the Stock Exchange) and so far as the Directors, chief executive and Supervisors are aware, as at the Latest Practicable Date (31 December 2008):

- (1). By virtue of CNAHC's 100% interest in CNACG, CNAHC is deemed to be interested in the 1,380,482,920 A Shares and 66,852,000 H shares of the Company directly held by CNACG.
- (2). By virtue of John Swire & Sons Limited's 100% interest in John Swire & Sons (H.K.) Limited and their approximately 38.15% equity interest and 56.52% voting rights in Swire Pacific Limited, and Swire Pacific Limited's approximately 39.98% equity interest in Cathay Pacific as at 31 December 2008, John Swire & Sons Limited, John Swire & Sons (H.K.) Limited and Swire Pacific Limited are deemed to be interested in the 2,217,617,455 H shares of the Company directly held by Cathay Pacific.

# Report of the Directors

Save as disclosed above, as at 31 December 2008, to the knowledge of the Directors, chief executive and Supervisors of the Company, no other person (other than a Director, Supervisor or chief executive of the Company) had an interest or short position in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company pursuant to the SFO, or otherwise was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company.

## PUBLIC FLOAT

Pursuant to public information available to the Company and to the best knowledge of the Directors of the Company, the Company has maintained a public float as required by the Listing Rules and agreed by the Stock Exchange throughout the current reporting period.

## DIVIDEND

The Board does not recommend the payment of final dividend for the year ended 31 December 2008. The relevant resolution will be submitted to the Company for consideration at the 2008 shareholders' annual general meeting.

## TAXATION ON DIVIDEND

Pursuant to the Circular on Issues Concerning Tax on Profits Earned by Enterprise with Foreign Investment, Foreign Enterprises and Individual Foreigners from the Transfer of Stocks (Stock Rights) and on Dividend Income (《關於外商投資企業、外國企業和外籍個人取得股票(股權)轉讓收益和股息所得稅收問題的通知》) promulgated by the State Administration of Taxation of the PRC (Guo Shui Fa [1993] No. 045), individual foreigners who are holders of H shares are temporarily exempted from paying an individual income tax on their gains from dividends (bonuses) distributed by H shares issuers that are PRC domestic enterprises.

Pursuant to the Circular on Issues Concerning Withholding the Enterprise Income Tax on the Dividends Paid by Chinese Resident Enterprises to Holders of H Shares which Are Overseas Non-resident Enterprises (《關於中國居民企業境外H股非居民企業股東派發股息代扣代繳企業所得稅有關問題的通知》) promulgated by the State Administration of Taxation of the PRC (Guo Shui Han [2008] No. 897), when a PRC resident enterprise distributes dividends for the year of 2008 and for the years afterwards to holders of its H shares who are overseas non-resident enterprises, it shall withhold the enterprise income tax thereon at a uniform rate of 10%. After receiving the dividends, the non-resident enterprise shareholder may apply for a tax refund in accordance with the relevant provisions of the tax treaties (arrangements). Shareholders are advised to consult with their tax advisers in connection with the tax implication in the PRC, Hong Kong and elsewhere arising from the ownership and disposal of H shares.

## PURCHASES, SALES AND REDEMPTION OF SHARES

During the year ended 31 December 2008, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's securities. For this purpose, the term "securities" has the meaning ascribed to it under the Listing Rules.

## PRE-EMPTIVE RIGHTS

None of the articles of association of the Company provide for any pre-emptive rights requiring the Company to offer new shares to existing shareholders in proportion to their existing shareholdings.

# Report of the Directors

## DIRECTORS AND SUPERVISORS OF THE COMPANY

### Directors

Name	Age	Position in the Company	Date of Appointment and if applicable, Resignation as Director
Kong Dong	60	Chairman and non-executive director	Appointed on 30 October 2007
Wang Yinxiang	53	Vice chairman and non-executive director	Appointed on 9 October 2008
Wang Shixiang	59	Vice chairman and non-executive director	Appointed on 30 October 2007
Yao Weiting	61	Non-executive director	Appointed on 30 October 2007 Resigned on 12 August 2008
Ma Xulun	44	Non-executive director	Appointed on 30 October 2007 Resigned on 22 December 2008
Christopher Dale Pratt	52	Non-executive director	Appointed on 30 October 2007
Chen Nan Lok, Philip	53	Non-executive director	Appointed on 30 October 2007
Cai Jianjiang	45	Executive director and president	Appointed on 30 October 2007
Fan Cheng	53	Executive director and vice president	Appointed on 30 October 2007
Hu Hung Lick, Henry	89	Independent non-executive director	Appointed on 30 October 2007
Wu Zhipan	52	Independent non-executive director	Appointed on 30 October 2007
Zhang Ke	55	Independent non-executive director	Appointed on 30 October 2007
Jia Kang	54	Independent non-executive director	Appointed on 30 October 2007

### Supervisors

Name	Age	Position in the Company	Date of Appointment and if applicable, Resignation as Supervisor
Sun Yude	54	Chairman of Supervisory Committee	Appointed on 30 October 2007
Liao Wei	44	Supervisor	Appointed on 30 October 2007 Resigned on 22 December 2008
He Chaofan	47	Supervisor	Appointed on 22 December 2008
Zhou Guoyou	57	Supervisor	Appointed on 30 October 2007
Liu Feng	50	Supervisor	Appointed on 30 October 2007
Liu Guoqing	46	Supervisor	Appointed on 30 October 2007

## INDEPENDENCE OF THE INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has confirmed its receipt of, from each of the independent non-executive directors of the Company, a confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive directors to be independent.

## BOARD COMMITTEES

The Board committees include the audit and risk control committee, nomination and remuneration committee, strategy and investment committee and aviation safety committee. The composition of each committee is set out in the "Corporate Governance Report" in this annual report.

## DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 31 December 2008, none of the Directors or Supervisors of the Company has interests or short positions in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which have been taken or deemed to be taken under such provisions of the SFO), or recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or which were notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Issuers.

# Report of the Directors

## REMUNERATION OF DIRECTORS AND SUPERVISORS

Details of the remuneration of directors and supervisors are set out in note 10 to the financial statements.

## INTERESTS OF DIRECTORS AND SUPERVISORS IN CONTRACTS AND SERVICE CONTRACTS

Each of the Directors has entered into a service contract with the Company. All Directors of the Company shall serve a term of three years only.

None of the Directors has any existing or proposed service contract with any member of the Group which is not expiring or terminable by the Group within one year without payment of compensation (other than statutory compensation).

None of the Directors or Supervisors of the Company is materially interested in any contract or arrangement subsisting as at 31 December 2008 and which is significant in relation to the business of the Group.

Mr. Christopher Dale Pratt is a non-executive director of the Company and is concurrently the chairman and executive director of Cathay Pacific. Mr. Chen Nan Lok, Philip is a non-executive director of the Company and is concurrently the vice chairman and non-executive director of Cathay Pacific. Cathay Pacific is a substantial shareholder of the Company and wholly owns Dragonair. Cathay Pacific and Dragonair compete or are likely to compete either directly or indirectly with some aspects of the business of the Company as they operate airline services to certain destinations, which are also served by the Company.

Save as above, none of the Directors or Supervisors of the Company and their respective associates (as defined in the Listing Rules) has any competing interests which would be required to be disclosed under Rule 8.10 of the Listing Rules if each of them were a controlling shareholder of the Company.

## CONVENTION OF BOARD MEETINGS AND COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company held 18 Board meetings during the year 2008. The Company has been improving its corporate governance structure since listing. The Board is committed to conducting normative operations to protect the interests of the Company and its shareholders. The Directors of the Company are of the opinion that as of 31 December 2008 the Company has refined its internal corporate governance structure in compliance with the requirements set out in the Code on Corporate Governance Practices in Appendix 14 to the Listing Rules then in effect.

# Report of the Directors

## EMPLOYEES

As at 31 December 2008, the Company had 20,494 employees and its subsidiaries and joint ventures had 12,270 employees. The categories of employees of the Company are as follows:

*Unit: Person*

<b>Professional Categories</b>	<b>Number of Employee</b>
Marketing and Sales	2,235
Operation	1,044
Ground Handling	1,867
Cabin Service	2,209
Logistics and Support	1,439
Flight Crew	2,614
Engineering and Maintenance	2,610
Management	5,380
Information Technology	273
Others	823
<b>Total</b>	<b>20,494</b>

*Note:* In 2008, the Company completed its reorganization such that the job positions were redefined accordingly. Therefore, the professional categories and numbers of employees shown in the above table may not completely correspond to those set forth in the 2007 annual report.

## COMPENSATION POLICY

In order to implement the Company's strategies and to incentivise its employees, the Board of the Company approved, upon consideration, the proposal relating to the welfare reform on the remuneration of the ground crew, flight attendants, safety officers and air police officers and the proposal relating to revising the welfare system applicable to flight crew. Accordingly, the welfare reform on the remuneration of the ground crew, flight attendants, safety officers and air police officers was implemented from 1 July 2007 and the welfare system applicable to flight crew (as revised) came into force on 1 March 2008.

## EMPLOYEES AND EMPLOYEES' PENSION SCHEME

288 employees of the Company retired in 2008. These retired employees are entitled to benefits under the social pension scheme approved and provided by the labour and social security authority of the local government. Details of the staff pension scheme and other welfare are set out in note 11 to the audited financial statements.

## SHARE APPRECIATION RIGHTS

The Directors and Senior Management Stock Appreciation Rights Handbook of the Company was considered and approved on the general meeting held on 28 December 2006. The First Phase Stock Appreciation Rights Scheme was implemented by the Company on 15 June 2007 under which a total of 14.94 million shares were granted and the lock-up period would expire on 15 June 2009. Details of the Share Appreciation Rights Scheme are set out in note 46 to the audited financial statements.

## SUBSIDIARIES AND ASSOCIATED COMPANIES

Details of the subsidiaries and associates of the Company as at 31 December 2008 are set out respectively in notes 20 and 22 to the audited financial statements.

# Report of the Directors

## BANK AND OTHER BORROWINGS

Details of the bank loans, other loans and corporate bonds of the Company and the Group are set out in note 38 to the audited financial statements.

## FIXED ASSETS

Change in the fixed assets of the Group for the year ended 31 December 2008 are set out in note 16 to the audited financial statements.

## CAPITALISED INTERESTS

Details of the capitalised interests of the Group for the year ended 31 December 2008 are set out in note 8 to the audited financial statements.

## RESERVES

Change in the reserves of the Company and the Group during the year are set out in note 45 to the audited financial statements and the Consolidated Statement of Changes in Equity.

## DONATIONS

For the year ended 31 December 2008, the Company made donations for charitable and other purposes amounting to RMB123 million.

## MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2008, the purchases from the largest supplier accounted for 27.51% of the total purchases of the Group, while purchases from the five largest suppliers accounted for 51.55%. None of the directors or supervisors of the Company, their associates, nor any shareholder, who to the knowledge of the directors own 5% or more of the Company's share capital, had any interest in the five largest suppliers of the Company.

For the year ended 31 December 2008, the sales of the Group to the five largest customers accounted for not more than 30% of the total sales of the Group.

## PROPERTY TITLE CERTIFICATE

The Company effected changes of titles of assets e.g. land use rights, buildings and vehicles, in accordance with its undertakings as disclosed in the Company's prospectus. The title transfer procedures for the land use rights and buildings of the Company's headquarters and branches have been substantially completed. The Company is in the process of completing the outstanding formalities in this respect, which should not have any material adverse effect on the operation of the Company.

## MATERIAL LEGAL PROCEEDINGS

As at 31 December 2008, save as disclosed in note 50 to the audited financial statements, the Company was not involved in any significant litigation or arbitration. To the knowledge of the Company, there was no litigation or claim of material importance pending or threatened or initiated against the Company.



# Report of the Directors

## CONNECTED TRANSACTIONS

The Group has entered into a number of transactions on a continuing basis with CNAHC and its associates (as defined under the Listing Rules) (for the purpose of this section "Report of the Directors", "**CNAHC Group**") and other connected persons of the Group. Description of the agreements is set out in the Company's circular dated 1 December 2006, the Company's announcement on 26 June 2008 and the Company's announcement on 26 August 2008. Details of those connected transactions conducted in 2008, which are not exempt under Rule 14A.33 of the Listing Rules, are as follows:

### I. Continuing Connected Transactions Between the Group and CNAHC Group

#### *Construction Project Management Services*

The Company entered into a construction project management agreement (the "**Construction Project Management Agreement**") and a supplemental agreement thereto with China National Aviation Construction and Development Company ("**CNACD**"), a wholly-owned subsidiary of CNAHC, on 1 November 2004 and on 10 November 2006, respectively.

Pursuant to these agreement:

- CNACD will provide the Company project management services on projects involving the construction of any property or industrial plant/facility with budgeted costs of RMB20.0 million or above;
- in return for its project management services, the Company shall pay CNACD a fee of up to 2% of the construction budget if the total budget of the project is RMB1 billion or more, and up to 2.5% if the total amount of the project is below RMB1 billion;
- if the actual settlement price of the project managed by CNACD is higher than the total budget of the project agreed upon in the contract, CNACD will pay the Company the difference between the actual settlement price and the total budget of the project agreed upon in the contract, unless the difference is caused by (i) a change of government policies; (ii) factors attributed to the Company; or (iii) force majeure; and
- if CNACD acquires land relating to a project on the Company's behalf, the Company will pay CNACD an agency fee of up to 2% of all the fees and expenses in relation to the land acquisition (including, among other things, land acquisition fee, formality fee, labour expenses and travelling expenses, but excluding land premium).

The Construction Project Management Agreement expired on 31 December 2006. As provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

# Report of the Directors

## Properties Leasing

The Company entered into a properties leasing framework agreement (the “**Properties Leasing Framework Agreement**”) and two supplemental agreements thereto with CNAHC on 1 November 2004, 10 November 2006, and 26 August 2008 respectively.

Pursuant to these agreements, the Company will lease from CNAHC 16 properties with an aggregate gross floor area of approximately 59,318.88 sq.m. for various uses including as business premises, offices and storage facilities. The Company will also lease to CNAHC Group 6 properties covering an aggregate gross floor area of approximately 7,996.55 sq.m. for various uses including as business premises and offices. The rent payable under these agreements currently is, and will continue to be, determined in accordance with the relevant PRC laws and regulations or market rates. In principle, the annual increment of the rent will not exceed 5%.

The Properties Leasing Framework Agreement expired on 31 December 2006. As provided in its supplemental agreement dated 10 November 2006, among others, its term has been extended to 31 December 2009.

In the supplemental agreement dated 26 August 2008, the annual caps for continuing connected transactions under the Properties Leasing Framework Agreement for the years ended 31 December 2008 and 2009 were revised. For reasons for revising the annual caps, please refer to the Company’s announcement dated 26 August 2008. The following table sets out the revised annual caps:

Transaction	Historical Annual Transaction Amount for the Year Ended	Original Annual Caps		Revised Annual Caps	
	31 December 2007	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009
Rent to be paid by the Group to CNAHC Group under the Properties Leasing Framework Agreement	RMB53 million	RMB60 million	RMB70 million	RMB85 million	RMB95 million

## Tourism Co-operation Services

The Company entered into a tourism services cooperation agreement (the “**Tourism Cooperation Agreement**”) and a supplemental agreement thereto with China National Aviation Tourism Company (“**CNATC**”) on 1 November 2004 and on 10 November 2006 respectively.

Pursuant to these agreement, the Company has agreed to provide the following services to CNATC:

- Commercial charter flight services: the Company will provide charter (including charter flight route) services to customers procured by CNATC at market rates.
- Package tours co-operation services: the Company and CNATC will sell package tours combining (i) the Company’s airline tickets with (ii) accommodation at hotels owned and operated by CNATC. For the airline tickets in such packages sold by CNATC, CNATC will pay the Company in accordance with the pricing principle under the “Sales Agency Framework Agreement” while the Company will pay CNATC for the hotel fee portion of the packages.
- Reciprocal frequent-flyer programme (“**FFP**”) co-operation services: CNATC will join the Company’s FFP under which our Companion Card members are encouraged to stay at CNATC’s hotels by receiving mileage credits for such stay. As consideration, CNATC will pay us the equivalent value represented by those mileage credits.

# Report of the Directors

Pursuant to the Tourism Cooperation Agreement, CNATC agreed to provide the following services to the Company:

- FFP co-operation services: Under the FFP, if our Companion Card members redeem their mileage credits for free, discounted or upgraded stay at CNATC's hotels, the Company will reimburse CNATC for such redemption at a price similar to our arrangements with other FFP partners.
- Hotel accommodation services: CNATC will provide hotel accommodation services to the Company's employees on duty and passengers affected by our flight delays or cancellations, for which services the Company will pay relevant fees to CNATC at group rates.
- Aviation tourist services with special features including but not limited to a newly launched service of ground transportation for passengers of two classes.

The Tourism Cooperation Agreement expired on 31 December 2006. As provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

## *Comprehensive Services*

The Company entered into a comprehensive services agreement (the "**Comprehensive Services Agreement**") and two supplemental agreements thereto with CNAHC on 1 November 2004, 10 November 2006 and 26 August 2008 respectively.

Pursuant to the Comprehensive Services Agreement and its supplemental agreement:

- CNAHC will provide the Company with various ancillary services, including but not limited to:
  - (i) catering service;
  - (ii) supply of various items for in-flight services;
  - (iii) manufacturing and repair of airline-related ground equipment and vehicles;
  - (iv) cabin decoration and equipment;
  - (v) passenger cabin and cargo cabin ancillary parts (including seats);
  - (vi) warehousing services;
  - (vii) in-flight articles cleaning services; and
  - (viii) printing of air tickets and other documents.
- The Company will provide certain welfare-logistics services to the retired employees of CNAHC and its subsidiaries.

The charges payable by the Company to CNAHC for the comprehensive services above shall be based on prevailing market rate or, if no prevailing market rate is available, fair and reasonable price determined after arm's length negotiation. The management charges payable by CNAHC to the Company for the welfare logistics services provided to its retired employees shall be settled at a rate of 4%. Such charges relating to retired employees shall be appropriated to the Company before the quarter for making such payment.

The Comprehensive Services Agreement expired on 31 December 2006. As provided in its supplemental agreement dated 10 November 2006, among others, its term has been extended to 31 December 2009.

# Report of the Directors

In the supplemental agreement dated 26 August 2008, the annual cap for continuing connected transactions under the Comprehensive Services Agreement for the years ended 31 December 2008 and 2009 were revised. For reasons for revising the annual caps, please refer to the Company's announcement dated 26 August 2008. The following table sets out the revised annual caps:

Transaction	Historical Annual Transaction Amount for the Year Ended	Original Annual Caps		Revised Annual Caps	
	31 December 2007	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009
Amount to be paid by the Group to CNAHC Group under the Comprehensive Services Agreement	RMB79 million	RMB90 million	RMB100 million	RMB650 million	RMB750 million

## *Line Maintenance and Other Ground Services*

The Company entered into a standard ground handling agreement (the "**Standard Ground Handling Agreement**") with China Aircraft Services Limited ("**CASL**"), a 40%-owned subsidiary of CNACG, on 17 April 2004, pursuant to which CASL shall provide line maintenance and other ground services to the Company at the Hong Kong International Airport. The services are charged at market rates.

The Standard Ground Handling Agreement was renewed in January 2006. All charges set out in the agreement shall remain unchanged for 12 months and shall continue thereafter unless both parties agree in writing to adjust the same.

## *Sales Agency Services for Airline Tickets and Cargo Space*

The Company entered into a sales agency framework agreement (the "**Sales Agency Services Framework Agreement**") and a supplemental agreement thereto with CNAHC on 1 November 2004 and on 10 November 2006, respectively.

Pursuant to these agreement, certain associates of CNAHC acting as the Company's sales agents will:

- purchase air tickets and cargo spaces from the Company at wholesale prices and resell such air tickets and cargo spaces to end-purchasers; or
- procure purchasers for the Company's air tickets and cargo spaces on a commission basis.

The Company will pay the relevant agency commission based on relevant PRC regulations or, where the regulations do not provide a specific commission, based on market rates. Currently, the commissions prescribed for sales of air tickets are as follows:

- for domestic routes, 3% of the ticket price;
- for Hong Kong and Macau routes, 7% of the ticket price; and
- for international routes, 9% of the ticket price.

In accordance with industry practice, and subject to applicable regulations, the Company may also offer incentives to sales agents for reaching certain ticket sale targets.

# Report of the Directors

The Sales Agency Services Framework Agreement expired on 31 December 2006. As provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

## *Financial Services*

The Company entered into a financial services agreement (the “**Financial Services Agreement**”) and a supplemental agreement thereto with China National Aviation Finance Co., Ltd. (“**CNAF**”), which is owned as to 74.89% by CNAHC and 19.31% by the Company, on 1 November 2004 and on 10 November 2006, respectively.

Pursuant to these agreement, CNAF has agreed to provide the Group with a range of financial services including the following:

- deposit services;
- loan and finance leasing services;
- negotiable instrument and letter of credit services;
- trust loan and trust investment services;
- underwriting services for debt issuances;
- intermediary and consulting services;
- guarantee services;
- settlement services;
- internet banking services; and
- any other services provided by CNAF under the approval of the China Banking Regulatory Commission (“**CBRC**”).

The fees and charges payable by the Group to CNAF under the Financial Services Agreement and its supplemental agreement are determined with reference to the applicable fees and charges specified by the People’s Bank of China (the “**PBOC**”) and the CBRC for the relevant services from time to time, and if neither the PBOC nor the CBRC has specified a fee or charge for a particular service, then the service will be provided by CNAF on terms no less favourable than terms available from commercial banks in China and than those offered by CNAF to other members of CNAHC Group.

The Financial Services Agreement expired on 31 December 2006. As provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

## *Subcontracting of Charter Flight Services*

The Company entered into a charter flight service framework agreement (the “**Charter Flight Service Framework Agreement**”) and a supplemental agreement thereto with CNAHC on 1 November 2004 and on 10 November 2006, respectively.

Pursuant to these agreement, CNAHC will subcontract to the Company its obligation of government charter flight that it undertakes from the PRC government. The Company’s hourly rate of the charter flight service fee will be calculated on the basis of the following formula that includes total cost and reasonable margins:

# Report of the Directors

Hourly rate = Total cost per flight hour x (1 + 6.5%)

Total cost includes all direct costs and indirect costs.

The Charter Flight Service Framework Agreement expired on 31 December 2006. As provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

## Media and Advertising Services

Reference is made to the section headed “DE MINIMIS CONTINUING CONNECTED TRANSACTIONS – 3.1 Media and Advertising Services” in the Company’s circular dated 1 December 2006 relating to the Advertising Services Framework Agreement, under which, among others, China National Aviation Media and Advertisement Co., Ltd., a wholly-owned subsidiary of CNAHC, (“**CNAMC**”) provides the Company with in-flight entertainment programmes it produces and bids for advertisement agency and design services to the Company (the “**Advertising Services Framework Agreement**”). The maximum annual amounts to be paid by the Company to CNAMC under the Advertising Services Framework Agreement for each of the three years ended 31 December 2007, 2008 and 2009 were expected to fall below the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules, therefore such transaction were exempted from the announcement and independent shareholders’ approval requirement for connected transactions.

In the supplemental agreement dated 26 August 2008, the annual caps for continuing connected transactions under the Advertising Services Framework Agreement for the years ended 31 December 2008 and 2009 were revised. For reasons for revising the annual caps, please refer to the Company’s announcement dated 26 August 2008. As each of the percentage ratios (other than the profits ratio) of the continuing connected transactions under the Advertising Services Framework Agreement with the annual caps revised as set out below is higher than 0.1% and less than 2.5%, such continuing connected transactions therefore fall under Rule 14A.34 of the Listing Rules. Accordingly, these continuing connected transactions are subject to the reporting and announcement requirements set out under Rules 14A.45 to 14A.47 of the Listing Rules, but are exempted from the requirements of independent shareholders’ approval under Chapter 14A of the Listing Rules. The following table sets out the revised annual caps:

Transaction	Historical Annual Transaction Amount for the Year Ended	Original Annual Caps		Revised Annual Caps	
	31 December 2007	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009	For the Year Ended 31 December 2008	For the Year Ended 31 December 2009
Amount to be paid by the Company to CNAMC under the Advertising Services Framework Agreement	RMB31.87 million	Below the de minimis threshold	Below the de minimis threshold	RMB60 million	RMB60 million

## II. Continuing Connected Transactions Between the Group and CNACG

Reference is made to the announcement dated 10 June 2008 issued by the Company in respect of a share transfer agreement entered into by China National Aviation Company Limited (“**CNAC**”), a wholly-owned subsidiary of the Company, and CNACG on 10 June 2008, by which CNAC, among others, transferred its 50% shareholding in Jardine Airport Services Limited (“**JASL**”) to CNACG (please refer to the Company’s announcement dated 10 June 2008 for details). As CNACG is both a substantial shareholder of the Company and a wholly-owned subsidiary of CNAHC, the Company’s controlling shareholder, upon the completion of the share transfer, JASL became an associate of CNACG and therefore a connected person of the Company under the Listing Rules. JASL has been providing the Company with ground handling services and engineering services. Such transactions will constitute continuing connected transactions of the Company under the Listing Rules.

# Report of the Directors

Other than the ground handling services, the Group and CNACG Group have cooperated in other aspects, including but not limited to the provision of catering services, management services, properties leasing service by CNACG Group to the Group. Since CNACG is the wholly-owned subsidiary of CNAHC, some continuing connected transactions such as catering and properties leasing shall be covered by the CNAHC Framework Agreements between the Company and CNAHC.

In part as a reflection of the abovementioned transactions and the expected increased cooperation between the Group and CNACG Group, the Company and CNACG entered into a Framework Agreement on 26 August 2008 in respect of relevant agreements between the Group and CNACG Group. The Framework Agreement applies to Transactions under relevant agreements in the three years ended on 31 December 2010.

The Transactions are transactions between members of the Group on the one hand and members of CNACG Group on the other hand relating to ground handling and engineering services, management services and other services and transactions as may be agreed by parties to be undertaken under the Framework Agreement **excluding** those which have been contemplated by the related CNAHC Framework Agreements.

The Framework Agreement applies to transactions undertaken pursuant to relevant agreements during the three years ended on 31 December 2010 and shall expire on that date. However, the Framework Agreement is renewable for successive periods of three years thereafter. The following table sets out the caps for continuing connected transactions under the Framework Agreement:

	2008 Cap	2009 Cap	2010 Cap
Annual Amount Paid by the Group to CNACG	RMB300 million	RMB300 million	RMB300 million

### III. Continuing Connected Transactions Between the Group and Cathay Pacific

Reference is made to the joint announcement dated 8 June 2006 issued by Air China and Cathay Pacific in respect of the operating agreement entered into between Air China and Cathay Pacific on 8 June 2006 (the “**Operating Agreement**”). The Operating Agreement provides for the parties to it to cooperate in various operational areas. That cooperation has developed since entry into the Operating Agreement. As a reflection of that cooperation, Air China and Cathay Pacific entered into a framework agreement (the “**Framework Agreement**”) on 26 June 2008 in respect of relevant agreements (“**Relevant Agreements**”) between Air China Group and Cathay Pacific and its subsidiary, including Dragonair (“**Cathay Pacific Group**”).

As Cathay Pacific is a substantial shareholder and therefore a connected person of Air China, the Transactions constitute continuing connected transactions for Air China under Rule 14A.14 of the Listing Rules and are subject to the reporting and announcement requirements under Rule 14A.35.

The Framework Agreement provides the framework under which Relevant Agreements between members of Air China Group on the one hand and members of Cathay Pacific Group on the other hand are entered into, renewed and extended. Relevant Agreements comprise the agreement dated 19 October 2007 between Air China, Cathay Pacific and Dragonair for the joint venture operation of passenger air transportation services between Hong Kong on the one hand and Beijing and certain other Mainland China destinations on the other hand, (the “**Joint Operating Services Agreement**”) and any other agreements between members of the Air China Group on one hand and members of the Cathay Pacific Group on the other hand in respect of the Transactions.

# Report of the Directors

The Transactions are transactions between members of Air China Group on the one hand and members of Cathay Pacific Group on the other hand arising from joint venture arrangements for the operation of passenger air transportation, code sharing arrangements, interline arrangements, aircraft leasing, frequent flyer programmes, the provision of airline catering, ground support and engineering services and other services agreed to be provided and other transactions agreed to be undertaken under the Framework Agreement.

The Framework Agreement applies to Transactions undertaken under Relevant Agreements during the three years ended on 31 December 2010 and shall expire on that date. However, the Framework Agreement shall be renewed for successive periods of three years thereafter unless either party to such agreement gives to the other notice of termination of not less than three months expiring on any 31 December.

The annual caps for the amounts payable by Cathay Pacific Group to Air China Group, and payable by Air China Group to Cathay Pacific Group, in respect of the Transactions for the 3 years ending 31 December 2010 are set out below.

Payable by Air China Group to Cathay Pacific Group:

(HK\$ million)	2008 Cap	2009 Cap	2010 Cap
Transactions	900	900	900

Payable by Cathay Pacific Group to Air China Group:

(HK\$ million)	2008 Cap	2009 Cap	2010 Cap
Transactions	900	900	900

#### IV. Continuing Connected Transactions between the Group and the Lufthansa Group

Deutsche Lufthansa AG ("**Lufthansa**") holds 40% equity interest in, and is a substantial shareholder of, Ameco, a joint venture of the Company, and is therefore a connected person of the Company under the Listing Rules.

The Company has entered into various transactions with Lufthansa and its associates (collectively, the "**Lufthansa Group**") in the ordinary course of its business, including, among others:

- Aircraft maintenance, repair and overhaul services ("**MRO**") provided by the Company to the Lufthansa Group;
- mutual provision of catering services;
- mutual provision of ground handling services in China and Germany;
- mutual provision of ticket sales agency services;
- airline codeshare arrangement under which the actual carrier's flights can be marketed under the airline designator code of the partner carrier and revenues earned from these arrangements are allocated between the parties based on negotiated terms according to airline industry standards;



# Report of the Directors

- special prorate arrangement under which a carrier agrees to accept passengers from another carrier and receive payment directly from that carrier; and
- other airline co-operation arrangements between the Lufthansa Group and the Company.

The above transactions have been entered into on normal commercial terms based on arm's length negotiations.

## V. Continuing Connected Transactions between the Group and the Beijing Capital Airports Group

Capital Airports Holding Company holds 24% equity interest in and is a substantial shareholder of Air China Cargo, and therefore is a connected person of the Company under the Listing Rules. The Company has entered into various transactions under various agreements with Beijing Capital Airports Group in the ordinary course of business. On 10 November 2006, the Company entered into a service framework agreement ("**Service Framework Agreement**") with Beijing Capital Airports Group for, including, among others:

- provision of taking-off/landing/parking services of the Company's aircraft at airports owned by the Beijing Capital Airports Group;
- provision of passengers' waiting lounge, check-in counters and office buildings to the Company by airports owned by the Beijing Capital Airports Group;
- provision of utilities (including water, gas and electricity) to the Company at Beijing Capital International Airport by the Beijing Capital Airports Group; and
- provision of ground handling services to the Company by the Beijing Capital Airports Group.

All the services provided by the Beijing Capital Airports Group to the Company are charged on the pricing terms which are prescribed, approved or recommended by PRC governmental authorities, and if there is no state-prescribed price, according to the relevant market prices.

The Service Framework Agreement is valid for three years from 1 January 2007 to 31 December 2009 and is renewable upon expiry.

# Report of the Directors

## VI. Transaction Caps and Actual Transaction Amounts in 2008

Actual transaction amounts and transaction caps of the above-mentioned continuing connected transactions during the year ended 31 December 2008 are as follows:

	Currency	Aggregate amount of transactions for the year ended 31 December 2008	
		Cap (in millions)	Actual Amount (in millions)
<b>Transactions with the CNAHC Group</b>			
Construction project management services	RMB	30.00	19.17
Properties leasing	RMB	85.00	70.75
Tourism co-operation services	RMB	69.04	29.09
Media and Advertising Services	RMB	60.00	20.36
Comprehensive services	RMB	650.00	369.98
Line maintenance and other ground services	RMB	50.00	21.86
Subcontracting of Charter Flight Services	RMB	812.00	453.27
Sales agency services			
Aggregate sales of airline tickets and cargo space to the CNAHC Group	RMB	408.00	192.59
Aggregate amount of commissions and incentives paid to CNAHC Group	RMB	75.60	8.31
Financial services			
Maximum daily outstanding deposits with CNAF	RMB	2,500.00	1,499.68
Maximum daily outstanding loans from CNAF	RMB	2,500.00	1,111.02
<b>Transactions with the CNACG Group</b>			
Aggregate amount paid by the Group to CNACG Group	RMB	300.00	88.98
<b>Transactions with the Lufthansa Group</b>			
Aggregate amount paid by the Company to the Lufthansa Group	RMB	900.00	549.45
Aggregate amount paid by the Lufthansa Group to the Company	RMB	687.70	567.97
<b>Transactions with the Beijing Capital Airports Group</b>			
Aggregate amount paid by the Company to the Beijing Capital Airports Group	RMB	1,190.00	1,156.65
<b>Transactions with Cathay Pacific Group</b>			
Aggregate amount paid by the Group to Cathay Pacific Group	HK\$	900.00	234.31
Aggregate amount paid by Cathay Pacific Group to the Group	HK\$	900.00	337.78

# Report of the Directors

## V. Confirmation from Independent Non-executive Directors

The Independent Non-Executive directors of the Company have confirmed that all connected transactions in the year ended 31 December 2008 to which the Company was a party have been entered into:

1. in the ordinary and usual course of business of the Company;
2. either:
  - (i) on normal commercial terms; or
  - (ii) where there was no comparable transactions to judge whether they were on normal commercial terms, on terms no less favourable to the Company than terms available to or from independent third parties, where applicable; and
3. in accordance with terms that were fair and reasonable and in the interests of the shareholders of the Company as a whole.

## VI. Confirmation from the Auditors

Ernst & Young, the auditors of the Company, has confirmed by a letter to the Board that the above connected transactions:

1. have been approved by the Board;
2. were conducted in accordance with the pricing policies as stated in the relevant agreements;
3. were entered into in accordance with the relevant agreements governing such transactions; and
4. have not exceeded the cap amounts disclosed in the Company's circular dated 1 December 2006 and the Company's announcements dated 26 June 2008 and 26 August 2008.

## CONTRACT OF SIGNIFICANCE

Save as disclosed in "Connected Transactions" of this report of Directors, none of the Company or any of its subsidiaries entered into any contract of significance with the controlling shareholder or any of its subsidiaries, and there is no contract of significance in relation to provision of services by the controlling shareholder or any of its subsidiaries to the Company or any of its subsidiaries. None of the shareholders entered into any arrangement to waive or agree to waive any dividend.

## AUDITORS

The Company appointed Ernst & Young and Ernst & Young Hua Ming as its international auditors and domestic auditors respectively for the year ended 31 December 2008. Ernst & Young has audited the attached financial statements prepared in accordance with International Financial Reporting Standards. The Company has retained Ernst & Young and Ernst & Young Hua Ming since the date of its listing. A resolution in respect of the reappointment of Ernst & Young and Ernst & Young Hua Ming as the Company's international and domestic auditors respectively for the year ended 31 December 2009 will be proposed at the forthcoming 2009 annual general meeting of the Company.

# Report of the Supervisory Committee

To all Shareholders,

The supervisory committee of the Company (the “**Supervisory Committee**”) has carried out its duties in accordance with the Company’s articles of association and relevant requirements in 2008. Members of the Supervisory Committee attended Board meetings, inspected relevant documents and conducted seminars, exercised effective supervision over the convening and decision-making process of Board meetings and the implementation of resolutions for compliance with the relevant laws and regulations and the Company’s articles of association, with the aim of safeguarding the interests of the Company and its shareholders as a whole.

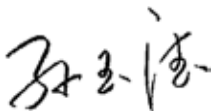
The Supervisory Committee is of the opinion that the decision-making process of the Company complied with the relevant laws and regulations, and the Company’s articles of association and was well-regulated. The directors and senior management of the Company observed their fiduciary duties and worked diligently and legally. The Supervisory Committee is not aware of any conduct of the directors and senior management of the Company in the course of discharging their duties which was in breach of the laws and regulations and the articles of association of the Company or against the interests of the Company.

The Supervisory Committee considers that the Company’s 2008 financial statements reflected a true and fair view of the financial position and financial performance of the Company, and the unqualified opinion expressed in the auditors’ report issued by Ernst & Young is objective and fair. The Supervisory Committee recognises the efforts made by the Company to ensure the stability of its core business despite the unfavorable market conditions in 2008. The Supervisory Committee hopes that the Company can strengthen its market control and cost control capability, improve the quality of its service, refine its risk control system, so as to ensure a stable development of its business operation and to improve its business results.

The Supervisory Committee is of the opinion that the connected transactions between the Company and its connected persons were conducted at fair market price without prejudice to the interests of the Company and its minority shareholders.

In 2009, the Supervisory Committee will continue to perform its duties of safeguarding the interests of the shareholders of the Company in strict adherence to the Company’s articles of associations and relevant requirements.

By Order of the Supervisory Committee



**Sun Yude**

*Chairman of the Supervisory Committee*

Beijing, PRC  
16 April, 2009

# Profile of Directors, Supervisors and Senior Management

As at the date of this Annual Report:

## DIRECTORS

**Mr. Kong Dong**, aged 60, graduated from Jiangxi Technology University majoring in mechanical engineering and is a senior economist. Mr. Kong was Deputy General Manager of China Ocean Helicopter Company, General Manager of Shenzhen Airport Group, Director-General in charge of the expansion project of the Beijing Capital International Airport, General Manager of China National Aviation Corporation and Chairman of CNAC, and Vice Chairman and President of CNACG. After the restructuring of China's civil aviation industry in October 2002, he joined CNAHC as Deputy General Manager. Mr. Kong was appointed as the acting Chairman in January 2008 and has served as Chairman of the Company and General Manager of CNAHC since April 2008.

**Ms. Wang Yinxiang**, aged 53, graduated from Party School of the Central Committee of C.P.C. majoring in economics and management. Ms. Wang is a senior engineer of political work and a senior flight attendant. Ms. Wang served several positions in Air China International Corporation, including Vice Captain of the in-flight service team of the Chief Flight Team, Deputy Manager of the in-flight service division, Deputy Manager of the passenger cabin service division and Deputy Secretary of the Communist Party Committee, etc. After the restructuring of China's civil aviation industry in October 2002, Ms. Wang served several positions in CNAHC, including Deputy General Manager, President of the Labor Union, Head of the Disciplinary and Supervisory Committee of the Communist Party Group and Secretary of the Communist Party Committee of CNAHC. Since March 2008, Ms. Wang has been serving as Secretary of the Communist Party Group, Deputy General Manager, President of the Labor Union and Secretary of the Communist Party Committee of CNAHC. Ms. Wang was appointed as Vice-Chairman of the Company in October 2008.

**Mr. Wang Shixiang**, aged 59, graduated from the China Civil Aviation Advanced School majoring in aviation and is a qualified First-Class Pilot. Mr. Wang was appointed as President of the Civil Aviation Flight Academy of China in 1995, and General Manager of China Southwest Airlines in 1999. After the restructuring of China's civil aviation industry in October 2002, he joined CNAHC as Deputy General Manager, a post he continues to hold. Mr. Wang has served as Vice-Chairman of the Company since September 2004.

**Mr. Christopher Dale Pratt**, aged 52, has been a non-executive director of the Company since June 2006. He is also Chairman of John Swire & Sons (H.K.) Limited, Swire Pacific Limited, Cathay Pacific Airways Limited, Hong Kong Aircraft Engineering Company Limited, and a director of Swire Properties Limited and The Hongkong and Shanghai Banking Corporation Limited. He joined John Swire & Sons Limited in 1978 and has worked with the Swire group in Hong Kong, Australia and Papua New Guinea. He has an honours degree in modern history from Oxford University.

**Mr. Chen Nan Lok, Philip**, aged 53, has been a non-executive director of the Company since June 2007. He is currently Chairman of John Swire & Sons (China) Limited, Deputy Chairman of Cathay Pacific Airways Limited, and a director of John Swire & Sons (H.K.) Limited, Swire Pacific Limited and Swire Properties Limited. He joined the Swire group in 1977 and in addition to Hong Kong, has worked with the Swire group in Mainland China and the Asia Pacific region. He holds an honours degree in political science and history from the University of Hong Kong.

**Mr. Cai Jianjiang**, aged 45, graduated from China Civil Aviation Institute majoring in aviation control. Mr. Cai was appointed as General Manager of Shenzhen Airlines Company Limited in 1999. He joined Air China International Corporation in 2001 as Manager of its Shanghai Branch, and subsequently as Assistant to the President and Manager of the Marketing Department. After the restructuring of China's civil aviation industry in October 2002, he was appointed as Vice President of Air China International Corporation, and subsequently was appointed as Vice President of the Company in September 2004. He has served as the President of the Company since February 2007.

**Mr. Fan Cheng**, aged 53, graduated from Nanjing Institute of Chemistry and Chemical Engineering with a major in organic fertilizer and graduated from Guanghua School of Management, Peking University in 2000 with an MBA degree. Mr. Fan is a senior accountant, senior engineer and Certified Public Accountant. Mr. Fan was appointed as Deputy General Manager of China New Technology Venture Capital Company in 1996. He started his career in China's civil aviation industry in 2001, and served as General Manager of the corporate management department and capital management department of CNAHC from October 2002 to October 2004. He has been the Chief Financial Officer of the Company since September 2004. Since October 2006, he has been serving as the Vice President of the Company.

# Profile of Directors, Supervisors and Senior Management

**Dr. Hu Hung Lick, Henry**, aged 89, is an independent non-executive director of the Company and is also currently the president of Shue Yan University in Hong Kong. He graduated from the University of Paris with a Docteur-en-Droit degree. Dr. Hu was a member of Preparatory Committee and Selection Committee for the First Government of the Hong Kong Special Administrative Region, China, and was a member of the Standing Committee of the 8th and 9th sessions of the Chinese People's Political Consultative Conference.

**Mr. Wu Zhipan**, aged 52, an independent non-executive director of the Company, obtained a Bachelor's degree, then a Master's degree and a Doctor's degree in Law from School of Law, Peking University, in 1982, 1985 and 1988 respectively. He was a visiting scholar at Harvard Law School from 1991 to 1992. Mr. Wu is currently the Vice Chancellor of Peking University. He is also an expert consultant of the Supreme People's Court of China and Consultant of the Drafting Group of the Banking Law in China etc.. Mr. Wu is also an independent non-executive director of China Minsheng Banking Corp., Ltd., and Fortune SGAM Fund Management Co., Ltd., and an independent supervisor of PetroChina Company Limited.

**Mr. Zhang Ke**, aged 55, an independent non-executive director of the Company, graduated from Renmin University of China in 1982 with a Bachelor's degree of economics. He is a certified public accountant and senior accountant. Mr. Zhang is currently Chairman and chief partner of Shine Wing Certified Public Accountants. Mr. Zhang is also the Vice Chairman of the Standing Council of CICPA, the Vice Chairman of Beijing Association of Forensic Science and a member of CPA Examination Committee of the Ministry of Finance.

**Mr. Jia Kang**, aged 54, an independent non-executive director of the Company, holds a Doctor's degree in Economics, and is a renowned economist and a member of CPPCC National Committee. He is a researcher, a tutor to doctorate students and the head of Financial Science Research Institute of Ministry of Finance, and also the vice chairman and general-secretary of China Financial Association. Mr. Jia is also a specially engaged professor of Renmin University of China, State Administration Institute, Xiamen University, Southwest University of Finance and Economics, Guangdong University of Business Studies and other Universities. Mr. Jia is also the winner of Sun Zhifang Economics Prize.

## SUPERVISORS

**Mr. Sun Yude**, aged 54, graduated from China Civil Aviation Institute majoring in economic management. He started his career in China's civil aviation industry in 1972 and served as Deputy Head of CAAC Taiyuan Terminal and Head of Ningbo Terminal, as well as General Manager of CNAC Zhejiang Airlines. After the restructuring of China's civil aviation industry in October 2002, Mr. Sun joined Air China International Corporation as Vice President and General Manager of Zhejiang branch, and was appointed as Vice President of the Company in September 2004. Mr. Sun was appointed as Chairman and President of Shandong Aviation Group in December 2005, and he has been serving as President of CNAIC since March 2007.

**Mr. He Chaofan**, aged 47, a senior accountant, graduated from the Civil Aviation University of China majoring in civil aviation planning and finance. Mr. He served as an accountant at the Beijing Administrative Bureau of Civil Aviation Administration of China, and served in various positions in Air China International Corporation including that of an accountant, section chief, deputy head and head of the finance department and director and general manager of the revenue accounting department of Air China International Corporation. From March 2003 to October 2008, he served as the general manager and deputy party secretary of China National Aviation Finance Co., Ltd.. He was appointed the general manager of the finance department of CNAHC in October 2008. He has been serving as a Supervisor of the Company since December 2008.

**Mr. Zhou Guoyou**, aged 57, graduated from the Party School of the Central Committee of C.P.C majoring in economics and management and is a senior economist. Mr. Zhou started his career in China's civil aviation industry in 1970 and served in various positions in the Company such as Deputy Director of Beijing ticketing department, Manager of the Shanghai business division, General Manager of the marketing and sale department of Beijing business division, Deputy Director of quality standard department and Deputy Director of the economic efficiency office. Mr. Zhou was appointed as Deputy General Manager of the corporate supervision division of CNAHC in February 2004. He has been serving as Deputy General Manager of the legal supervision division of CNAHC since October 2008.

**Mr. Liu Feng**, aged 50, is the representative of the employees on the Supervisory Committee. Mr. Liu graduated from the Party School of the Central Committee of C.P.C. He joined Air China International Corporation in 1992 as Secretary to the Labour Union. He was appointed as the Deputy Director of the Labour Union Office of Air China International Corporation in December 1995. From June 2007 to January 2009, he was the Deputy Director of the Labour Union of the Company. He was appointed as the Deputy Secretary of the Company's Shanghai branch in January 2009.

# Profile of Directors, Supervisors and Senior Management

**Mr. Liu Guoqing**, aged 46, is the representative of the employees on the Supervisory Committee. He graduated from the Beijing University of Technology majoring in automation in July 1984, and served as an assistant economist. He joined Air China International Corporation in December 1988 and worked in its Beijing ticketing and seat reservation centre until 1994, when he was transferred to the marketing department and market development department where he has since served.

## OTHER SENIOR MANAGEMENT PERSONNEL

**Mr. Tan Zhihong**, aged 58, graduated from Sichuan International Studies University majoring in English. In August 1975, he joined the Beijing Administrative Bureau of CAAC. From April 1981 to September 1985, he worked at the London office of CAAC as the commercial officer and from September 1985 to March 1988, he served as the Deputy Director of the international passengers office of the passengers transportation department of the transportation division, and the Director of the scheduling and distribution division, of the Beijing Administrative Bureau of CAAC. From March 1988 to August 1998, he served in various positions such as Deputy Manager and Manager of Air China Transportation Services Company, Director of the passengers transportation division as well as the General Manager of the ground services department of Air China International Corporation. From August 1998 to September 2004, he was the General Manager of the Inner Mongolia Branch and Tianjin Branch of Air China International Corporation respectively. He was appointed as General Manager of Southwest Branch of the Company in September 2004. Mr. Tan has been serving as Vice President of the Company since February 2007.

**Mr. Song Zhiyong**, aged 43, graduated from the Second Flying Academy of China Air Force majoring in aviation. Mr. Song started his career in the China's civil aviation industry in 1987 and was previously the pilot of the Third Group of the Chief Flight Team, Deputy Captain of the Chief Flight Team and Director of the Training Department of Air China International Corporation. In September 2004, Mr. Song was appointed as the Assistant to President and Chief Captain of the Chief Flight Team of the Company. Mr. Song was appointed as Chief Captain of the Chief Flight Team of the Company in October 2006 and no longer serves as the Chief Captain of the Chief Flight Team as of June 2008. Mr. Song has been serving as Vice President of the Company since October 2006.

**Mr. He Li**, aged 57, holds a Master degree in Business Administration from China-Euro Management Institute. Mr. He started his career in the China's civil aviation industry in 1973 and was previously an engineer of Beijing Administrative Bureau of CAAC and General Manager of Aircraft Maintenance and Engineering Corporation, Beijing. In November 2005, Mr. He was appointed as General Manager of the Engineering Technology Branch of the Company. Mr. He has been serving as Vice President of the Company since October 2006.

**Ms. Yang Lihua**, aged 53, graduated from Beijing Languages University majoring in French, and is a senior flight attendant. She started her career in China's civil aviation industry in 1973 and had served in Air China International Corporation as Manager of the cabin service department, Deputy Chief of the Chief Flight Team, and as General Manager of the passenger service department. Ms. Yang was appointed as Vice President of Air China International Corporation after the restructuring of China's civil aviation industry in October 2002, and has been serving as Vice President of the Company since September 2004.

**Mr. Li Huxiao**, aged 58, graduated from Beijing Communist Party School and is a senior engineer of political work. From July 1990 to November 2001, he served in various positions, such as Deputy General Manager and General Manager of the Inner Mongolia Branch of Air China International Corporation. He was the Deputy General Manager of the cargo branch of Air China International Corporation from November 2001 to October 2003 and was the Deputy General Manager of Air China Cargo from October 2003 to September 2004. Mr. Li has been serving as Chairman of Air China Cargo since June 2006 and as Vice President of the Company since July 2007.

**Ms. Zhang Lan**, aged 53, graduated from Beijing Foreign Studies University majoring in English. She started her career in the China's civil aviation industry in 1977 and had been seconded to work in various places including the United States and Switzerland. Ms. Zhang joined Air China International Corporation in 1988 and served in various positions, including General Manager of the Sales and Marketing Department. In September 2004, Ms. Zhang was appointed as the Assistant to President and Director of the Commercial Committee of the Company. In October 2006, Ms. Zhang was appointed as Vice President of the Company and Director of the Commercial Committee of the Company. As of July 2008, Ms. Zhang Lan has been serving as Vice President of the Company and no longer serves as the Director of the Commercial Committee.

# Profile of Directors, Supervisors and Senior Management

**Mr. Xu Chuanyu**, aged 44, graduated from China Civil Aviation Institution with a major in aviation and is a Second-Class Pilot. Mr. Xu previous appointments include serving as a pilot, Deputy Chief and Captain of the Third Group of the Chief Flight Team and as an inspector in the Safety Supervisory Office. In December 2001, Mr. Xu was appointed as the Deputy Captain of the Chief Flight Team of Air China International Corporation. In March 2006, Mr. Xu was appointed as the General Manager of the Tianjin branch of the Company. Mr. Xu has been serving as the Chief Pilot of the Company since January 2009.

**Mr. Huang Bin**, aged 45, graduated from China Civil Aviation Institution in 1983 with a major in financial planning. From 1998 to 2000, he studied Management and Engineering in Naning University of Aeronautics and Astronautics. He is a senior accountant. Mr. Huang started his career in the civil aviation industry in 1983 and served in various positions including Section Chief, Deputy Director, Director and General Manager of the Finance Department of Air China International Corporation. In October 2002, Mr. Huang was appointed as Deputy General Manager and Chief Accountant of the Southwest branch of Air China International Corporation. In September 2004, he was appointed as Deputy General Manager and Chief Accountant of Southwest branch of the Company. He has been serving as the Secretary of the Board since June 2007.

## JOINT COMPANY SECRETARIES

**Mr. Huang Bin**, his biographical details are set out in the section headed "Other Senior Management Personnel" above.

**Ms. Tam Shuit Mui**, aged 38, is ordinarily resident in Hong Kong and studied in the Hong Kong Polytechnic University from 1993 to 1995 with a Higher Certificate in Accountancy for Year 1 & 2 and graduated from the State University of New York at Buffalo, USA in 1998 with a Bachelor of Science in Business Administration majoring in Accounting and Financial Analysis. Ms. Tam is an associate member of the Hong Kong Institute of Certified Public Accountants (HKICPA) and a member of The American Institute of Certified Public Accountants (AICPA), USA. Between September 1998 to April 2001, Ms. Tam worked as an accountant with Tommy Hilfiger (HK) Limited. From May 2001 to October 2007, Ms. Tam served as the company secretary of Chaoyue Group Limited (formerly known as Graneagle Holdings Limited), a company listed on the Stock Exchange with stock code 147. Ms. Tam has been serving as the Company Secretary of the Company since October 2008.



# Independent Auditors' Report



18th Floor  
Two International Finance Centre  
8 Finance Street, Central  
Hong Kong  
Phone: (852) 2846 9888  
Fax: (852) 2868 4432  
www.ey.com/china

To the shareholders of

**Air China Limited**

*(Established in the People's Republic of China with limited liability)*

We have audited the accompanying financial statements set out on pages 57 to 152 of Air China Limited (the "Company"), its subsidiaries and joint ventures (collectively the "Group"), which comprise the Company's balance sheet and the Group's consolidated balance sheet as at 31 December 2008, and the Group's consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's Directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Company's Directors, as well as evaluating the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

# Independent Auditors' Report

## OPINION

In our opinion, the financial statements give a true and fair view of the financial position of the Company and of the Group as at 31 December 2008, and of the financial performance and cash flows of the Group for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

### **Ernst & Young**

*Certified Public Accountants*

Hong Kong  
16 April 2009

# Consolidated Income Statement

Year ended 31 December 2008  
(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>TURNOVER</b>			
Air traffic revenue	4	50,536,695	47,484,210
Other operating revenue	5	2,371,466	3,597,457
		<b>52,908,161</b>	51,081,667
<b>OPERATING EXPENSES</b>			
Jet fuel costs		(22,613,935)	(17,201,143)
Take-off, landing and depot charges		(5,538,092)	(5,537,907)
Depreciation		(6,365,275)	(5,554,443)
Aircraft maintenance, repair and overhaul costs		(1,804,416)	(2,076,119)
Employee compensation costs	6	(5,843,887)	(5,209,766)
Air catering charges		(1,443,855)	(1,473,543)
Aircraft and engine operating lease expenses		(2,400,060)	(2,239,359)
Other operating lease expenses		(448,406)	(311,262)
Other flight operation expenses		(4,665,630)	(4,232,726)
Selling and marketing expenses		(2,602,904)	(2,617,843)
General and administrative expenses		(1,089,467)	(951,377)
		<b>(54,815,927)</b>	(47,405,488)
<b>PROFIT/(LOSS) FROM OPERATIONS</b>	7	<b>(1,907,766)</b>	3,676,179
<b>Finance revenue</b>	8	<b>1,584,437</b>	2,376,572
<b>Finance costs</b>	8	<b>(9,948,518)</b>	(1,969,326)
<b>Gain on disposal of subsidiaries and an associate</b>	9	<b>477,680</b>	–
<b>Share of profits and losses of associates</b>		<b>(1,183,513)</b>	1,364,740
<b>PROFIT/(LOSS) BEFORE TAX</b>		<b>(10,977,680)</b>	5,448,165
<b>Tax</b>	12	<b>1,610,650</b>	(1,512,613)
<b>PROFIT/(LOSS) FOR THE YEAR</b>		<b>(9,367,030)</b>	3,935,552
<b>Attributable to:</b>			
Equity holders of the Company		(9,255,822)	4,046,213
Minority interests		(111,208)	(110,661)
		<b>(9,367,030)</b>	3,935,552
<b>Dividends:</b>			
Interim	14	–	–
Proposed final		–	837,987
		–	837,987
<b>Earnings/(loss) per share attributable to equity holders of the Company:</b>			
Basic	15	(78.01 cents)	34.06 cents
Diluted		NA	NA

# Consolidated Balance Sheet

31 December 2008

(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment	16	71,821,000	61,691,673
Lease prepayments	17	1,945,258	1,046,042
Intangible asset	18	60,147	75,194
Goodwill	19	346,845	–
Interests in associates	22	6,271,533	9,542,677
Advance payments for aircraft and related equipment		7,052,508	7,652,365
Deposits for aircraft under operating leases		229,899	257,505
Long term receivable from ultimate holding company	23	231,813	331,813
Available-for-sale investments	24	1,997	1,997
Deferred tax assets	25	2,022,652	870,645
		<b>89,983,652</b>	81,469,911
<b>CURRENT ASSETS</b>			
Aircraft held for sale	26	350,896	184,728
Inventories	27	1,242,597	1,142,050
Accounts receivable	28	1,850,289	2,794,280
Bills receivable		1,604	1,599
Prepayments, deposits and other receivables	29	1,555,908	1,318,062
Derivative financial instruments	30	253,406	6,493
Due from ultimate holding company	31	361,892	335,129
Due from related companies	32	7,537	22,881
Tax recoverable		55,625	–
Pledged deposits	33	1,750,460	118,624
Cash and cash equivalents	33	2,987,358	3,906,520
		<b>10,417,572</b>	9,830,366
<b>TOTAL ASSETS</b>		<b>100,401,224</b>	91,300,277
<b>CURRENT LIABILITIES</b>			
Air traffic liabilities		(2,262,338)	(2,570,897)
Accounts payable	34	(6,923,895)	(5,930,800)
Bills payable	35	(1,420,438)	–
Other payables and accruals	36	(4,689,649)	(4,153,696)
Derivative financial instruments	30	(7,727,918)	(14,826)
Tax payable		(10,332)	(1,111,404)
Obligations under finance leases	37	(4,064,038)	(2,216,680)
Interest-bearing bank and other borrowings	38	(15,330,837)	(10,978,835)
Provision for major overhauls	39	(232,926)	(83,907)
Due to related companies	32	(62,924)	(45,142)
		<b>(42,725,295)</b>	(27,106,187)
<b>NET CURRENT LIABILITIES</b>		<b>(32,307,723)</b>	(17,275,821)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>57,675,929</b>	64,194,090

# Consolidated Balance Sheet

31 December 2008  
(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>NON-CURRENT LIABILITIES</b>			
Obligations under finance leases	37	(16,480,784)	(13,328,193)
Interest-bearing bank and other borrowings	38	(17,342,868)	(16,615,291)
Provision for major overhauls	39	(1,262,921)	(1,190,415)
Provision for early retirement benefits obligations		(211,209)	(164,837)
Long term payables	40	(44,785)	(190,005)
Deferred income related to frequent-flyer programme	41	(689,233)	(780,895)
Deferred income related to government grant	42	(795,080)	(872,023)
Deferred tax liabilities	25	(392,543)	(300,181)
		<b>(37,219,423)</b>	<b>(33,441,840)</b>
<b>NET ASSETS</b>			
		<b>20,456,506</b>	<b>30,752,250</b>
<b>EQUITY OF THE COMPANY ATTRIBUTABLE TO EQUITY HOLDERS</b>			
Issued capital	43	12,251,362	12,251,362
Treasury shares	44	(1,353,714)	(1,283,492)
Reserves	45	9,045,204	18,808,343
Proposed final dividend	14	–	837,987
		<b>19,942,852</b>	<b>30,614,200</b>
<b>MINORITY INTERESTS</b>			
		<b>513,654</b>	<b>138,050</b>
<b>TOTAL EQUITY</b>			
		<b>20,456,506</b>	<b>30,752,250</b>

**Cai Jianjiang**  
Director

**Fan Cheng**  
Director

# Consolidated Statement of Changes in Equity

Year ended 31 December 2008  
(Prepared under International Financial Reporting Standards)

	Attributable to equity holders of the Company									
	Issued capital	Treasury shares	Capital reserve	Reserve funds	Foreign	Retained earnings	Proposed	Total	Minority interests	Total equity
					exchange translation reserve		final dividend			
RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
As at 1 January 2007										
As previously reported	12,251,362	(1,246,955)	13,484,123	768,398	(188,791)	4,053,354	602,767	29,724,258	2,011,435	31,735,693
Prior year adjustments (note 2(i))	-	-	-	-	166	(561,895)	-	(561,729)	(9,002)	(570,731)
As restated	12,251,362	(1,246,955)	13,484,123	768,398	(188,625)	3,491,459	602,767	29,162,529	2,002,433	31,164,962
Profit for the year	-	-	-	-	-	4,046,213	-	4,046,213	(110,661)	3,935,552
Final 2006 dividend declared	-	-	-	-	-	-	(602,767)	(602,767)	-	(602,767)
Proposed final 2007 dividend (note 14(a))	-	-	-	-	-	(837,987)	837,987	-	-	-
Transfer to reserve funds (note 14(b))	-	-	-	582,602	-	(582,602)	-	-	-	-
Acquisition of minority interest of a subsidiary	-	-	(1,294,115)	-	-	-	-	(1,294,115)	(1,738,839)	(3,032,954)
Share of reserves of associates	-	-	138,272	-	-	-	-	138,272	-	138,272
Dividends paid to minority shareholders of subsidiaries	-	-	-	-	-	-	-	-	(1,077)	(1,077)
Elimination for reciprocal shareholding (note 44)	-	(36,537)	-	-	-	-	-	(36,537)	-	(36,537)
Exchange realignment	-	-	-	-	(799,395)	-	-	(799,395)	(13,806)	(813,201)
As at 31 December 2007 and 1 January 2008										
	12,251,362	(1,283,492)	12,328,280*	1,351,000*	(988,020)*	6,117,083*	837,987	30,614,200	138,050	30,752,250
As at 31 December 2007 and 1 January 2008										
As previously reported	12,251,362	(1,283,492)	12,328,280	1,351,000	(989,762)	6,861,762	837,987	31,357,137	150,216	31,507,353
Prior year adjustments (note 2(i))	-	-	-	-	1,742	(744,679)	-	(742,937)	(12,166)	(755,103)
As restated	12,251,362	(1,283,492)	12,328,280*	1,351,000*	(988,020)*	6,117,083*	837,987	30,614,200	138,050	30,752,250
Loss for the year	-	-	-	-	-	(9,255,822)	-	(9,255,822)	(111,208)	(9,367,030)
Final 2007 dividend declared (note 14(a))	-	-	-	-	-	-	(837,987)	(837,987)	-	(837,987)
Transfer to reserve funds (note 14(b))	-	-	-	264,700	-	(264,700)	-	-	-	-
Acquisition of minority interest of a subsidiary	-	-	272,502	-	-	-	-	272,502	489,752	762,254
Share of reserves of associates	-	-	(227,830)	-	-	-	-	(227,830)	-	(227,830)
Disposal of subsidiaries and an associate	-	-	(5,377)	-	-	-	-	(5,377)	-	(5,377)
Elimination for reciprocal shareholding (note 44)	-	(70,222)	-	-	-	-	-	(70,222)	-	(70,222)
Exchange realignment	-	-	-	-	(608,032)	-	-	(608,032)	(2,940)	(610,972)
Others	-	-	61,420	-	-	-	-	61,420	-	61,420
As at 31 December 2008										
	12,251,362	(1,353,714)	12,428,995*	1,615,700*	(1,596,052)*	(3,403,439)*	-	19,942,852	513,654	20,456,506

\* These reserve accounts comprise the consolidated reserves of RMB9,045,204,000 (2007: RMB18,808,343,000, as restated) in the consolidated balance sheet.

# Consolidated Cash Flow Statement

Year ended 31 December 2008  
(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit/(loss) before tax		<b>(10,977,680)</b>	5,448,165
Adjustments for:			
Share of profits and losses of associates		<b>1,183,513</b>	(1,364,740)
Gain on disposal of subsidiaries and an associate		<b>(477,680)</b>	–
Exchange gains, net		<b>(1,486,746)</b>	(2,030,391)
Dividend income from available-for-sale investments	8	<b>(302)</b>	(224)
Loss/(gain) on derivative financial instruments, net	8	<b>8,154,835</b>	(235,944)
Depreciation	16	<b>6,365,275</b>	5,554,443
Impairment of property, plant and equipment	16	<b>74,835</b>	–
Gain on disposal of property, plant and equipment, net	5	<b>(29,624)</b>	(165,311)
Loss on derecognition of property, plant and equipment	7	<b>26,300</b>	37,138
Amortisation of lease prepayments	17	<b>28,656</b>	22,478
Impairment of available-for-sale investments	7	–	4,481
Impairment of aircraft held for sale	26	<b>206,566</b>	142,800
Impairment of inventories		<b>36,135</b>	–
Impairment of accounts receivable	28	<b>653</b>	–
Interest income	8	<b>(97,389)</b>	(110,013)
Interest expense, net of interest capitalised	8	<b>1,793,683</b>	1,969,326
Increase in capital reserve		<b>61,420</b>	–
		<b>4,862,450</b>	9,272,208
Decrease/(increase) in deposits for aircraft under operating leases		<b>29,790</b>	(37,645)
Increase in inventories		<b>(136,733)</b>	(126,784)
Decrease in accounts receivable		<b>860,291</b>	92,052
Increase in bills receivable		<b>(5)</b>	(1,599)
Increase in prepayments, deposits and other receivables		<b>(273,560)</b>	(215,065)
Decrease in amount due from ultimate holding company		<b>73,237</b>	54,804
Decrease/(increase) in amounts due from related companies		<b>15,344</b>	(8,503)
Increase/(decrease) in air traffic liabilities		<b>(324,064)</b>	625,620
Increase in accounts payable		<b>1,108,202</b>	709,739
Increase/(decrease) in bills payable		<b>1,420,438</b>	(651,345)
Increase in other payables and accruals		<b>96,170</b>	14,277
Increase in amounts due to related companies		<b>17,782</b>	5,153
Increase in provision for major overhauls		<b>176,733</b>	305,075
Increase/(decrease) in provision for early retirement benefits obligations		<b>46,372</b>	(36,362)
Increase/(decrease) in deferred income		<b>(168,605)</b>	22,815
Cash generated from operations		<b>7,803,842</b>	10,024,440
Interest paid		<b>(2,093,441)</b>	(2,267,801)
Corporate income tax paid in Mainland China		<b>(650,051)</b>	(454,989)
<b>NET CASH INFLOW FROM OPERATING ACTIVITIES</b>		<b>5,060,350</b>	7,301,650

# Consolidated Cash Flow Statement

Year ended 31 December 2008  
(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of property, plant and equipment		(8,151,769)	(7,657,281)
Proceeds from disposal of property, plant and equipment		90,515	282,755
Increase in lease prepayments		(625,836)	(61,969)
Acquisition of intangible asset		(21,476)	(38,671)
Decrease/(increase) in advance payments for aircraft and related equipment		599,857	(676,311)
Net settlements of derivative financial instruments		(87,035)	88,035
Decrease/(increase) in amounts due from associates		22,005	(38,310)
Increase in amounts due to associates		349,766	33,729
Decrease/(increase) in pledged deposits		(1,631,836)	92,880
Decrease in non-pledged deposits with original maturity of more than three months when acquired		1,390,883	141,598
Interest received		97,389	110,013
Proceeds from disposal of subsidiaries and an associate	9	802,201	–
Acquisition of an additional interest in a joint venture	49	(711,750)	–
Acquisition of minority interest of a subsidiary		–	(3,032,954)
Capital contributions to associates		–	(2,938)
Dividends received from available-for-sale investments		302	224
Dividends received from associates		608,207	546,832
<b>NET CASH OUTFLOW FROM INVESTING ACTIVITIES</b>		<b>(7,268,577)</b>	<b>(10,212,368)</b>
<b>NET CASH OUTFLOW BEFORE FINANCING ACTIVITIES</b>		<b>(2,208,227)</b>	<b>(2,910,718)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
New bank loans and other loans		17,404,349	17,271,722
Repayment of bank and other loans		(11,306,135)	(12,404,754)
Repayment of principals under finance lease obligations		(2,232,655)	(2,361,068)
Settlement of long term payables		(157,234)	(62,586)
Dividends paid to minority shareholders		–	(1,077)
Dividends paid		(837,987)	(602,767)
<b>NET CASH INFLOW FROM FINANCING ACTIVITIES</b>		<b>2,870,338</b>	<b>1,839,470</b>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>		<b>662,111</b>	<b>(1,071,248)</b>
Cash and cash equivalents at beginning of year		2,477,341	3,588,404
Effect of exchange rate changes on cash and cash equivalents		(190,390)	(39,815)
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		<b>2,949,062</b>	<b>2,477,341</b>
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>			
Cash and bank balances	33	2,668,728	1,974,342
Non-pledged time with original maturity of less than three months when acquired	33	280,334	502,999
		<b>2,949,062</b>	<b>2,477,341</b>



# Balance Sheet

31 December 2008

(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment	16	66,570,539	59,258,919
Lease prepayments	17	1,572,711	969,725
Intangible asset	18	60,147	75,194
Interests in subsidiaries	20	10,707,219	8,819,247
Interests in joint ventures	21	303,287	1,403,788
Interests in associates	22	833,203	933,246
Advance payments for aircraft and related equipment		7,052,508	7,652,365
Deposits for aircraft under operating leases		166,689	192,848
Long term receivable from ultimate holding company	23	231,813	331,813
Available-for-sale investments	24	3,516	3,516
Deferred tax assets	25	1,974,543	790,690
		<b>89,476,175</b>	80,431,351
<b>CURRENT ASSETS</b>			
Aircraft held for sale	26	307,598	–
Inventories	27	741,916	689,871
Accounts receivable	28	1,210,055	2,326,307
Bills receivable		965	1,599
Prepayments, deposits and other receivables	29	1,411,527	1,121,608
Derivative financial instruments	30	253,406	6,493
Due from ultimate holding company	31	376,894	350,377
Tax recoverable		55,625	–
Pledged deposits	33	2,274	2,486
Cash and cash equivalents	33	1,508,947	1,348,887
		<b>5,869,207</b>	5,847,628
<b>TOTAL ASSETS</b>		<b>95,345,382</b>	86,278,979
<b>CURRENT LIABILITIES</b>			
Air traffic liabilities		(2,150,322)	(2,427,831)
Accounts payable	34	(5,572,222)	(4,850,304)
Bills payable	35	(1,493,815)	–
Other payables and accruals	36	(3,989,851)	(3,457,394)
Derivative financial instruments	30	(7,727,918)	(6,819)
Tax payable		(202)	(1,105,443)
Obligations under finance leases	37	(4,064,038)	(2,216,680)
Interest-bearing bank and other borrowings	38	(14,636,854)	(10,605,465)
Provision for major overhauls	39	(232,926)	(83,907)
Due to related companies	32	(24,878)	(27,730)
		<b>(39,893,026)</b>	(24,781,573)
<b>NET CURRENT LIABILITIES</b>		<b>(34,023,819)</b>	(18,933,945)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>55,452,356</b>	61,497,406

# Balance Sheet

31 December 2008

(Prepared under International Financial Reporting Standards)

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
<b>NON-CURRENT LIABILITIES</b>			
Obligations under finance leases	37	(16,480,784)	(13,328,193)
Interest-bearing bank and other borrowings	38	(15,855,636)	(15,938,092)
Provision for major overhauls	39	(973,006)	(940,806)
Provision for early retirement benefits obligations		(112,754)	(97,015)
Long term payables	40	(44,785)	(158,050)
Deferred income related to frequent-flyer programme	41	(681,000)	(766,958)
Deferred income related to government grant	42	(795,080)	(872,023)
Deferred tax liabilities	25	(392,543)	(286,690)
		<b>(35,335,588)</b>	<b>(32,387,827)</b>
<b>NET ASSETS</b>			
		<b>20,116,768</b>	<b>29,109,579</b>
<b>EQUITY</b>			
Issued capital	43	12,251,362	12,251,362
Reserves	45	7,865,406	16,020,230
Proposed final dividend	14	–	837,987
<b>TOTAL EQUITY</b>			
		<b>20,116,768</b>	<b>29,109,579</b>

**Cai Jianjiang**  
Director

**Fan Cheng**  
Director

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 1 CORPORATE INFORMATION

Air China Limited (the "Company") was incorporated as a joint stock limited company in Beijing, the People's Republic of China (the "PRC"), on 30 September 2004. The Company's H shares are listed on the Hong Kong Stock Exchange ("HKSE") and the London Stock Exchange while the Company's A shares are listed on the Shanghai Stock Exchange. In the opinion of the Directors, the Company's parent and ultimate holding company is China National Aviation Holding Company ("CNAHC"), a PRC state-owned enterprise under the supervision of the State Council.

On 3 January 2008, China National Aviation Company Limited ("CNAC", a wholly-owned subsidiary of the Company) entered into a sale and purchase agreement (the "CITIC Agreement") with China International Trust and Investment Corporation Pacific Limited ("CITIC") and Gold Leaf Enterprises Holdings Ltd. ("Gold Leaf", a wholly-owned subsidiary of CITIC). Pursuant to the CITIC Agreement, CNAC agreed to purchase from Gold Leaf the entire issued share capital of Fine Star Enterprise Corporation (another wholly-owned subsidiary of CITIC), which in turn held a 25% equity interest in the registered capital of Air China Cargo Co., Ltd. ("Air China Cargo"). The aggregate consideration paid by CNAC for the transaction amounted to approximately RMB857 million. Upon completion of the transaction, the Company's interest in Air China Cargo, including both direct and indirect interests, increased from 51% to 76%. Air China Cargo was then changed from a joint venture to a subsidiary of the Company.

On 10 June 2008, CNAC entered into another sale and purchase agreement together with an agreement for indebtedness assignment with China National Aviation Corporation (Group) Limited ("CNACG", a wholly-owned subsidiary of CNAHC) (collectively the "CNACG Agreement"). Pursuant to the CNACG Agreement, CNAC agreed to sell to CNACG the entire issued share capital of each of Fly Top Limited ("Fly Top", a wholly-owned subsidiary of CNAC) and China National Aviation Logistics Company Limited ("CNAL", another wholly-owned subsidiary of CNAC) and 50% of the issued share capital of Jardine Airport Services Limited ("JASL", an associate of CNAC). Fly Top held 60% of the issued share capital of each of Southwest Air Catering Company Limited and Beijing Air Catering Company Limited (two joint ventures of CNAC) and 20.2% of the issued share capital of Lufthansa Services Hong Kong Limited ("LSG", an associate of CNAC). CNAL held 25% of the issued share capital of Tradeport Hong Kong Limited (another associate of CNAC). The aggregate consideration payable by CNACG amounted to RMB850,000,000.

The principal activities of the Company, its subsidiaries and joint ventures (collectively the "Group") and associates consist of the provision of airline, airline-related services, including aircraft engineering services, air catering services and airport ground handling services, mainly in Mainland China, Hong Kong and Macau.

The registered office of the Company is located at 9th Floor, Blue Sky Mansion, 28 Tianzhu Road, Zone A, Tianzhu Airport Industrial Zone, Shunyi District, Beijing 101312, the PRC.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of preparation

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs", which comprise standards and interpretations approved by the International Accounting Standards Board (the "IASB"), and International Accounting Standards ("IAS") and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee that remain in effect) and the disclosure requirements of the Hong Kong Companies Ordinance.

As at 31 December 2008, the Group's net current liabilities amounted to approximately RMB32,308 million, which comprised current assets of approximately RMB10,417 million and current liabilities of approximately RMB42,725 million. The liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations and sufficient financing to meet its financial obligations as and when they fall due. In preparing the financial statements, the directors of the Company have considered the Group's sources of liquidity and believe that adequate funding is available to fulfil the Group's debt obligations and capital expenditure requirements. Accordingly, the consolidated financial statements have been prepared on a basis that the Group will be able to continue as a going concern.

The financial statements have been prepared on a historical cost basis, except for derivative financial instruments which have been measured at fair value and aircraft held for sale which have been stated at the lower of their carrying amounts and fair values less costs to sell.

### Impact of New and Revised IFRSs

The Group has adopted the following new interpretations and amendments to IFRSs for the first time for the current year's financial statements. Except for in certain cases, giving rise to additional disclosures, the adoption of these new interpretations and amendments has had no significant effect on these financial statements.

IAS 39 and IFRS 7 Amendments	Amendments to <i>IAS 39 Financial Instruments: Recognition and Measurement</i> and <i>IFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets</i>
IFRIC 11	<i>IFRS 2 – Group and Treasury Share Transactions</i>
IFRIC 12	<i>Service Concession Arrangements</i>
IFRIC 14	<i>IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction</i>

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of New and Revised IFRSs (Continued)

The principal effects of adopting these new and revised IFRSs are as follows:

- (a) Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*

The amendments to IAS 39 permit an entity to reclassify a non-derivative financial asset classified as held for trading, other than a financial asset designated by an entity as at fair value through profit or loss upon initial recognition, out of the fair value through profit or loss category if the financial asset is no longer held for the purpose of selling or repurchasing in the near term, if specified criteria are met.

A debt instrument that would have met the definition of loans and receivables (if it had not been required to be classified as held for trading at initial recognition) may be classified out of the fair value through profit or loss category or (if it had not been designated as available for sale) may be classified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold it for the foreseeable future or until maturity.

In rare circumstances, financial assets that are not eligible for classification as loans and receivables may be transferred from the held-for-trading category to the available-for-sale category or to the held-to-maturity category (in the case of a debt instrument), if the financial asset is no longer held for the purpose of selling or repurchasing in the near term.

The financial asset shall be reclassified at its fair value on the date of reclassification and the fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable. The amendments to IFRS 7 require extensive disclosures of any financial asset reclassified in the situations described above. The amendments are effective from 1 July 2008.

As the Group has not reclassified any of its financial instruments, the amendments have had no impact on the financial position or results of operations of the Group.

- (b) IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*

IFRIC 11 requires arrangements whereby an employee is granted rights to the Group's equity instruments to be accounted for as an equity-settled scheme, even if the Group buys the instruments from another party, or the shareholders provide the equity instruments needed. IFRIC 11 also addresses the accounting for share-based payment transactions involving two or more entities within the Group. As the Group currently has no such transactions, the interpretation has had no impact on the financial position or results of operations of the Group.

- (c) IFRIC 12 *Service Concession Arrangements*

IFRIC 12 applies to service concession operators and explains how to account for the obligations undertaken and the rights received in service concession arrangements. No member of the Group is an operator and, therefore, this interpretation has had no impact on the financial position or results of operations of the Group.

- (d) IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

IFRIC 14 addresses on how to assess the limit under IAS 19 *Employee Benefits*, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognised as an asset, including situations when a minimum funding requirement exists. As the Group has no defined benefit scheme, the interpretation has had no effect on these financial statements.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of Issued but not yet Effective IFRSs

Except for IFRIC 13 *Customer Loyalty Programmes*, the Group has not applied the following new and revised IFRSs which have been issued but are not yet effective in these financial statements:

IFRS 1 and IAS 27 Amendments	Amendments to IFRS 1 <i>First-time Adoption of IFRSs</i> and IAS 27 <i>Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate</i> <sup>1</sup>
IFRS 2 Amendment	Amendments to IFRS 2 <i>Share-based Payment – Vesting Conditions and Cancellations</i> <sup>1</sup>
IFRS 3 (Revised)	<i>Business Combinations</i> <sup>2</sup>
IFRS 7 Amendments	Amendments to IFRS 7 <i>Financial Instruments: Disclosures</i> <sup>1</sup>
IFRS 8	<i>Operating Segments</i> <sup>1</sup>
IAS 1 (Revised)	<i>Presentation of Financial Statements</i> <sup>1</sup>
IAS 23 (Revised)	<i>Borrowing Costs</i> <sup>1</sup>
IAS 27 (Revised)	<i>Consolidated and Separate Financial Statements</i> <sup>2</sup>
IAS 32 and IAS 1 Amendment	Amendments to IAS 32 <i>Financial Instruments: Presentation</i> and IAS 1 <i>Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation</i> <sup>1</sup>
IAS 39 Amendments	Amendment to IAS 39 <i>Financial Instruments: Recognition and Measurement – Eligible Hedged Items</i> <sup>2</sup>
IAS 39 and IFRIC 9 Amendments	Amendments to IFRIC 9 <i>“Reassessment of Embedded Derivatives”</i> and IAS 39 <i>“Financial Instruments: Recognition and Measurement”</i> <sup>5</sup>
IFRIC 13	<i>Customer Loyalty Programmes</i> <sup>3</sup>
IFRIC 15	<i>Agreements for the Construction of Real Estate</i> <sup>1</sup>
IFRIC 16	<i>Hedges of a Net Investment in a Foreign Operation</i> <sup>4</sup>
IFRIC 17	<i>Distribution of Non-cash Assets to Owners</i> <sup>2</sup>
IFRIC 18	<i>Transfers of Assets from Customers</i> <sup>2</sup>

Apart from the above, the IASB has issued *Improvements to IFRSs*\* which sets out amendments to a number of IFRSs primarily with a view to removing inconsistencies and clarifying wording. Except for the amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (“IFRS 5”) which is effective for annual periods beginning on or after 1 July 2009, other amendments are effective for annual periods beginning on or after 1 January 2009 although there are separate transitional provisions for each standard.

<sup>1</sup> Effective for annual periods beginning on or after 1 January 2009

<sup>2</sup> Effective for annual periods beginning on or after 1 July 2009

<sup>3</sup> Effective for annual periods beginning on or after 1 July 2008

<sup>4</sup> Effective for annual periods beginning on or after 1 October 2008

<sup>5</sup> Effective for annual periods ending on or after 30 June 2009

\* *Improvements to IFRSs* contains amendments to IFRS 5, IFRS 7, IAS 1, IAS 8, IAS 10, IAS 16, IAS 18, IAS 19, IAS 20, IAS 23, IAS 27, IAS 28, IAS 29, IAS 31, IAS 34, IAS 36, IAS 38, IAS 39, IAS 40 and IAS 41.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of Issued but not yet Effective IFRSs (Continued)

- (a) IFRS 1 and IAS 27 Amendments – *Cost of an Investment in a Subsidiary, Jointly controlled Entity or Associate*

The IAS 27 Amendment requires all dividends from subsidiaries, associates or jointly-controlled entities to be recognised in the income statement in the separate financial statements. The amendment is applied prospectively only. The IFRS 1 Amendment allows a first-time adopter of IFRSs to measure its investment in subsidiaries, associates or jointly-controlled entities using a deemed cost of either fair value or the carrying amount under the previous accounting practice in the separate financial statements. The amendments have no impact on the consolidated financial statements.

- (b) IFRS 2 Amendments *Share-based Payment – Vesting Conditions and Cancellations*

The IFRS 2 Amendments clarify that vesting conditions are service conditions and performance conditions only. Any other conditions are non-vesting conditions. Where an award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this is accounted for as a cancellation. The Group has not entered into share-based payment schemes with non-vesting conditions attached and, therefore, the amendments are unlikely to have any significant implications on its accounting for share-based payments.

- (c) IFRS 3 (Revised) *Business Combinations* and IAS 27 (Revised) *Consolidated and Separate Financial Statements*

IFRS 3 (Revised) introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results.

IAS 27 (Revised) requires that a change in the ownership interest of a subsidiary without loss of control is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7 *Statement of Cash Flows*, IAS 12 *Income Taxes*, IAS 21 *The Effects of Changes in Foreign Exchange Rates*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

The changes introduced by these revised standards must be applied prospectively and will affect future acquisitions, loss of control and transactions with minority interests.

- (d) IFRS 7 *Financial Instruments: Disclosures*

IFRS 7 has been amended to enhance disclosures about fair value measurement and liquidity risk. In the first year of application, entities need not provide comparative information for the disclosures required by the amended paragraphs of IFRS 7.

- (e) IFRS 8 *Operating Segments*

IFRS 8, which will replace IAS 14 *Segment Reporting*, specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purposes of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of Issued but not yet Effective IFRSs (Continued)

(f) IAS 1 (Revised) *Presentation of Financial Statements*

IAS 1 (Revised) introduces changes in the presentation and disclosures of financial statements. The revised standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, this standard introduces the statement of comprehensive income, with all items of income and expense recognised in profit or loss, together with all other items of recognised income and expense recognised directly in equity, either in one single statement, or in two linked statements.

(g) IAS 23 (Revised) *Borrowing Costs*

IAS 23 has been revised to require capitalisation of borrowing costs when such costs are directly attributable to the acquisition, construction or production of a qualifying asset. As the Group's current policy for borrowing costs aligns with the requirements of the revised standard, the revised standard is unlikely to have any financial impact on the Group.

(h) IAS 32 and IAS 1 Amendments *Financial Instruments: Presentation and Puttable Financial Instruments and Obligations Arising on Liquidation*

The IAS 32 Amendments provide a limited scope exception for puttable financial instruments and instruments that impose specified obligations arising on liquidation to be classified as equity if they fulfil a number of specified features. IAS 1 Amendments require disclosure of certain information relating to these puttable financial instruments and obligations classified as equity. As the Group currently has no such financial instruments or obligations, the amendments are unlikely to have any financial impact on the Group.

(i) IAS 39 Amendment *Financial Instruments: Recognition and Measurement – Eligible Hedged Items*

The amendment to IAS 39 addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. As the Group has not entered into any such hedges, the amendment is unlikely to have any financial impact on the Group.

(j) Amendments to IFRIC 9 *“Reassessment of Embedded Derivatives”* and IAS 39 *“Financial Instruments: Recognition and Measurement”*

The Amendments to IFRIC 9 require an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial assets out of the fair value through profit or loss category; and the assessment to be made on the basis of the circumstances that existed on the later of the date when the entity first became a party to the contract, and the date of a change in the terms of the contract that significantly modifies the cash flows that otherwise would have been required under the contract. IAS 39 is also amended to state that, if the fair value of an embedded derivative that would have to be separated on reclassification cannot be reliably measured, the entire hybrid financial instrument must remain classified as at fair value through profit or loss.



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of Issued but not yet Effective IFRSs (Continued)

#### (k) IFRIC 13 *Customer Loyalty Programmes*

IFRIC 13 requires that customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted. The fair value of the consideration received or receivable from the sales transaction is allocated between the loyalty award credits and the other components of the sale transactions. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed when the Group fulfils its obligations to supply the awards.

The Group has been operating a frequent-flyer programme and has early adopted IFRIC 13 for the accounting period beginning on 1 January 2008. Prior to the adoption of IFRIC 13, the incremental cost of providing awards in exchange for miles earned by the members of the Group's frequent-flyer programme was accrued as operating expense after allowing for miles which were not expected to be redeemed. Upon the adoption of IFRIC 13, the miles earned by customers as part of a sales transaction are accounted for as a separate component of the sales transaction and is deferred until the miles are redeemed or the miles are expired. IFRIC 13 has been adopted by the Group retrospectively and therefore certain comparatives have been restated. The effect of the abovementioned changes is summarised as follows:

	2008 RMB'000	2007 RMB'000
<b>Consolidated income statement for the year ended 31 December</b>		
Decrease in turnover	(75,849)	(248,874)
Decrease in selling and marketing expenses	58,440	90,927
Decrease/(increase) in deferred tax charge	(141,000)	(28,000)
Decrease in profit for the year	<b>(158,409)</b>	(185,947)
<b>Consolidated balance sheet as at 1 January</b>		
Increase in deferred income	(1,095,002)	(891,581)
Decrease in other payables and accruals	95,899	48,850
Increase in deferred tax assets	244,000	272,000
Decrease in total equity	<b>(755,103)</b>	(570,731)
<b>Consolidated balance sheet as at 31 December</b>		
Increase in deferred income	(1,123,855)	(1,095,002)
Decrease in other payables and accruals	106,903	95,899
Increase in deferred tax assets	103,000	244,000
Decrease in total equity	<b>(913,952)</b>	(755,103)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impact of Issued but not yet Effective IFRSs (Continued)

(l) IFRIC 15 *Agreements for the Construction of Real Estate*

IFRIC 15 will replace IFRIC 3 *Revenue – Pre-completion Contracts for the Sale of Development Properties*. It clarifies when and how an agreement for the construction of real estate should be accounted for as a construction contract in accordance with IAS 11 *Construction Contracts* or an agreement for the sale of goods or services in accordance with IAS 18 *Revenue*. As the Group currently is not involved in any construction of real estate, the interpretation is unlikely to have any financial impact on the Group.

(m) IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*

IFRIC 16 provides guidance on the accounting for a hedge of a net investment in a foreign operation. This includes clarification that (i) hedge accounting may be applied only to the foreign exchange differences arising between the functional currencies of the foreign operation and the parent entity; (ii) a hedging instrument may be held by any entities within a group; and (iii) on disposal of a foreign operation, the cumulative gain or loss relating to both the net investment and the hedging instrument that was determined to be an effective hedge should be reclassified to the income statement as a reclassification adjustment. As the Group currently has no hedge of a net investment in a foreign operation, the interpretation is unlikely to have any financial impact on the Group.

(n) IFRIC 17 *Distribution of Non-cash Assets to Owners*

IFRIC 17 standardises practice in the accounting for non-reciprocal distributions of non-cash assets to owners. The interpretation clarifies that (i) a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity; (ii) an entity should measure the dividend payable at the fair value of the net assets to be distributed; and (iii) an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. Other consequential amendments were made to IAS 10 *Events after the Reporting Period* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. While the adoption of the interpretation may result in changes in certain accounting policies, the interpretation is unlikely to have any material financial impact on the Group.

(o) IFRIC 18 *Transfers of Assets from Customers*

The transfers of assets from customers to entities in sectors such as telecoms and utilities have resulted in diversity in the accounting methods used. IFRIC 18 provides guidance on when and how to recognize such assets.

In May 2008, the IASB issued its first *Improvements to IFRSs* which sets out amendments to a number of IFRSs. The Group expects to adopt the amendments from 1 January 2009. There are separate transitional provisions for each standard. While the adoption of some of the amendments may result in changes in accounting policies, none of these amendments are expected to have a significant financial impact on the Group.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company, its subsidiaries and joint ventures for the year ended 31 December 2008. The financial statements of the subsidiaries and joint ventures are prepared for the same reporting year as the Company. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Joint ventures are proportionally consolidated from the date on which joint control is transferred to the Group and cease to be proportionally consolidated from the date on which joint control is transferred out of the Group. All income, expenses and unrealised gains and losses resulting from intercompany transactions and intercompany balances within the Group are eliminated on consolidation in full.

The acquisition of a subsidiary during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of 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.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries and are presented in the consolidated balance sheet separately from the shareholders' equity within equity. An acquisition of minority interests is accounted for using the entity concept method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as an equity transaction.

### Foreign currencies

These financial statements are presented in RMB, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currencies transactions are initially recorded in the functional currency rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of certain overseas subsidiaries, joint ventures and associates are currencies other than RMB. As at the balance sheet date, the assets and liabilities of these entities are translated into RMB at the rates of exchange ruling at the balance sheet date and their income statements are translated into RMB at the average exchange rates for the period of the translations. The exchange differences arising on the translation are included in the foreign exchange translation reserve within equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign entity is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries and joint ventures are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into RMB at the average exchange rates for the period of the translations.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. In the Company's balance sheet, the Company's interests in subsidiaries that are not classified as held for sales in accordance with IFRS 5 are stated at cost less any impairment losses.

### Interests in joint ventures

The Group has interests in certain joint ventures which are considered as jointly-controlled entities. A joint venture is an entity set up by contractual arrangement whereby the Group and other parties undertake an economic activity that is subject to joint control. A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

Unrealised gains and losses resulting from transactions between the Group and its jointly-controlled entities are eliminated to the extent of the Group's interests in the jointly-controlled entities, except where unrealised losses provide evidence of an impairment of the asset transferred.

The results of joint ventures are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in joint ventures are treated as non-current assets and are stated at cost less any impairment losses.

### Interests in associates

The Group's interests in its associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture of the Group.

Under the equity method, the interests in associates are carried in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associates, less any impairment losses. Goodwill relating to the associates is included in the carrying amounts of the investments and is not amortised. The Group's share of the post-acquisition results and reserve of associates is included in the consolidated income statement and consolidated reserves, respectively. Unrealised gains and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred.

The financial statements of the associates are prepared for the same reporting year as the Company. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in associates are treated as non-current assets and are stated at cost less any impairment losses.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Goodwill

Goodwill arising on the acquisition of subsidiaries, associates and joint ventures represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities as at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. In the case of associates and joint ventures, goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet. The carrying amount of goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

### Related parties

A party is considered to be related to the Group if:

- (a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a jointly-controlled entity;
- (d) the party is a member of the key management personnel of the Group or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d); or
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property, plant and equipment and depreciation

Property, plant and equipment other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. When an item of property, plant and equipment is classified as held for sale or when it is part of a disposal group classified as held for sale, it is not depreciated and is accounted for in accordance with IFRS 5, as further explained in the accounting policy for "Non-current assets and disposal groups held for sale". The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

When each major overhaul is performed, its cost is recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The principal estimated useful lives and residual values used for this purpose are as follows:

	<b>Estimated useful life</b>	<b>Residual value</b>
Aircraft and flight equipment	2 to 25 years	Nil – 5%
Buildings	15 to 35 years	5%
Machinery, transportation equipment and office equipment	4 to 20 years	5%

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

The asset's residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at least at each year end.

Construction in progress represents buildings or various infrastructure projects under construction, and equipment pending installation in aircraft which is stated at cost less any impairment losses and is not depreciated. Costs of construction in progress comprise the direct costs of construction, the cost of equipment as well as capitalised borrowing costs on related borrowed funds during the construction or installation period. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered principally through a sales transaction rather than through continuing use. For this to be the case, the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for the sale of such assets or disposal groups and its sale must be highly probable.

Non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amounts and fair values less costs to sell.

### Lease prepayments

Lease prepayments represent acquisition costs of land use rights less accumulated amortisation and any impairment losses. The prepaid land lease payments are amortised on the straight-line basis over the lease terms.

### Intangible assets

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangible assets are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis.

### Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Minimum Lease payments are apportioned between the finance charges and reduction of the outstanding liability so as to achieve a constant periodical rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term. And capitalised leased assets are depreciated over the estimated useful life of the assets, if there is reasonable certainty that the Group will obtain ownership by the end of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Advance payments for aircraft and related equipment

Advance contract payments to aircraft manufacturers to secure deliveries of aircraft and related equipment in future years, including attributable finance costs, are included in assets. The advances are accounted for as part of the costs of property, plant and equipment upon delivery of the aircraft and related equipment.

### Impairment of non-financial assets other than goodwill

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. Indefinite life intangible assets are tested for impairment annually and at other times when such indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. If any such indicator exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less cost to sell and its value in use, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the income statement in the period in which it arises in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

### Investments and other financial assets

Financial assets in the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, investments and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The Group assesses whether a contract contains an embedded derivative when the Group first becomes a party to it and assesses whether an embedded derivatives is required to be separated from the host contract when the analysis shows that the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Investments and other financial assets (Continued)

#### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments or financial guarantee contracts. Gains or losses on investments held for trading are recognised in the income statement. The net fair value gain or loss recognised in the income statement does not include any dividends on these financial assets, which are recognised in accordance with the policy set out for "Revenue recognition" below.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; (ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

#### *Available-for-sale financial assets*

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments and loans and receivables. After initial recognition, available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement. Interest and dividends earned are reported as interest income and dividend income, respectively and are recognised in the income statement in accordance with the policies set out for "Revenue recognition" below. Losses arising from the impairment of such investments are recognised in the income statement as "Impairment losses on available-for-sale financial assets" and are transferred from the available-for-sale investment revaluation reserve.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

#### *Fair value*

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument, which is substantially the same, discounted cash flow analysis and option pricing models.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impairment of financial assets

The Group assesses at each balance sheet date whether a financial asset or a group of financial assets is impaired.

#### *Assets carried at amortised cost*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in the income statement. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to accounts receivable and other receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor and significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

#### *Assets carried at cost*

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

#### *Available-for-sale financial assets*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. A provision for impairment is made for available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgement. In addition, the Group evaluates other factors, such as the share price volatility. Reversals of impairment loss in respect of equity instruments classified as available-for-sale are not recognised in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement, if the increase in fair value of the instruments can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Derecognition of financial assets and liabilities

#### *Financial assets*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed obligations to pay them in full without material delay to a third party under a “pass-through” arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group’s continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group’s continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

#### *Financial liabilities*

A financial liability is derecognised when the obligations under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

#### *Financial liabilities at amortised cost (including interest-bearing loans and borrowings)*

Financial liabilities including, accounts payable, other payables and accruals, bills payable, amounts due to related companies and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Financial Liabilities (Continued)

#### *Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement. The net fair value gain or loss recognised in the income statement does not include any interest charged on these financial liabilities.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial liability at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial liabilities may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis; (ii) the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liability contains an embedded derivative that would need to be separately recorded.

### Derivative financial instruments and hedging

The Group uses derivative financial instruments to hedge its exposure to jet fuel prices and interest rate. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the income statement for the year.

The fair value of such derivative financial instruments is determined using valuation techniques.

### Treasury shares

Own equity instruments which are reacquired (treasury shares) are deducted from equity. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of the Group's own equity instruments.

### Inventories

Inventories, which consist primarily of expendable spare parts and supplies, are stated at lower of cost and net realisable value. Cost is determined on the weighted average basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated costs to be incurred to completion and disposal.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Cash and cash equivalents

Cash and cash equivalents in the balance sheets comprise cash at banks and on hand and short term deposits with an original maturity of three months or less, which are not restricted as to use.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

### Manufacturers' credits

In connection with the acquisition of certain aircraft and related equipment, the Group receives various credits from the manufacturers. Such credits are deferred until the aircraft and related equipment are delivered, at which time they are applied as a reduction of the cost of acquiring the aircraft and related equipment.

### Provisions

Provisions are recognised when the Group has present obligations (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations and a reliable estimate can be made of the amount of the obligations. The expense relating to any provision is recognised in the income statement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

### Employee benefits

#### (a) Pension obligations

The full-time employees of the Group are covered by various government-sponsored pension plans under which the employees are entitled to a monthly pension based on certain formulae. Certain government agencies are responsible for the pension liability to these retired employees. The Group contributes on a monthly basis to these pension plans. Under these plans, the Group has no legal or constructive obligations for retirement benefits beyond the contributions made. Contributions to these plans are expensed as incurred.

#### (b) Termination and early retirement benefits

Termination benefits are payable whenever an employee's employment is voluntarily terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or to providing termination benefits as a result of an offer made to encourage voluntary redundancy.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Employee benefits (Continued)

#### (c) *Housing benefits*

In prior years, the Group sold staff quarters to its employees, subject to a number of eligibility requirements, at below market 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 the sales proceeds and the carrying amount of the staff quarters is charged to the income statement. The above staff quarters' allocation scheme was phased out before the incorporation of the Company 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 the staff quarters. However, the specific timetable and procedures to implement these policies are to be determined by the individual provincial or municipal government based on the particular situation of the province or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans, whereby, for those eligible employees who have not been allocated with any quarters or who have not been allocated with quarters up to the prescribed standards before the staff quarters' allocation scheme was terminated, the Group will pay them one-off cash housing subsidies based on their years of service, position 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.

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 year.

#### (d) *Share-based payment transactions*

The Company operates a Share Appropriation Rights ("SARs") plan for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group are entitled to a future cash payment (rather than an equity instrument) ("cash-settled transactions"), based on the increase in the entity's share price from a specified level over a specified period of time. The Company recognises the services received, and a liability to pay for those services, as the employees render service.

The cost of cash-settled transactions with employees is measured initially at fair value at the grant date using a binomial model. The liability is remeasured at each reporting date up to and including the settlement date, with any changes in fair value recognised in profit or loss for the period.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Maintenance and overhaul costs

In respect of aircraft and engines under operating leases, the Group has the responsibility to fulfill certain return conditions under the relevant operating leases. In order to fulfill these return conditions, major overhauls are required to be conducted on a regular basis. Accordingly, estimated costs of major overhauls for aircraft and engines under operating leases are accrued and charged to the income statement over the estimated period between overhauls using the ratios of actual flying hours/cycles and estimated flying hours/cycles between overhauls. The costs of major overhauls comprise mainly labour and materials. Differences between the estimated costs and the actual costs of overhauls are included in the income statement in the period of overhaul.

In respect of aircraft and engines owned by the Group or held under finance leases, costs of major overhauls are recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied.

All other routine repair and maintenance costs incurred in restoring such property, plant and equipment to their normal working condition are charged to the income statement as and when incurred.

### Frequent-flyer programme

The Group operates a frequent-flyer programme which allows customers to earn miles when they purchase air tickets from the Group. The miles can then be redeemed for free services or products, subject to a minimum number of miles being obtained. The consideration received or receivable from the tickets sold is allocated between the miles earned by the frequent-flyer programme members and the other components of the sales transactions. The amount allocated to the miles earned by the frequent-flyer programme members is deferred until the miles are redeemed when the Group fulfils its obligations to supply services or products or when the miles are expired.

### Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

#### (a) *Provision of airline and airline-related services*

Passenger revenue is recognised either when transportation services are provided or when a ticket expires unused rather than when a ticket is sold. Unused tickets generally expire one year from the date the ticket was sold, or for partially used tickets, the date of first flight. Ticket sales for transportation not yet provided are included in current liabilities as air traffic liabilities. In addition, the Group has code-sharing agreements with other airlines under which a carrier's flights can be marketed under the two-letter airline designator code of another carrier. Revenue earned under these arrangements are allocated between the code share partners based on existing contractual agreements and airline industry standard pro-ratio formulae and are recognised as passenger revenue when the transportation services are provided.

Cargo and mail revenue is recognised when transportation services are provided.

Revenue from airline-related services is recognised when the relevant services are rendered.

Revenue is stated net of business tax.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Revenue recognition (Continued)

(b) *Sale of goods*

Revenue is recognised when the significant risks and rewards of ownership of the goods have been passed to the buyer.

(c) *Interest income*

Revenue is recognised on a time proportion basis taking into account the principal outstanding and the effective rate of interest applicable.

(d) *Dividend income*

Revenue is recognised when the Group's right to receive payments is established.

(e) *Rental income and aircraft and related equipment lease income*

Revenue is recognised on a time proportion basis over the terms of the respective leases.

### Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual installments.

### Income tax

#### *Current tax*

Current tax assets and liabilities for the current and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

#### *Deferred tax*

Deferred income tax is provided, using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Income tax (Continued)

#### Deferred tax (Continued)

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Current tax and deferred tax shall be charged or credited to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

### Borrowing costs

Borrowing costs directly attributable to the acquisition of aircraft, construction or production of qualifying assets, that is, assets that necessarily take a substantial period of time to get ready for their intended use, are capitalised as part of the costs of those assets. The capitalisation of aircraft borrowing costs ceases when the aircraft is placed into revenue earning services and the capitalisation of other assets' borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing cost capitalised.

Where funds have been borrowed generally, and used for the purpose of obtaining qualifying assets, a capitalisation rates ranging between 2.3% and 7.0% (2007: ranging between 4.5% and 5.9%) has been applied to the expenditure on the individual asset.

All other borrowing costs are recognised as expenses when incurred.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are recognised immediately as a liability when they are proposed and declared.

### Significant accounting judgements and estimates

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenue, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

### Judgements

In the process of applying the Group's accounting policies, management has made judgements regarding revenue recognition, classification of leases, classification of financial instruments, impairment indication of financial assets, classification of assets held for sale, derecognition of financial instruments, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements.

### Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, 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.

#### (a) *Impairment of goodwill*

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2008 was RMB347 million (2007: Nil). More details are given in note 19 to the financial statements.

#### (b) *Impairment of non-financial assets (other than goodwill)*

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. Indefinite life intangible assets are tested for impairment annually and at other times when such indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Estimation uncertainty (Continued)

#### (c) *Deferred tax assets*

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies. The carrying value of deferred tax assets relating to recognised tax losses as at 31 December 2008 was RMB453 million (2007: RMB13 million). The amount of unrecognised tax losses as at 31 December 2008 was RMB42 million (2007: RMB9 million). Further details are contained in note 25 to the financial statements.

#### (d) *Overhaul cost*

Cost of overhaul for aircraft and engines under operating leases are accrued and charged to the income statement over the estimated overhaul period. This requires estimation of the expected flying hours/cycles, overhaul cost and overhaul cycles, which are largely based on the past experience of overhauls of aircraft and engines of the same or similar types. Different estimates could affect the estimated overhaul provision and the results of operations.

#### (e) *Deferred income*

The amount of revenue attributable to the miles earned by the members of the Group's frequent-flyer programme is estimated based on the fair value of the miles awarded and the expected redemption rate. The expected redemption rate was estimated considering the number of the miles that will be available for redemption in the future after allowing for miles which are not expected to be redeemed.

#### (f) *Early retirement benefits*

Early retirement benefits are occurred and charged to the income statement when the conditions for early retirement are realised. The estimated liabilities were affected by the uncertainty of the changes in salary standards, life expectancy of early retired employees and discount rate.

#### (g) *Fair value of financial instruments*

Where the fair value of financial assets and financial liabilities recorded in the balance sheet cannot be derived from active markets, they are determined using valuation techniques. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgements include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

#### (h) *Share-based payment*

The Group measures the cost of cash-settled transactions with employees by reference to the instruments at the date at which they are granted. Estimating fair value for share-based payments requires determining the most appropriate valuation model for a grant of instruments, which is dependent on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model and making assumptions about them. The assumptions and models used for estimating fair value for SARs are disclosed in note 46 to the financial statements.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 3 SEGMENT INFORMATION

Segment information of the Group is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the services they provide. Each of the Group's business segments represents a strategic business unit that offers services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

- (a) the airline operations segment comprises the provision of air passenger and air cargo services;
- (b) the engineering services segment comprises the provision of aircraft engineering services, including aircraft maintenance, repair and overhaul services;
- (c) the airport terminal services segment comprises the provision of ground services, including check-in service, boarding service, premium class lounge service, ramp service, luggage handling service, loading and unloading services, cabin cleaning and transit services; and
- (d) the "others" segment comprises the provision of air catering services and other airline-related services.

The profit before tax of a segment represents revenue less expenses directly attributable to a segment and the relevant portion of enterprise revenue less expenses that can be allocated on a reasonable basis to a segment, whether from external transactions or from transactions with other segments of the Group.

Segment assets and liabilities mainly comprise operating assets and liabilities that are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

In determining the Group's geographical segments, revenue is attributed to the segments based on the origin and destination of each flight segment. Assets, which consist principally of aircraft and ground equipment, supporting the entire worldwide transportation system, are mainly located in Mainland China. An analysis of assets and capital expenditure of the Group by geographical distribution has therefore not been included.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 3 SEGMENT INFORMATION (Continued)

### Business segments

The following tables present revenue, profit/(loss) and certain asset, liability and expenditure information for the Group's business segments for the years ended 31 December 2008 and 2007:

#### Year ended 31 December 2008

	Airline operations RMB'000	Engineering services RMB'000	Airport terminal services RMB'000	Others RMB'000	Eliminations RMB'000	Total RMB'000
<b>REVENUE</b>						
Sales to external customers	51,512,906	613,784	547,571	233,900	-	52,908,161
Intersegment sales	-	794,571	-	418,566	(1,213,137)	-
<b>Total revenue</b>	<b>51,512,906</b>	<b>1,408,355</b>	<b>547,571</b>	<b>652,466</b>	<b>(1,213,137)</b>	<b>52,908,161</b>
<b>PROFIT/(LOSS) FROM OPERATIONS</b>						
Segment results	(1,815,873)	9,512	(128,709)	27,304	-	(1,907,766)
Finance revenue	1,529,955	25,151	-	29,331	-	1,584,437
Finance costs	(9,926,827)	(21,524)	-	(167)	-	(9,948,518)
Gain on disposal of subsidiaries and associates	477,680	-	-	-	-	477,680
Share of profits and losses of associates	(1,273,558)	7,272	61,817	20,956	-	(1,183,513)
Loss before tax						(10,977,680)
Tax						1,610,650
<b>Loss for the year</b>						<b>(9,367,030)</b>
<b>ASSETS</b>						
Segment assets	89,989,169	1,771,651	714,647	1,505,361	(1,929,414)	92,051,414
Interests in associates	5,896,050	154,086	39,525	181,872	-	6,271,533
Unallocated assets						2,078,277
<b>Total assets</b>						<b>100,401,224</b>
<b>LIABILITIES</b>						
Segment liabilities	(77,942,245)	(1,136,944)	(1,134,812)	(1,257,256)	1,929,414	(79,541,843)
Unallocated liabilities						(402,875)
<b>Total liabilities</b>						<b>(79,944,718)</b>
<b>OTHER SEGMENT INFORMATION</b>						
Capital expenditure (including additions to property, plant and equipment and advance payments for aircraft, and related equipment)	21,408,251	311,556	1,034,871	5,832	-	22,760,510
Depreciation of property, plant and equipment	6,249,646	53,840	54,359	7,430	-	6,365,275
Amortisation of lease prepayments	28,656	-	-	-	-	28,656
Impairment of property, plant and equipment	74,835	-	-	-	-	74,835
Impairment of aircraft held for sale	206,566	-	-	-	-	206,566
Impairment of inventories	11,115	25,020	-	-	-	36,135
Impairment of accounts receivable	653	-	-	-	-	653
Unrealised loss on derivative financial instruments	7,706,894	-	-	-	-	7,706,894
Recognition of deferred income related to frequent-flyer programme	(678,925)	-	-	-	-	(678,925)
Recognition of deferred income related to government grant	(76,943)	-	-	-	-	(76,943)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 3 SEGMENT INFORMATION (Continued)

### Business segments (Continued)

Year ended 31 December 2007 (Restated)

	Airline operations RMB'000	Engineering services RMB'000	Airport terminal services RMB'000	Others RMB'000	Eliminations RMB'000	Total RMB'000
<b>REVENUE</b>						
Sales to external customers	49,779,975	487,710	509,450	304,532	-	51,081,667
Intersegment sales	-	674,123	-	190,758	(864,881)	-
<b>Total revenue</b>	<b>49,779,975</b>	<b>1,161,833</b>	<b>509,450</b>	<b>495,290</b>	<b>(864,881)</b>	<b>51,081,667</b>
<b>PROFIT FROM OPERATIONS</b>						
Segment results	3,642,044	12,478	7,238	14,419	-	3,676,179
Finance revenue	2,328,035	21,791	-	26,746	-	2,376,572
Finance costs	(1,954,476)	(13,400)	-	(1,450)	-	(1,969,326)
Share of profits and losses of associates	1,214,190	5,189	117,808	27,553	-	1,364,740
Profit before tax						5,448,165
Tax						(1,511,613)
Profit for the year						<b>3,936,552</b>
<b>ASSETS</b>						
Segment assets	79,308,581	1,441,639	371,119	1,096,601	(1,330,985)	80,886,955
Interests in associates	9,013,689	153,911	119,317	255,760	-	9,542,677
Unallocated assets						870,645
<b>Total assets</b>						<b>91,300,277</b>
<b>LIABILITIES</b>						
Segment liabilities	(58,140,630)	(827,806)	(608,978)	(890,013)	1,330,985	(59,136,442)
Unallocated liabilities						(1,411,585)
<b>Total liabilities</b>						<b>(60,548,027)</b>
<b>OTHER SEGMENT INFORMATION</b>						
Capital expenditure (including additions to property, plant and equipment and advance payments for aircraft, and related equipment)	20,591,633	215,990	134,954	3,852	-	20,946,429
Depreciation of property, plant and equipment	5,447,151	38,594	66,324	2,374	-	5,554,443
Amortisation of lease prepayments	22,478	-	-	-	-	22,478
Impairment of aircraft held for sale	142,800	-	-	-	-	142,800
Impairment of available-for-sale investments	-	-	-	4,481	-	4,481
Unrealised gain on derivative financial instruments	(133,840)	-	-	-	-	(133,840)
Recognition of deferred income related to frequent-flyer programme	(578,211)	-	-	-	-	(578,211)
Recognition of deferred income related to government grant	(76,943)	-	-	-	-	(76,943)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 3 SEGMENT INFORMATION (Continued)

### Geographical segments

The following tables present the Group's consolidated revenue by geographical segment for the years ended 31 December 2008 and 2007:

#### Year ended 31 December 2008

	Mainland China <i>RMB'000</i>	Hong Kong and Macau <i>RMB'000</i>	Europe <i>RMB'000</i>	North America <i>RMB'000</i>	Japan and Korea <i>RMB'000</i>	Asia Pacific and others <i>RMB'000</i>	Total <i>RMB'000</i>
Sales to external customers and total revenue	27,272,415	3,559,564	8,971,139	5,708,150	4,205,811	3,191,082	52,908,161

#### Year ended 31 December 2007 (Restated)

	Mainland China <i>RMB'000</i>	Hong Kong and Macau <i>RMB'000</i>	Europe <i>RMB'000</i>	North America <i>RMB'000</i>	Japan and Korea <i>RMB'000</i>	Asia Pacific and others <i>RMB'000</i>	Total <i>RMB'000</i>
Sales to external customers and total revenue	27,558,480	3,930,462	7,581,769	4,658,495	4,583,332	2,769,129	51,081,667

## 4 AIR TRAFFIC REVENUE

Air traffic revenue comprises revenue from the airline operations business and is stated net of business tax. An analysis of the Group's air traffic revenue during the year is as follows:

	Group	
	2008 <i>RMB'000</i>	2007 <i>RMB'000</i> (Restated)
Passenger	43,352,020	43,398,754
Cargo and mail	7,184,675	4,085,456
	50,536,695	47,484,210

Pursuant to the relevant business tax rules and regulations in Mainland China, air traffic revenue for all domestic and outbound international flights is subject to business tax at a rate of 3%. All inbound international, Hong Kong and Macau regional flights are exempted from business tax. Business tax incurred and set off against air traffic revenue for the year ended 31 December 2008 amounted to approximately RMB1,047 million (2007: RMB1,224 million).

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 5 OTHER OPERATING REVENUE

	Group	
	2008 RMB'000	2007 RMB'000 (Restated)
Bellyhold income from a joint venture (note 55)	–	1,579,185
Aircraft engineering income	<b>613,784</b>	487,710
Ground service income	<b>547,571</b>	509,450
Air catering income	<b>86,234</b>	162,886
Government grants:		
Recognition of deferred income related to government grant (note 42)	<b>76,943</b>	76,943
Others	<b>331,358</b>	131,136
Service charges on return of unused flight tickets	<b>186,002</b>	152,107
Cargo handling service income	<b>129,167</b>	62,466
Sale of materials	<b>20,415</b>	12,648
Import and export service income	<b>8,784</b>	7,850
Training service income	<b>23,955</b>	20,837
Rental income:		
Aircraft and related equipment	<b>14,952</b>	12,688
Others	<b>24,974</b>	27,755
Gain on disposal of property, plant and equipment, net	<b>29,624</b>	165,311
Others	<b>277,703</b>	188,485
	<b>2,371,466</b>	3,597,457

## 6 EMPLOYEE COMPENSATION COSTS

An analysis of the Group's employee compensation costs, including the emoluments of Directors and Supervisors, is as follows:

	Group	
	2008 RMB'000	2007 RMB'000
Wages, salaries and social security costs	<b>5,424,748</b>	4,817,539
Retirement benefits costs (note 11)	<b>439,733</b>	368,241
Share-based benefits (note 46)	<b>(20,594)</b>	23,986
	<b>5,843,887</b>	5,209,766



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 7 PROFIT/(LOSS) FROM OPERATIONS

The Group's profit/(loss) from operations is arrived at after charging/(crediting):

	Group	
	2008 RMB'000	2007 RMB'000
Auditors' remuneration	13,789	14,261
Depreciation (note 16)	6,365,275	5,554,443
Impairment of property, plant and equipment (note 16)	74,835	–
Loss on derecognition of property, plant and equipment	26,300	37,138
Amortisation of lease prepayments (note 17)	28,656	22,478
Minimum lease payments under operating leases:		
Aircraft and related equipment	2,400,060	2,239,359
Land and buildings	444,483	311,262
Impairment of available-for-sale investments (note 24)	–	4,481
Impairment of aircraft held for sale (note 26)	206,566	142,800
Impairment of inventories	36,135	–
Impairment of accounts receivable (note 28)	653	–

## 8 FINANCE REVENUE AND FINANCE COSTS

An analysis of the Group's finance revenue and finance costs during the year is as follows:

### Finance revenue

	Group	
	2008 RMB'000	2007 RMB'000
Exchange gains, net	1,486,746	2,030,391
Interest income	97,389	110,013
Dividend income from available-for-sale investments	302	224
Gain on derivative financial instruments:		
Realised gain	–	102,104
Unrealised gain	–	133,840
	<b>1,584,437</b>	<b>2,376,572</b>

### Finance costs

	Group	
	2008 RMB'000	2007 RMB'000
Interest on interest-bearing bank and other borrowings	1,531,015	1,572,793
Interest on finance leases	580,447	650,613
Loss on derivative financial instruments:		
Realised loss	447,941	–
Unrealised loss	7,706,894	–
	<b>10,266,297</b>	<b>2,223,406</b>
Less: Interest capitalised	<b>(317,779)</b>	<b>(254,080)</b>
	<b>9,948,518</b>	<b>1,969,326</b>

The interest capitalisation rates ranging from 2.3% to 7.0% (2007: 4.5% to 6.8%) per annum represent the cost of related borrowings during the year.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 9 GAIN ON DISPOSAL OF SUBSIDIARIES AND AN ASSOCIATE

During the year ended 31 December 2008, CNAC sold the entire issued share capital of each of Fly Top and CNAL and 50% of the issued share capital of JASL. Further details of the transaction are included in note 1 to the financial statements.

	2008 RMB'000
Net assets of subsidiaries disposed of:	
Property, plant and equipment ( <i>Note 16</i> )	280,689
Interest in an associate	91,082
Deferred tax assets	7,604
Inventories	5,157
Accounts receivable	89,007
Prepayments, deposits and other receivables	9,141
Cash and cash equivalents	47,799
Accounts payable	(40,377)
Other payables and accruals	(80,663)
Tax payable	(2,902)
Bank and other loans	(100,680)
Long term payables	(22,294)
	283,563
Share of net assets of an associate disposed of	88,757
Gain on disposal of subsidiaries and an associate	477,680
Satisfied by cash	850,000

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of subsidiaries and an associate is as follows:

	RMB'000
Cash consideration	850,000
Cash and cash equivalents disposed of	(47,799)
Net inflow of cash and cash equivalents in respect of the disposal of subsidiaries and an associate	802,201

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES

Remuneration of the Company's Directors and Supervisors for the year disclosed pursuant to the Rules Governing the Listing of Securities on the HKSE and Section 161 of the Hong Kong Companies Ordinance is as follows:

	Group	
	2008 RMB'000	2007 RMB'000
Fees	240	200
Basic salaries, housing benefits, other allowances and benefits in kind	766	1,289
Discretionary bonuses	1,178	1,795
Retirement benefits	87	105
	<b>2,271</b>	<b>3,389</b>

	Basic salaries, housing benefits, other allowances and benefits in kind		Discretionary bonuses RMB'000	Retirement benefits RMB'000	Total RMB'000
	Fees RMB'000	RMB'000			
<b>Year ended 31 December 2008</b>					
<b>Directors</b>					
Kong Dong	-	-	-	-	-
Wang Yinxiang	-	-	-	-	-
Wang Shixiang	-	-	-	-	-
Yao Weiting	-	-	-	-	-
Christopher Dale Pratt	-	-	-	-	-
Chen Nan Lok Philip	-	-	-	-	-
Ma Xulun	-	-	-	-	-
Cai Jianjiang	-	259	514	23	796
Fan Cheng	-	236	462	23	721
Hu Hung Lick, Henry	60	-	-	-	60
Wu Zhipan	60	-	-	-	60
Zhang Ke	60	-	-	-	60
Jia Kang	60	-	-	-	60
	240	495	976	46	1,757
<b>Supervisors</b>					
Sun Yude	-	-	-	-	-
Liao Wei	-	-	-	-	-
He Chaofan	-	-	-	-	-
Zhou Guoyou	-	-	-	-	-
Liu Feng	-	173	170	23	366
Liu Guoqing	-	98	32	18	148
	-	271	202	41	514
	240	766	1,178	87	2,271

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES (Continued)

	Fees RMB'000	Basic salaries, housing benefits, other allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Retirement benefits RMB'000	Total RMB'000
Year ended 31 December 2007					
<b>Directors</b>					
Li Jiaxiang	-	-	-	-	-
Kong Dong	-	196	-	-	196
Wang Shixiang	-	-	-	-	-
Yao Weiting	-	-	-	-	-
Christopher Dale Pratt	-	-	-	-	-
Chen Nan Lok Philip	-	-	-	-	-
Ma Xulun	-	250	552	21	823
Cai Jianjiang	-	250	552	21	823
Fan Cheng	-	228	497	21	746
Hu Hung Lick, Henry	50	15	-	-	65
Wu Zhipan	50	-	-	-	50
Zhang Ke	50	-	-	-	50
Jia Kang	50	-	-	-	50
	200	939	1,601	63	2,803
<b>Supervisors</b>					
Zhang Xianlin	-	163	-	-	163
Sun Yude	-	-	-	-	-
Liao Wei	-	-	-	-	-
Zhang Huilan	-	-	-	-	-
Zhou Guoyou	-	-	-	-	-
Liu Feng	-	115	137	21	273
Liu Guoqing	-	72	57	21	150
	-	350	194	42	586
	200	1,289	1,795	105	3,389

Fees of RMB240,000 (2007: RMB200,000) were paid or payable to the Company's Independent Non-Executive Directors during the year. There were no emoluments payable to other Independent Non-Executive Directors during the year (2007: RMB15,000).

The discretionary bonuses disclosed above were determined based on the Group's operating result of the prior year and were approved in the current year. The discretionary bonuses for the current year would be determined based on the Group's operating results for 2008 and will be approved in 2009.

In addition to the above, certain Directors and Supervisors have been granted SARs in respect of their services to the Group, further details of which are set out in note 46 to the financial statements. The aggregate fair value of these SARs was RMB405,000 as at 31 December 2008 (2007: RMB3,339,000).

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES (Continued)

An analysis of the five highest paid employees within the Group is as follows:

	Group	
	2008 <i>Number of individuals</i>	2007 <i>Number of individuals</i>
Directors	1	1
Employees	4	4

The emoluments paid to the four (2007: four) non-director and non-supervisor highest paid employees are as follows:

	Group	
	2008 <i>RMB'000</i>	2007 <i>RMB'000</i>
Basic salaries, housing benefits, other allowances and benefits in kind	3,704	3,886
Retirement benefits	47	33
	<b>3,751</b>	<b>3,919</b>

The number of these four (2007: four) non-director and non-supervisor highest paid employees whose remuneration for the year fell within the following bands is as follows:

	Group	
	2008 <i>Number of individuals</i>	2007 <i>Number of individuals</i>
Nil to HK\$1,000,000 (equivalent to 2008: RMB454,573 to RMB909,144; 2007: Nil)	3	–
HK\$1,000,001 to HK\$1,500,000 (equivalent to 2008: RMB909,145 to RMB1,363,718; 2007: RMB970,551 to RMB1,455,825)	1	1
HK\$1,500,001 to HK\$2,000,000 (equivalent to 2008: RMB1,363,719 to RMB1,818,290; 2007: RMB1,455,826 to RMB1,941,100)	–	3
	<b>4</b>	<b>4</b>

There was no arrangement under which a Director or a Supervisor waived or agreed to waive any remuneration during the year (2007: Nil).

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 11 RETIREMENT BENEFIT COSTS

All of the Group's full-time employees in Mainland China are covered by a government-regulated defined contribution retirement scheme, and are entitled to an annual pension determined by their basic salaries upon their retirement. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated defined contribution retirement scheme at rates ranging from 15% to 20% (2007: 15% to 20%) of the employees' basic salaries during the year and has no further obligations for post-retirement benefits in respect of the above. The related pension costs are expensed as incurred. Contributions to other defined contribution retirement schemes operated by the Group are charged to the income statement in the year which the contributions relate to.

The Group also implemented an early retirement plan for certain employees in addition to the benefits under the government-regulated defined contribution retirement scheme described above. The benefits of the early retirement plan are calculated based on factors including the remaining number of years of services from the date of early retirement to the normal retirement date and the salary amount on the date of early retirement of the employees. The costs of early retirement benefits were recognised in the period when employees opted for early retirement. Where the effect of discounting is material, the amount recognised for early retirement benefits is the present value at the balance sheet date of the future cash flows expected to be required to settle the obligations. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

The retirement benefits costs in relation to the defined contribution retirement scheme and the early retirement benefits are as follows:

	Group	
	2008 RMB'000	2007 RMB'000
Contributions to defined contribution retirement scheme	367,938	332,411
Early retirement benefits	71,795	35,830
Total retirement benefits costs (note 6)	439,733	368,241

As at 31 December 2008, no forfeited contributions were available to reduce its contributions to the defined contribution retirement schemes operated by the Group in future years (2007: Nil).

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 12 TAX

Under the relevant PRC Corporate Income Tax Law and the respective regulations, except for certain preferential treatment available to the Company's subsidiaries and joint ventures, which are taxed at preferential rates ranging from 12.5% to 18% (2007: 12% to 15%), the PRC entities within the Group are subject to corporate income tax at a rate of 25% (2007: 33%) during the year.

In accordance with an approval document issued by the relevant tax bureau on 28 November 2005 (the "Approval Document"), Air China Cargo was subject to a state corporate income tax rate of 24% and was fully exempted from state corporate income tax for the year ended 31 December 2005, followed by a three-year 50% reduction in state corporate income tax during the period between 1 January 2006 and 31 December 2008. In addition, pursuant to the Approval Document, Air China Cargo has been granted a four-year local corporate income tax exemption during the period between 1 January 2005 and 31 December 2008, followed by a five-year 50% reduction in local corporate income tax during the period between 1 January 2009 and 31 December 2013.

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law (the "New CIT Law") was approved and became effective on 1 January 2008. The New CIT Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested enterprises and foreign-invested enterprises, which results in a reduction of income tax rate from 33% to 25%. The effect of this change has been reflected in the calculation of deferred income tax as at 31 December 2007.

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the territories/countries in which the relevant companies within the Group operate, based on existing legislation, interpretations and practices in respect thereof.

	<b>Group</b>	
	<b>2008</b>	2007
	<b>RMB'000</b>	RMB'000
		(Restated)
Current income tax - Mainland China:		
Provision for the year	<b>38,121</b>	1,260,855
Overprovision in prior years	<b>(541,865)</b>	-
	<b>(503,744)</b>	1,260,855
Deferred income tax ( <i>note 25</i> )	<b>(1,106,906)</b>	251,758
Income tax charge/(credit) for the year	<b>(1,610,650)</b>	1,512,613

The share of tax credit attributable to associates amounting to RMB239,425,000 (2007: share of tax charge of RMB193,915,329) is included in the "Share of profits and losses of associates" on the face of the consolidated income statement.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 12 TAX (Continued)

A reconciliation of the tax expense applicable to profit or loss before tax using the statutory rates for Mainland China in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rate, and a reconciliation of the applicable rate (i.e., the statutory tax rates) to the effective tax rate, are as follows:

	Group			
	2008		2007	
	RMB'000	%	RMB'000 (Restated)	%
(Loss)/profit before tax	<b>(10,977,680)</b>		5,448,165	
Tax at statutory tax rate	<b>(2,744,420)</b>	<b>25.0</b>	1,797,894	33.0
Tax effect of share of profits and losses of associates, net	<b>295,815</b>	<b>(2.7)</b>	(450,364)	(8.3)
Lower income tax rates enacted by other territories	<b>28,038</b>	<b>(0.3)</b>	54,074	1.0
Effect on opening deferred income tax due to decrease in income tax rate	–	–	157,128	2.9
Adjustment in respect of current income tax of previous periods	<b>(142,802)</b>	<b>1.3</b>	(67,033)	(1.2)
Income not subject to tax	<b>(134,807)</b>	<b>1.3</b>	(27,716)	(0.5)
Expenses not deductible for tax	<b>35,333</b>	<b>(0.3)</b>	22,650	0.4
Tax losses recognised from previous periods	<b>(19,511)</b>	<b>0.2</b>	–	–
Deductible temporary differences and tax losses not recognised	<b>1,071,704</b>	<b>(9.8)</b>	25,980	0.5
At the Group's effective income tax rate	<b>(1,610,650)</b>	<b>14.7</b>	1,512,613	27.8

As at 31 December 2008, there was no significant unrecognised deferred tax liability (2007: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and joint ventures as the Directors of the Company have no intention to request remittance of any significant amount of earnings to the Company in the foreseeable future.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

## 13 PROFIT/(LOSS) ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated loss attributable to equity holders of the Company for the year ended 31 December 2008 includes a loss of approximately RMB8,375 million (2007: profit of RMB2,917 million, as restated), which was arrived at after deducting dividend income received from subsidiaries, joint ventures and associates aggregating approximately RMB159 million (2007: RMB91 million) from the Company's loss of approximately RMB8,216 million (2007: profit of RMB3,008 million, as restated) that has been dealt with in the financial statements of the Company (note 45).



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 14 APPROPRIATIONS

	Company	
	2008 RMB'000	2007 RMB'000
Proposed final dividend – Nil (2007: RMB0.684) per 10 shares	–	837,987

- (a) No proposed final dividend has been proposed for 2008 (2007: RMB0.684).
- (b) Under the PRC Company Law and the Company's articles of association, profit after tax as reported in the PRC statutory financial statements can only be distributed as dividends after allowances has been made for the following:
- (i) Making up prior years' cumulative losses, if any;
  - (ii) Allocations to the statutory common reserve fund of at least 10% of after-tax profit, until the fund aggregates 50% of the Company's registered capital. For the purpose of calculating the transfer to reserves, the profit after tax shall be the amount determined under China Accounting Standards for Business Enterprises ("ASBE"). The transfer to this reserve must be made before any distribution of dividends to shareholders.

The statutory common reserve fund can be used to offset previous years' losses, if any, and part of the statutory common reserve fund can be capitalised as the Company's share capital provided that the amount of such reserve remaining after the capitalisation shall not be less than 25% of the share capital of the Company;

- (iii) Allocations to the discretionary common reserve if approved by the shareholders.

The above reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

In accordance with the articles of association of the Company, the profit after tax of the Company for the purpose of dividends payment is based on the lesser of (i) the profit determined in accordance with ASBE; and (ii) the profit determined in accordance with IFRSs.

## 15 EARNINGS/(LOSS) PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The calculation of basic loss per share for the year ended 31 December 2008 is based on the loss attributable to equity holders of the Company for the year ended 31 December 2008 of approximately RMB9,256 million, and the weighted average number of 11,864,209,374 ordinary shares in issue during the year, as adjusted to reflect the weighted average number of treasury shares held by Cathay Pacific Airways Limited ("Cathay") through reciprocal shareholding.

The calculation of basic earnings per share for the year ended 31 December 2007 was based on the profit attributable to equity holders of the Company for the year ended 31 December 2007 of approximately RMB4,046 million (restated), and the weighted average number of 11,878,992,909 ordinary shares in issue during the year, as adjusted to reflect the weighted average number of treasury shares held by Cathy through reciprocal shareholding.

Diluted earnings/(loss) per share amounts for the years ended 31 December 2008 and 2007 have not been disclosed because no diluting events existed during both years.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 16 PROPERTY, PLANT AND EQUIPMENT

### Group

	Aircraft and flight equipment RMB'000	Buildings RMB'000	Machinery RMB'000	Transportation equipment RMB'000	Office equipment RMB'000	Construction in progress RMB'000	Total RMB'000
As at 1 January 2007, net of accumulated depreciation	48,337,845	2,658,727	955,774	463,540	133,347	2,218,431	54,767,664
Additions	9,231,312	6,036	112,445	172,058	60,635	3,711,578	13,294,064
Disposals	(383,744)	(74,636)	(2,941)	(6,038)	(811)	-	(468,170)
Transfer from construction in progress	1,964,974	239,364	86,429	91,694	1,070	(2,383,531)	-
Reclassification to aircraft held for sale under current assets (note 26)	(327,528)	-	-	-	-	-	(327,528)
Depreciation charge for the year	(5,058,427)	(125,237)	(193,679)	(132,714)	(44,386)	-	(5,554,443)
Exchange adjustment	(13,269)	(4,574)	-	(2,071)	-	-	(19,914)
As at 31 December 2007 and 1 January 2008, net of accumulated depreciation	53,751,163	2,699,680	958,028	586,469	149,855	3,546,478	61,691,673
Additions	11,427,465	13,896	107,164	63,007	111,967	3,984,503	15,708,002
Acquisition of additional interest in a joint venture	1,220,474	125,334	64,960	34,374	-	53,487	1,498,629
Disposals	(120,986)	(16,459)	(3,808)	(3,255)	(753)	-	(145,261)
Disposal of subsidiaries (note 9)	-	(69,769)	(22,254)	(46,987)	(2,205)	(139,474)	(280,689)
Transfer from construction in progress	1,719,070	1,030,774	400,200	337,868	14,393	(3,502,305)	-
Reclassification to aircraft held for sale under current assets (note 26)	(195,249)	-	-	-	-	-	(195,249)
Impairment	(74,835)	-	-	-	-	-	(74,835)
Depreciation charge for the year	(5,776,824)	(149,402)	(211,868)	(159,503)	(67,678)	-	(6,365,275)
Exchange adjustment	(10,143)	(3,910)	-	(1,942)	-	-	(15,995)
As at 31 December 2008, net of accumulated depreciation and impairment	<b>61,940,135</b>	<b>3,630,144</b>	<b>1,292,422</b>	<b>810,031</b>	<b>205,579</b>	<b>3,942,689</b>	<b>71,821,000</b>
As at 31 December 2007 and 1 January 2008							
Cost	89,419,255	4,007,940	2,493,040	1,489,509	374,775	3,546,478	101,330,997
Accumulated depreciation	(35,668,092)	(1,308,260)	(1,535,012)	(903,040)	(224,920)	-	(39,639,324)
Net book value	53,751,163	2,699,680	958,028	586,469	149,855	3,546,478	61,691,673
As at 31 December 2008							
Cost or valuation	<b>103,087,583</b>	<b>5,082,355</b>	<b>3,012,386</b>	<b>1,863,624</b>	<b>487,525</b>	<b>3,942,689</b>	<b>117,476,162</b>
Accumulated depreciation and impairment	<b>(41,147,448)</b>	<b>(1,452,211)</b>	<b>(1,719,964)</b>	<b>(1,053,593)</b>	<b>(281,946)</b>	<b>-</b>	<b>(45,655,162)</b>
Net book value	<b>61,940,135</b>	<b>3,630,144</b>	<b>1,292,422</b>	<b>810,031</b>	<b>205,579</b>	<b>3,942,689</b>	<b>71,821,000</b>

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 16 PROPERTY, PLANT AND EQUIPMENT (Continued)

### Company

	Aircraft and flight equipment RMB'000	Buildings RMB'000	Machinery RMB'000	Transportation equipment RMB'000	Office equipment RMB'000	Construction in progress RMB'000	Total RMB'000
As at 1 January 2007, net of accumulated depreciation	46,640,435	2,015,427	755,782	342,570	103,466	2,164,195	52,021,875
Additions	9,176,250	-	67,933	135,469	46,700	3,401,865	12,828,217
Disposals	(337,853)	(9,735)	(736)	(2,459)	(292)	-	(351,075)
Transfer from construction in progress	1,964,974	234,732	81,927	91,694	1,070	(2,374,397)	-
Depreciation charge for the year	(4,843,730)	(93,745)	(160,706)	(107,665)	(34,252)	-	(5,240,098)
As at 31 December 2007 and 1 January 2008, net of accumulated depreciation	52,600,076	2,146,679	744,200	459,609	116,692	3,191,663	59,258,919
Additions	11,142,616	11,167	44,766	42,969	84,785	2,803,240	14,129,543
Disposals	(379,211)	(16,081)	(1,595)	(1,142)	(313)	-	(398,342)
Transfer from construction in progress	1,588,429	689,991	344,026	330,990	-	(2,953,436)	-
Reclassification to aircraft held for sale under current assets (note 26)	(349,107)	-	-	-	-	-	(349,107)
Depreciation charge for the year	(5,623,127)	(111,444)	(163,460)	(126,375)	(46,068)	-	(6,070,474)
As at 31 December 2008, net of accumulated depreciation	<b>58,979,676</b>	<b>2,720,312</b>	<b>967,937</b>	<b>706,051</b>	<b>155,096</b>	<b>3,041,467</b>	<b>66,570,539</b>
As at 31 December 2007 and 1 January 2008							
Cost	88,146,626	3,183,536	1,891,739	1,193,658	250,943	3,191,663	97,858,165
Accumulated depreciation	(35,546,550)	(1,036,857)	(1,147,539)	(734,049)	(134,251)	-	(38,599,246)
Net book value	52,600,076	2,146,679	744,200	459,609	116,692	3,191,663	59,258,919
As at 31 December 2008							
Cost	<b>98,613,433</b>	<b>3,856,636</b>	<b>2,257,951</b>	<b>1,545,942</b>	<b>331,008</b>	<b>3,041,467</b>	<b>109,646,437</b>
Accumulated depreciation	<b>(39,633,757)</b>	<b>(1,136,324)</b>	<b>(1,290,014)</b>	<b>(839,891)</b>	<b>(175,912)</b>	<b>-</b>	<b>(43,075,898)</b>
Net book value	<b>58,979,676</b>	<b>2,720,312</b>	<b>967,937</b>	<b>706,051</b>	<b>155,096</b>	<b>3,041,467</b>	<b>66,570,539</b>

As at 31 December 2008, certain of the Group's aircraft and buildings with an aggregate net book value of approximately RMB12,057 million (2007: RMB12,255 million) were pledged to secure certain bank loans of the Group (note 38).

The aggregate net book value of aircraft held under finance leases included in the property, plant and equipment of the Group amounted to RMB23,279 million (2007: RMB21,948 million) (note 37 (a)).

As at 31 December 2008, the Group was in the process of applying for the title certificates of certain of its buildings with an aggregate net book value of approximately RMB101 million (2007: RMB114 million) which were transferred from Air China International Corporation, the predecessor of the Company, upon incorporation. The Group was also in the process of applying for title certificates of certain buildings acquired by the Group after incorporation with an aggregate net book value of approximately RMB1,197 million (2007: RMB384 million). The Directors of the Company are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned buildings. The Directors of the Company are also of the opinion that the aforesaid matter did not have any significant impact on the Group's financial position as at 31 December 2008.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 17 LEASE PREPAYMENTS

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<b>Cost</b>				
As at 1 January	1,111,225	1,056,558	1,032,079	1,034,219
Additions	625,836	61,969	625,836	5,162
Acquisition of additional interest in a joint venture	306,636	–	–	–
Disposal	(4,693)	(7,302)	(2,432)	(7,302)
As at 31 December	2,039,004	1,111,225	1,655,483	1,032,079
<b>Accumulated amortisation</b>				
As at 1 January	(65,183)	(43,029)	(62,354)	(42,335)
Amortisation for the year	(28,656)	(22,478)	(20,511)	(20,343)
Disposal	93	324	93	324
As at 31 December	(93,746)	(65,183)	(82,772)	(62,354)
<b>Net book value</b>				
As at 31 December	1,945,258	1,046,042	1,572,711	969,725

The Group's lease prepayments comprise land use rights which are held under long term leases and are situated in Mainland China.

As at 31 December 2008, certain of the Group's land use rights with an aggregate net book value of approximately RMB36 million (2007: RMB37 million) were pledged to secure certain of the Group's bank loans (note 38(a)).

As at 31 December 2008, the Group was in the process of applying for the title certificates of certain land use rights acquired by the Group after incorporation with an aggregate net book value of approximately RMB606 million (2007: RMB5 million). The Directors of the Company are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned land use rights. The Directors of the Company are also of the opinion that the aforesaid matter did not have any significant impact on the Group's financial position as at 31 December 2008.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 18 INTANGIBLE ASSET

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
As at 1 January	75,194	–	75,194	–
Addition upon admission to Star Alliance	–	75,194	–	75,194
Deduction upon admission of new Star Alliance member	(15,047)	–	(15,047)	–
As at 31 December	60,147	75,194	60,147	75,194

The Group's intangible asset represents admission rights to Star Alliance which is stated at cost and has an indefinite useful life.

## 19 GOODWILL

	Group	
	2008 RMB'000	2007 RMB'000
Acquisition of additional interest in a joint venture during the year and balance as at 31 December (note 49)	346,845	–

The Group's goodwill arose from the acquisition of 25% equity interest in Air China Cargo in addition to the 51% equity interest it already held (note 1).

## 20 INTERESTS IN SUBSIDIARIES

	Company	
	2008 RMB'000	2007 RMB'000
Unlisted investments, at cost	10,327,299	9,205,299
Due from subsidiaries (note 53)	858,658	65,367
Due to subsidiaries (note 53)	(478,738)	(451,419)
	10,707,219	8,819,247

The balances with the subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 20 INTERESTS IN SUBSIDIARIES (Continued)

Particulars of the principal subsidiaries at 31 December 2008 are as follows:

Company name	Place of incorporation/ registration and operations	Legal status	Nominal value of paid-up capital	Percentage of equity interests attributable to the Company		Principal activities
				Direct	Indirect	
Air China Cargo (中國國際貨運航空有限公司)	PRC/ Mainland China	Limited liability company	RMB2,200,000,000	51	25	Provision of cargo carriage services
CNAC (中航興業有限公司)	Hong Kong	Limited liability company	HK\$400,000,000	69	31	Investment holding
Air Macau Company Limited ("Air Macau") (澳門航空股份有限公司)	Macau	Limited liability company	MOP400,000,000	–	51	Airline operator
Air China Group Import and Export Trading Co. ("AIE") (國航集團進出口貿易公司)	PRC/ Mainland China	Limited liability company	RMB95,080,786	100	–	Import and export trading
Zhejiang Air Services Co., Ltd.# (浙江航空服務有限公司)	PRC/ Mainland China	Limited liability company	RMB20,000,000	100	–	Provision of airline catering and shuttle bus service
Air China Shantou Industrial Development Company (中國國際航空汕頭實業 發展公司)	PRC/ Mainland China	Limited liability company	RMB18,000,000	51	–	Manufacture and retail of aircraft supplies
Air China Development Corporation (Hong Kong) Limited (國航香港發展有限公司)	Hong Kong	Limited liability company	HK\$9,379,010	95	–	Provision of air ticketing services
Shanghai Air China Aviation Service Co., Ltd.# (上海國航航空服務有限公司)	PRC/ Mainland China	Limited liability company	RMB2,000,000	100	–	Provision of ground service, air passenger, cargo and consultancy services
Beijing Golden Phoenix Human Resource Co., Ltd.# (北京金鳳凰人才交流有限公司)	PRC/ Mainland China	Limited liability company	RMB1,700,000	100	–	Provision of human resources services
Total Transform Group Limited (國航海外控股有限公司)	British Virgin Islands	Limited liability company	HK\$8,427,046,547	99.9	0.1	Investment holding
Angel Paradise Limited	British Virgin Islands	Limited liability company	US\$10	–	100	Investment holding

# The English names of these companies are direct translations of their Chinese names.

The above table lists the subsidiaries of the Company which, in the opinion of the Directors, principally affected the results for the year ended 31 December 2008 or formed a substantial portion of the net assets of the Group at 31 December 2008. To give details of other subsidiaries would, in the opinion of the Directors, result in particulars of excessive length.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 21 INTERESTS IN JOINT VENTURES

	Company	
	2008 RMB'000	2007 RMB'000
Unlisted investments, at cost	303,287	1,403,788

Particulars of the joint ventures of the Group at 31 December 2008 are as follows:

Company name	Place of incorporation/ registration and operations	Issued capital	Percentage of			Principal activities
			Ownership interest	Voting power	Profit sharing	
Aircraft Maintenance and Engineering Corporation, Beijing (北京飛機維修工程有限公司)	PRC/ Mainland China	US\$187,533,000	60	57.1	60	Provision of aircraft overhaul and maintenance services
Macau Asia Express Ltd.	Macau	MOP100,000,000	68	68	68	Airline operator
SkyWork Capital Asia Ltd.	Hong Kong	HK\$30	33	33	33	Provision of financial services
ACT Cargo (USA), Inc.	United States	US\$500,000	51	50	51	Cargo forwarding agent

As at the balance sheet date and for the two years ended 31 December 2008, the Group's proportionate share of the assets, liabilities, and the Group's proportionate share of the revenue and expenses of the joint ventures are as follows:

	Group	
	2008 RMB'000	2007 RMB'000
Current assets	1,036,905	1,489,241
Non-current assets	925,928	2,618,253
Current liabilities	(737,848)	(1,393,529)
Non-current liabilities	(339,678)	(762,336)
Net assets attributable to the Group	<b>885,307</b>	1,951,629
Revenue	1,359,457	4,977,977
Operating expenses	(1,322,240)	(5,169,310)
Finance revenue	25,180	58,037
Finance costs	(22,378)	(48,898)
Profit/(loss) before tax	40,019	(182,194)
Tax	(15,872)	(30,245)
Profit/(loss) attributable to the Group	<b>24,147</b>	(212,439)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 22 INTERESTS IN ASSOCIATES

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Listed shares in Mainland China, at cost	–	–	163,477	163,477
Unlisted investments, at cost	–	–	720,982	847,982
Share of net assets	5,004,702	7,854,720	–	–
Goodwill on acquisition	1,578,533	1,627,888	–	–
Due from associates (note 53)	161,219	183,224	35,791	40,555
Due to associates (note 53)	(472,921)	(123,155)	(87,047)	(118,768)
	<b>6,271,533</b>	9,542,677	<b>833,203</b>	933,246
Market value of listed shares			157,776	640,224

As at 31 December 2008, certain number of listed shares in an associate of the Group with an aggregate market value of approximately RMB3,071 million (2007: RMB7,609 million) were pledged to secure certain bank loans of the Group (note 38(b)).

As at 31 December 2008, the Group was in the process of completing the registration of its equity interests in an associate, which was transferred from Air China International Corporation upon incorporation, with an aggregate investment cost of approximately RMB75 million (2007: RMB200 million) and carrying amount of approximately RMB171 million (2007: RMB564 million). The Directors of the Company are of the view that the aforesaid matter did not have any significant impact on the Group's ownership in those equity interests and hence the Group's financial position as at 31 December 2008.

Particulars of the associates as at 31 December 2008 are as follows:

Company name	Place of incorporation/ registration and operations	Nominal value of registered/issued share capital	Percentage of equity interests attributable to the Group	Principal activities
Cathay*# (國泰航空有限公司)	Hong Kong	HK\$787,139,514	17.5	Airline operator
Shenzhen Airlines Co., Ltd. (深圳航空有限責任公司) #	PRC/ Mainland China	RMB300,000,000	25	Airline operator
Shandong Aviation Group Corporation ("Shandong Aviation")# (山東航空集團有限公司)	PRC/ Mainland China	RMB580,000,000	49.4	Investment holding
Shandong Airlines Co., Ltd.# ("Shandong Airlines") (山東航空股份有限公司)	PRC/ Mainland China	RMB400,000,000	22.8	Airline operator
Sichuan SNECMA Aeroengine Maintenance Co., Ltd. ("SNECMA")# (四川斯奈克瑪航空發動機維修有限公司)	PRC/ Mainland China	US\$31,900,000	43.6	Provision of aircraft maintenance and repair services



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 22 INTERESTS IN ASSOCIATES (Continued)

Company name	Place of incorporation/ registration and operations	Nominal value of registered/issued share capital	Percentage of equity interests attributable to the Group	Principal activities
Chengdu Falcon Aircraft Engineering Service Co., Ltd. <sup>#</sup> (成都富凱飛機工程服務有限公司)	PRC/ Mainland China	RMB16,474,293	35.6	Provision of aircraft maintenance and repair services
Yunnan Airport Aircraft Maintenance Services Co., Ltd. <sup>#</sup> (雲南空港飛機維修服務公司)	PRC/ Mainland China	RMB10,000,000	40	Provision of aircraft maintenance and repair services
Menzies Macau Airport Services Limited* <sup>#</sup> (明捷澳門機場服務有限公司)	Macau	MOP10,000,000	41	Provision of airport ground handling services
Macau Aircraft Maintenance and Engineering Corporation*** <sup>#</sup> (澳門飛機維修工程有限公司)	Macau	MOP100	35	Provision of aircraft maintenance and repair services
Guangzhou Baiyun International Airport Ground Handling Service Company Limited <sup>#</sup> (廣州白雲國際機場地勤服務有限公司)	PRC/ Mainland China	RMB100,000,000	21	Provision of airport ground handling services
CAAC Cares Chongqing Co., Ltd. <sup>#</sup> (重慶民航凱亞信息技術有限公司)	PRC/ Mainland China	RMB9,800,000	24.5	Provision of airline-related information system services
Chengdu CAAC Southwest Cares Co., Ltd.*** <sup>#</sup> (成都民航西南凱亞有限責任公司)	PRC/ Mainland China	RMB2,000,000	35	Provision of airline-related information system services
China National Aviation Finance Co., Ltd. ("CNAF")*** <sup>#</sup> (中國航空集團財務有限責任公司)	PRC/ Mainland China	RMB505,269,500	23.5	Provision of financial services
Shanghai Guocheng aviation travel services co., Ltd.*** <sup>#</sup> (上海國程航空旅行社有限公司)	PRC/ Mainland China	RMB1,000,000	49	Provision of ticket agency and tour services

\* The equity interests of these associates are held indirectly through certain subsidiaries of the Company.

\*\* 19.3% of the Group's equity interest in CNAF is held directly by the Company, and the remaining 4.2% is held indirectly through subsidiaries of the Company.

\*\*\* The English names of these companies are direct translations of their Chinese names.

# Not audited by Ernst & Young Hong Kong or other member firm of the Ernst & Young global network.

The above table lists the associates of the Group which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group as at 31 December 2008. To give details of other associates would, in the opinion of the directors, result in particulars of excessive length.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 22 INTERESTS IN ASSOCIATES (Continued)

Summarised financial information of the Group's associates is as follows:

	Group	
	2008 RMB'000	2007 RMB'000
Aggregate of associates' financial position:		
Total assets	134,785,583	138,516,852
Total liabilities	(98,007,287)	(86,527,778)
Aggregate of associates' results:		
Revenue	95,929,284	89,211,451
Net profit	(7,943,592)	7,791,767

Movements of goodwill are as follows:

	Group	
	2008 RMB'000	2007 RMB'000
As at 1 January	1,627,888	1,630,205
Additions	–	1,283
Disposal	(49,355)	–
Exchange realignment	–	(3,600)
As at 31 December	1,578,533	1,627,888

## 23 LONG TERM RECEIVABLE FROM ULTIMATE HOLDING COMPANY

On 30 September 2004, the Company entered into an agreement with CNAHC whereby CNAHC agreed to assume the obligations to settle an aggregate amount of approximately RMB757 million, which was recorded by the Group as a government grant receivable as at 31 December 2003 of RMB842 million, consisting of a long term portion and a short term portion of RMB764 million and RMB78 million, respectively. This receivable from CNAHC is unsecured, interest-free and is repayable over eight years commencing from 31 December 2004 by 16 semi-annual instalments to be made by 30 June and 31 December each year. Pursuant to the relevant agreement, the first instalment amount of RMB25 million was settled by 31 December 2004 and the final instalment amount of approximately RMB32 million shall be settled by 30 June 2012, with the remaining 14 semi-annual instalment amounts of RMB50 million each to be settled by 30 June and 31 December each year between 30 June 2005 and 31 December 2011.

## 24 AVAILABLE-FOR-SALE INVESTMENTS

Available-for-sale investments consist of unlisted equity investments measured at cost less impairment losses.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 25 DEFERRED TAX ASSETS AND LIABILITIES

The movements in deferred tax assets and liabilities during the year are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000 (Restated)	2008 RMB'000	2007 RMB'000 (Restated)
Deferred tax liabilities:				
Balance at 1 January	300,181	513,935	286,690	502,633
Charge for the year (note 12)	92,362	(213,754)	105,853	(215,943)
Gross deferred tax liabilities at 31 December	392,543	300,181	392,543	286,690
Deferred tax assets:				
Balance at 1 January	870,645	1,336,157	790,690	1,269,633
Charge for the year (note 12)	1,199,268	(465,512)	1,183,853	(478,943)
Acquisition of additional interests in a joint venture	(39,657)	–	–	–
Disposal of interests in subsidiaries	(7,604)	–	–	–
Gross deferred tax assets at 31 December	2,022,652	870,645	1,974,543	790,690
Net deferred assets at 31 December	1,630,109	570,464	1,582,000	504,000

The principal components of the Group's and the Company's deferred tax assets and liabilities are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000 (Restated)	2008 RMB'000	2007 RMB'000 (Restated)
Deferred tax liabilities:				
Accelerated depreciation for tax purposes	(182,543)	(299,181)	(182,543)	(285,690)
Unrealised exchange gain	(210,000)	–	(210,000)	–
Other deferred tax liabilities	–	(1,000)	–	(1,000)
Gross deferred tax liabilities	(392,543)	(300,181)	(392,543)	(286,690)
Deferred tax assets:				
Additional tax deduction on revaluation surplus arising from restructuring	27,543	148,790	27,543	105,329
Provisions and accruals	512,788	606,620	473,000	583,361
Losses available for offsetting against future taxable income	453,321	13,235	447,000	–
Unrealised loss on derivative financial instruments	929,000	–	929,000	–
Other deferred tax assets	100,000	102,000	98,000	102,000
Gross deferred tax assets	2,022,652	870,645	1,974,543	790,690
Net deferred tax assets	1,630,109	570,464	1,582,000	504,000

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 25 DEFERRED TAX ASSETS AND LIABILITIES (Continued)

Deferred tax assets have not been recognised in respect of the following items:

	Group 2008 RMB'000	2007 RMB'000
Tax losses	347,983	50,537
Deductible temporary differences	4,252,090	142,800
	<b>4,600,073</b>	193,337

The Group has tax losses arising from the operation out of Mainland China of RMB347,983,000 (2007: RMB50,537,000) that will expire in three financial years for offsetting against future taxable profits. Deferred tax assets have not been recognised in respect of these losses as they have arisen in a subsidiary that has been loss-making for some years and it is not considered probable that sufficient taxable profits will be available in the near future against which the tax losses can be utilised.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

## 26 AIRCRAFT HELD FOR SALE

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
At 1 January	327,528	–	–	–
Acquisition of additional interest in a joint venture	314,685	–	–	–
Reclassification from property plant and equipment during the year (note 16)	195,249	327,528	349,107	–
At 31 December	837,462	327,528	349,107	–
Impairment	(486,566)	(142,800)	(41,509)	–
	<b>350,896</b>	184,728	<b>307,598</b>	–

The movements in provision for impairment of aircraft held for sale are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
At 1 January	(142,800)	–	–	–
Acquisition of additional interest in a joint venture	(137,200)	–	–	–
Provision during the year (note 7)	(206,566)	(142,800)	(41,509)	–
At 31 December	<b>(486,566)</b>	(142,800)	<b>(41,509)</b>	–

Aircraft held for sale represent aircraft to retire in the next 12 months and are measured at the lower of their carrying amounts and fair values less costs to sell.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 27 INVENTORIES

An analysis of inventories as at the balance sheet date is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Flight equipment spare parts	977,365	932,517	711,939	658,955
Work in progress	233,616	179,302	5,271	6,034
Catering supplies	31,616	30,231	24,706	24,882
	<b>1,242,597</b>	1,142,050	<b>741,916</b>	689,871

## 28 ACCOUNTS RECEIVABLE

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Accounts receivable	1,893,057	2,839,785	1,241,739	2,362,573
Impairment	(42,768)	(45,505)	(31,684)	(36,266)
	<b>1,850,289</b>	2,794,280	<b>1,210,055</b>	2,326,307

The Group normally allows a credit period ranging from 30 to 90 days to its sales agents and other customers while some major customers are granted a credit period up to or above six months. The Group seeks to maintain strict control over its outstanding receivables to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's accounts receivable relate to a large number of diversified customers, there is no significant concentration of credit risk. Accounts receivable are non-interest-bearing.

An aged analysis of the accounts receivable as at the balance sheet date, net of provision for impairment, is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Within 30 days	1,533,390	2,246,288	997,021	1,873,381
31 to 60 days	166,412	279,497	90,785	244,015
61 to 90 days	59,916	136,078	42,982	157,763
Over 90 days	90,571	132,417	79,267	51,148
	<b>1,850,289</b>	2,794,280	<b>1,210,055</b>	2,326,307

Included in accounts receivable as at the balance sheet date is the following amount due from a joint venture:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Joint venture	79	306,831	–	585,703

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 28 ACCOUNTS RECEIVABLE (Continued)

The movements in provision for impairment of account receivables are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
As at 1 January	45,505	46,916	36,266	36,370
Acquisition of additional interest in a joint venture	1,755	–	–	–
Impairment losses recognised, net	653	–	–	–
Amount written off as uncollectible	(5,145)	(1,411)	(4,582)	(104)
As at 31 December	42,768	45,505	31,684	36,266

As at 31 December 2008, account receivables with a nominal value of RMB9,856,534 (2007: RMB15,170,307) were impaired and fully provided for. The individually impaired accounts receivable relate to customers that were in financial difficulties. The Group does not hold any collateral or other credit enhancements over these balances.

The aged analysis of the account receivables that are not considered to be impaired is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Neither past due nor impaired	1,054,810	1,979,033	913,160	1,785,489
Less than 3 months past due	725,870	690,539	238,589	497,379
More than 3 months past due	69,609	124,708	58,306	43,439
	1,850,289	2,794,280	1,210,055	2,326,307

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, the Directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral or other credit enhancements over these balances.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 29 PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

An analysis of prepayments, deposits and other receivables as at the balance sheet date is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<b>Prepayments</b>				
Advances and others	578,775	743,946	492,262	604,508
Manufacturers' credits	21,860	55,741	11,177	30,516
Prepaid aircraft operating lease rentals	207,020	195,970	187,372	195,970
	<b>807,655</b>	995,657	<b>690,811</b>	830,994
<b>Deposits and other receivables</b>	<b>748,253</b>	322,405	<b>720,716</b>	290,614
	<b>1,555,908</b>	1,318,062	<b>1,411,527</b>	1,121,608

None of the above assets is either past due or impaired. The financial assets included in the above balances relate to receivables for which there was no recent history of default.

## 30 DERIVATIVE FINANCIAL INSTRUMENTS

### Group

	2008		2007	
	Assets RMB'000	Liabilities RMB'000	Assets RMB'000	Liabilities RMB'000
Fuel derivative contracts	253,406	7,478,463	6,493	8,682
Interest rate swaps	–	249,455	–	–
Foreign exchange derivative contracts	–	–	–	6,144
	<b>253,406</b>	<b>7,727,918</b>	6,493	14,826

### Company

	2008		2007	
	Assets RMB'000	Liabilities RMB'000	Assets RMB'000	Liabilities RMB'000
Fuel derivative contracts	253,406	7,478,463	6,493	675
Interest rate swaps	–	249,455	–	–
Foreign exchange derivative contracts	–	–	–	6,144
	<b>253,406</b>	<b>7,727,918</b>	6,493	6,819

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 30 DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

The above derivative financial instruments contracts are accounted for as held for trading financial instruments and any fair value change is recognised in the income statement (note 8).

The fair value of the fuel derivative contracts as at the balance sheet date was estimated by using Monte Carlo simulation with considerations of mean reversion, taking into account the terms and conditions of the derivative contracts. The major inputs used in the estimation process include expected volatility, mean-reverting speed, long term equilibrium price and risk-free rate which can be obtained from observable markets.

The fair value of interest rate swaps as at the balance sheet date was estimated by using the Rendlemen and Barter model, taken into account the terms and conditions of the derivative contracts. The major inputs used in the estimation process include volatility of short term interest rate and LIBOR curve, which can be obtained from observable markets.

## 31 BALANCE WITH ULTIMATE HOLDING COMPANY

The amount due from the Company's ultimate holding company mainly arose from transactions as set out in notes 23 and 55 to the financial statements. The amount is unsecured, interest-free and repayable within one year.

## 32 BALANCES WITH RELATED COMPANIES

The balances with related companies are unsecured, interest-free and repayable within one year or no fixed terms of repayment.

## 33 DEPOSITS AND CASH AND CASH EQUIVALENTS

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Cash and bank balances	2,283,485	1,586,380	1,087,714	530,374
Cash placed with CNAF	385,243	387,962	349,756	357,016
<b>Total cash and bank balances</b>	<b>2,668,728</b>	1,974,342	<b>1,437,470</b>	887,390
Time deposits placed with banks	2,069,090	2,050,802	73,751	463,983
Pledged deposits against:				
Aircraft operating leases and financial derivatives	(1,746,210)	(118,624)	(2,274)	(2,486)
Others	(4,250)	–	–	–
<b>Non-pledged deposits</b>	<b>318,630</b>	1,932,178	<b>71,477</b>	461,497
<b>Cash and cash equivalents</b>	<b>2,987,358</b>	3,906,520	<b>1,508,947</b>	1,348,887



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 33 DEPOSITS AND CASH AND CASH EQUIVALENTS (Continued)

An analysis of non-pledged time deposit placed with banks is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Non-pledged time deposits with original maturity of:				
Less than 3 months when acquired	280,334	502,999	34,786	438,523
Over 3 months when acquired	38,296	1,429,179	36,691	22,974
	<b>318,630</b>	1,932,178	<b>71,477</b>	461,497

Cash at banks earns interest at floating rates based on daily bank deposit rates. Time deposits are placed for vesting periods of up to one year, depending on the cash requirements of the Group and the Company, and earn interest at the respective time deposit rates. The bank balances and pledged deposits are deposited with creditworthy banks with no recent history of default.

## 34 ACCOUNTS PAYABLE

An aged analysis of the accounts payable as at the balance sheet date is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Within 30 days	4,645,064	4,249,353	4,050,251	3,623,987
31 to 60 days	948,831	788,374	541,813	584,583
61 to 90 days	413,886	412,435	261,271	334,575
Over 90 days	916,114	480,638	718,887	307,159
	<b>6,923,895</b>	5,930,800	<b>5,572,222</b>	4,850,304

Included in the accounts payable as at the balance sheet date is the following amount due to a joint ventures:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Joint ventures	114,637	141,419	176,979	334,047

The accounts payables are non-interest-bearing and are normally settled on 90-day terms.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 35 BILLS PAYABLE

An aged analysis of the bills payable as at the balance sheet date is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Within 30 days	780,245	–	830,833	–
31 to 60 days	640,193	–	662,982	–
	<b>1,420,438</b>	–	<b>1,493,815</b>	–

## 36 OTHER PAYABLES AND ACCRUALS

An analysis of other payables and accruals as at the balance sheet date is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000 (Restated)	2008 RMB'000	2007 RMB'000 (Restated)
Provision for staff housing benefits	46,857	23,038	44,598	17,921
Accrued salaries, wages and benefits	981,774	1,213,017	795,646	1,050,627
Interest payable	305,416	287,886	307,333	286,765
Custom duties and levies payable	455,210	651,594	378,204	569,855
Current portion of long term payables (note 40)	120,725	55,155	120,725	55,155
Current portion of deferred income related to frequent-flyer programme (note 41)	434,622	314,107	428,705	303,524
Current portion of deferred income related to government grant (note 42)	76,944	76,944	76,944	76,944
Deposits received from sales agents	463,244	404,796	341,940	291,641
Accrued operating expenses	1,035,535	725,303	889,230	604,464
Others	769,322	401,856	606,526	200,498
	<b>4,689,649</b>	4,153,696	<b>3,989,851</b>	3,457,394

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 37 OBLIGATIONS UNDER FINANCE LEASES

The Group and the Company have obligations under finance lease agreements expiring during the years from 2009 to 2018 (2007: 2008 to 2017) in respect of aircraft. An analysis of the future minimum lease payments under these finance leases as at the balance sheet date, together with the present value of the net minimum lease payments which are principally denominated in foreign currencies, are as follows:

	Group and Company			
	Minimum lease payments 2008 RMB'000	Present value of minimum lease payments 2008 RMB'000	Minimum lease payments 2007 RMB'000	Present value of minimum lease payments 2007 RMB'000
Amounts repayable:				
Within one year	4,569,762	4,064,038	2,839,608	2,216,680
In the second year	3,974,251	3,599,513	3,372,767	2,821,518
In the third to fifth years, inclusive	5,749,811	5,109,696	6,429,660	5,484,352
Over five years	8,216,543	7,771,575	5,521,634	5,022,323
Total minimum finance lease payments (note 53)	<b>22,510,367</b>	<b>20,544,822</b>	18,163,669	<b>15,544,873</b>
Less: Amounts representing finance charges	<b>(1,965,545)</b>		(2,618,796)	
Present value of minimum lease payments	<b>20,544,822</b>		15,544,873	
Less: Portion classified as current liabilities	<b>(4,064,038)</b>		(2,216,680)	
Non-current portion	<b>16,480,784</b>		13,328,193	

Certain finance lease arrangements comprise finance leases between the Company and certain of its subsidiaries, and the corresponding borrowings between such subsidiaries and commercial banks. The Company has guaranteed the subsidiaries' obligations under those bank borrowing arrangements and, accordingly, the relevant assets and obligations are recorded in the Company's balance sheet to reflect the substance of the transactions. The future payments under these finance leases have therefore been presented by the Company and the Group in the amounts that reflect the payments under the bank borrowing arrangements between the subsidiaries and commercial banks.

As at 31 December 2008, there were 60 (2007: 43) aircraft under finance lease agreements. Under the terms of the leases, the Company has the option to purchase, at the end of or during the lease terms, certain aircraft at market value and others at either market value or at the price as stipulated in the finance lease agreements. The effective borrowing rates during the current year ranged from 1.44% to 9.84% (2007: 2.36% to 9.84%).

The Group's and the Company's finance leases were secured by:

- (a) mortgages over certain of the Group's and the Company's aircraft, which had an aggregate net book value of approximately RMB23,279 million as at 31 December 2008 (2007: RMB21,948 million) (note 16); and
- (b) guarantees by certain commercial banks in an aggregate amount of approximately RMB5,516 million (2007: RMB6,925 million).

As at 31 December 2008, certain PRC state-owned banks have provided counter-guarantees in an aggregate amount of RMB702 million (2007: RMB1,274 million) in respect of the above-mentioned commercial bank guarantee arrangements.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 38 INTEREST-BEARING BANK AND OTHER BORROWINGS

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Bank loans:				
Secured	7,872,912	10,086,265	6,687,437	9,551,478
Unsecured	20,689,771	14,283,542	19,899,046	13,869,976
	<b>28,562,683</b>	24,369,807	<b>26,586,483</b>	23,421,454
Other loans:				
Secured	486,117	19,613	486,117	19,613
Unsecured	624,905	204,706	419,890	102,490
	<b>1,111,022</b>	224,319	<b>906,007</b>	122,103
Corporate bonds – unsecured	3,000,000	3,000,000	3,000,000	3,000,000
	<b>32,673,705</b>	27,594,126	<b>30,492,490</b>	26,543,557
Bank loans repayable:				
Within one year	14,639,705	10,904,944	14,150,737	10,592,390
In the second year	8,001,444	4,032,991	7,538,036	3,980,463
In the third to fifth years, inclusive	5,012,694	8,038,098	4,521,590	7,726,976
Over five years	908,840	1,393,774	376,120	1,121,625
	<b>28,562,683</b>	24,369,807	<b>26,586,483</b>	23,421,454
Other loans repayable:				
Within one year	691,132	73,891	486,117	13,075
In the second year	–	6,538	–	6,538
In the third to fifth years, inclusive	419,890	143,890	419,890	102,490
	<b>1,111,022</b>	224,319	<b>906,007</b>	122,103
Corporate bonds – over five years	3,000,000	3,000,000	3,000,000	3,000,000
Total bank loans, other loans and corporate bonds	<b>32,673,705</b>	27,594,126	<b>30,492,490</b>	26,543,557
Less: Portion classified as current liabilities	<b>(15,330,837)</b>	(10,978,835)	<b>(14,636,854)</b>	(10,605,465)
Non-current portion	<b>17,342,868</b>	16,615,291	<b>15,855,636</b>	15,938,092

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 38 INTEREST-BEARING BANK AND OTHER BORROWINGS (Continued)

Further details of the bank loans, other loans and corporate bonds at the balance sheet date are as follows:

Nature	Interest rate and final maturity	Group		Company	
		2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<b>RMB denominated loans and corporate bonds:</b>					
Loans for purchases of aircraft and related equipment	Floating interest rates ranging from 5.10% to 7.05% (2007: 6.08% to 6.64%) per annum, with maturities up until 2016	1,895,512	2,007,520	1,594,800	2,007,520
Loans for construction in progress	Fixed interest rates at 5.51% per annum with maturities up until 2008	–	40,000	–	40,000
Loans for construction in progress	Floating interest rates ranging from 2.10% to 6.97% (2007: 5.67% to 6.80%) per annum, with maturities up until 2012	1,185,550	617,030	752,510	344,690
Loans for working capital	Fixed interest rates ranging from 4.23% to 4.77% (2007: 4.23% to 5.43%) per annum, with maturities up until 2010	1,076,378	1,743,000	1,000,000	1,730,000
Loans for working capital	Floating interest rate at 4.37% to 6.85% (2007: 5.43% to 5.83%) per annum, as at with maturities up until 2013 (2007: 2009)	1,801,740	232,480	1,521,740	223,480
Corporate bonds for purchases of aircraft and related equipment	Fixed interest rate at 4.50% (2007: 4.50%) per annum, with maturity in September 2015	3,000,000	3,000,000	3,000,000	3,000,000
		<b>8,959,180</b>	7,640,030	<b>7,869,050</b>	7,345,690

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 38 INTEREST-BEARING BANK AND OTHER BORROWINGS (Continued)

Nature	Interest rate and final maturity	Group		Company	
		2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<b>United States dollars ("USD") denominated loans:</b>					
Loans for purchases of aircraft and related equipment	Fixed interest rates ranging from 5.85% to 7.98% (2007: 5.34% to 8.28%) per annum, with maturities up until 2012	2,244,558	3,321,072	2,244,558	3,321,072
Loans for purchases of aircraft and related equipment	Floating interest rate at six months LIBOR+0.40% to 1.20% (2007: six months LIBOR+0.40% to 0.70%) per annum, with maturities up until 2018	5,239,887	5,101,110	4,355,124	4,566,324
Loans for working capital	Floating interest rate at three months LIBOR+ 0.27% to six months LIBOR+2.50% (2007: six months LIBOR+0.27% to 0.50%) per annum, with maturities up until 2010	13,595,229	8,220,550	13,423,155	8,013,146
		<b>21,079,674</b>	16,642,732	<b>20,022,837</b>	15,900,542
<b>Hong Kong dollars denominated loans:</b>					
Loans for working capital	Floating interest rate at three months Hong Kong Interbank offered rate ("HIBOR") +1.15% per annum, with maturities up until 2008	–	14,039	–	–
Loans for capital investment	Floating interest rate at three months HIBOR+0.45% (2007: three months HIBOR+0.45%) per annum, with maturities up until 2013	2,345,854	3,015,208	2,345,854	3,015,208
		<b>2,345,854</b>	3,029,247	<b>2,345,854</b>	3,015,208

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 38 INTEREST-BEARING BANK AND OTHER BORROWINGS (Continued)

Nature	Interest rate and final maturity	Group		Company	
		2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<b>MOP denominated loans:</b>					
Loans for capital investment	Floating interest rate at three months HIBOR+0.5% with maturities up until 2010	34,248	–	–	–
		34,248	–	–	–
<b>Euros denominated loans:</b>					
Loans for purchase of related equipment	Fixed interest rate at 3.88% (2007: 3.88%) per annum, with maturities up until 2013	254,749	282,117	254,749	282,117
		254,749	282,117	254,749	282,117
Total bank and other borrowings		32,673,705	27,594,126	30,492,490	26,543,557
Less: Portion falling due within one year and classified as current liabilities		(15,330,837)	(10,978,835)	(14,636,854)	(10,605,465)
Non-current portion		17,342,868	16,615,291	15,855,636	15,938,092

The interest rates of RMB denominated loans are set and subject to change by the People's Bank of China.

The Group's bank and other loans of approximately RMB11,359 million as at 31 December 2008 (2007: RMB13,106 million) and the Company's bank and other loans of approximately RMB10,474 million as at 31 December 2008 (2007: RMB13,106 million) were secured or guaranteed by:

- mortgages over certain of the Company's aircraft and buildings with an aggregate net book value of approximately RMB9,987 million as at 31 December 2008 (2007: RMB12,255 million) (note 16); and land use rights with an aggregate carrying amount of approximately RMB36 million as at 31 December 2008 (2007: RMB37 million) (note 17);
- pledge of certain number of listed shares in an associate of the Group with an aggregate market value of approximately RMB3,071 million as at 31 December 2008 (2007: RMB7,609 million) (note 22); and
- guarantees by certain commercial banks amounting to approximately RMB2,648 million as at 31 December 2008 (2007: RMB3,896 million).

In addition to the above, the Group had mortgages over the aircraft of a subsidiary with an aggregate net book value of approximately RMB2,070 million as at 31 December 2008 (2007: Nil) (note 16).

As at 31 December 2008, certain PRC state-owned banks provided counter-guarantees in an aggregate amount of approximately RMB2,037 million (2007: RMB2,872 million) to one of the above-mentioned commercial banks.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 39 PROVISION FOR MAJOR OVERHAULS

Details of the movements of provision for major overhauls in respect of aircraft and engines under operating leases for each of the two years ended 31 December 2008 and 2007 are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
At 1 January	1,274,322	969,247	1,024,713	744,146
Acquisition of additional interest in a joint venture	44,793	–	–	–
Provision for the year	660,374	800,463	469,471	588,858
Utilised during the year	(483,642)	(495,388)	(288,252)	(308,291)
At 31 December	1,495,847	1,274,322	1,205,932	1,024,713
Less: Portion classified as current liabilities	(232,926)	(83,907)	(232,926)	(83,907)
Non-current portion	1,262,921	1,190,415	973,006	940,806

The amount of the provision is estimated based on the costs of overhauls and actual flying hours/cycles of aircraft and engines under operating leases. The estimation basis is reviewed on an ongoing basis and revised where appropriate.

## 40 LONG TERM PAYABLES

Long term payables mainly represent customs duties and value-added tax payable due after one year in respect of the acquisition of aircraft and related equipment under finance leases. The customs duties and value-added tax are payable upon repayment of the corresponding finance lease instalments. Set out below are details of the customs duties and value-added tax payable further analysed into non-current and current portions:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Customs duties and value-added tax payable	165,510	213,205	165,510	213,205
Others	–	31,955	–	–
	165,510	245,160	165,510	213,205
Less: Portion classified as current liabilities (note 36)	(120,725)	(55,155)	(120,725)	(55,155)
Non-current portion	44,785	190,005	44,785	158,050



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 41 DEFERRED INCOME RELATED TO FREQUENT-FLYER PROGRAMME

The movement of deferred income related to frequent-flyer programme during the year is as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000 (Restated)	2008 RMB'000	2007 RMB'000 (Restated)
At 1 January	1,095,002	891,582	1,070,482	872,182
Arising during the year	707,778	781,631	697,487	766,958
Recognised as air traffic revenue during the year	(678,925)	(578,211)	(658,264)	(568,658)
At 31 December	1,123,855	1,095,002	1,109,705	1,070,482
Less: Portion classified as current liabilities (note 36)	(434,622)	(314,107)	(428,705)	(303,524)
Non-current portion	689,233	780,895	681,000	766,958

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 42 DEFERRED INCOME RELATED TO GOVERNMENT GRANT

In 2000, the Group acquired an aircraft which was funded by the PRC government, and a further aircraft was injected into the Group by the PRC government during 2004. In accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, the Group recorded these aircraft purchased in 2000 and received in 2004 as property, plant and equipment with the corresponding amounts of government grant recorded as deferred income at the respective dates of the delivery of the aircraft. As such, the government subsidies in relation to the aforesaid aircraft purchased in 2000 and the aircraft received in 2004 are recorded in deferred income of the Group in 2000 and 2004, respectively. The deferred income is recognised as income over the expected useful lives of the relevant aircraft on the straight-line basis.

The movements of deferred income as stated under current and non-current liabilities are as follows:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Deferred income:				
At 1 January and 31 December	<b>1,462,667</b>	1,462,667	<b>1,462,667</b>	1,462,667
Accumulated income recognised as other operating revenue:				
At 1 January	<b>(513,700)</b>	(436,757)	<b>(513,700)</b>	(436,757)
Recognised as other operating revenue during the year (note 5)	<b>(76,943)</b>	(76,943)	<b>(76,943)</b>	(76,943)
At 31 December	<b>(590,643)</b>	(513,700)	<b>(590,643)</b>	(513,700)
Net carrying amounts	<b>872,024</b>	948,967	<b>872,024</b>	948,967
Less: Portion classified as current liabilities (note 36)	<b>(76,944)</b>	(76,944)	<b>(76,944)</b>	(76,944)
Non-current portion	<b>795,080</b>	872,023	<b>795,080</b>	872,023

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 43 ISSUED CAPITAL

	Number of shares 2008	Nominal value 2008 <i>RMB'000</i>	Number of shares 2007	Nominal value 2007 <i>RMB'000</i>
Registered, issued and fully paid:				
State legal person shares of RMB1.00 each	4,826,195,989	4,826,196	4,826,195,989	4,826,196
Non-H foreign shares of RMB1.00 each	1,380,482,920	1,380,483	1,380,482,920	1,380,483
H shares of RMB1.00 each	4,405,683,364	4,405,683	4,405,683,364	4,405,683
A shares of RMB1.00 each	1,639,000,000	1,639,000	1,639,000,000	1,639,000
	<b>12,251,362,273</b>	<b>12,251,362</b>	12,251,362,273	12,251,362
			Number of shares	Nominal value <i>RMB'000</i>
As at 31 December 2008 and 2007			12,251,362,273	12,251,362

The H shares and A shares rank pari passu, in all material respects, with the state legal person shares and non-H foreign shares of the Company.

## 44 TREASURY SHARES

As at 31 December 2008, the Group owned a 17.5% equity interest in Cathay, which in turn owned a 18.1% equity interest in the Company. Accordingly, the 17.5% of Cathay's shareholding in the Company should be recorded in the Group's consolidated financial statements as treasury shares through deduction from equity.

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 45 RESERVES

### Group

The amounts of the Group's reserves and the movements therein for each of the two years ended 31 December 2008 are presented in the consolidated statement of changes in equity.

### Company

	Capital reserve <i>RMB'000</i>	Reserve funds <i>RMB'000</i>	Retained earnings/ (accumulated losses) <i>RMB'000</i>	Total <i>RMB'000</i>
As at 1 January 2007				
As previously reported	10,964,458	707,022	2,730,708	14,402,188
Prior year adjustment	–	–	(552,361)	(552,361)
As restated	10,964,458	707,022	2,178,347	13,849,827
Profit for the year	–	–	3,008,390	3,008,390
Proposed final 2007 dividend ( <i>note 14 (a)</i> )	–	–	(837,987)	(837,987)
Transfer to reserve funds ( <i>note 14 (b)</i> )	–	582,602	(582,602)	–
<b>As at 31 December 2007</b>	<b>10,964,458</b>	<b>1,289,624</b>	<b>3,766,148</b>	<b>16,020,230</b>
As at 31 December 2007				
As previously reported	10,964,458	1,289,624	4,498,112	16,752,194
Prior year adjustment	–	–	(731,964)	(731,964)
As restated	10,964,458	1,289,624	3,766,148	16,020,230
Loss for the year	–	–	(8,216,244)	(8,216,244)
Transfer to reserve funds ( <i>note 14 (b)</i> )	–	264,700	(264,700)	–
Others	61,420	–	–	61,420
<b>As at 31 December 2008</b>	<b>11,025,878</b>	<b>1,554,324</b>	<b>(4,714,796)</b>	<b>7,865,406</b>

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 46 SHARE APPRECIATION RIGHTS

The Company has adopted a share appreciation rights arrangement (the "Plan") which was approved by the shareholders on 18 October 2004 for the purpose of motivating its employees. The Plan provides for the grant of SARs to eligible participants, including the Company's Directors (excluding independent non-executive Directors), supervisors (excluding independent supervisors), president, vice presidents, heads of key departments in the Company's headquarters, general managers and general deputy managers of principal branches and subsidiaries as well as selected senior professionals and key specialists. In any event, SARs will be granted to no more than 200 individuals.

Under the Plan, the holders of SARs are entitled the rights to receive an amount in respect of the appreciation in market value of the Company's H shares from the date of grant of SARs and the date of exercise. No shares will be issued under the Plan and therefore the Company's equity interests will not be diluted as a result of the issuance of SARs. The maximum number of unexercised SARs permitted to be granted under the Plan is, upon their exercise, limited to 2% of the Company's H shares in issue at any time during each year. The maximum number of SARs granted to eligible participants under the Plan within any 12-month period is, upon their exercise, limited to 0.4% of the Company's H shares in issue at any time during each year. The maximum number of SARs granted to any eligible participant is limited to 10% of the total number of unexercised SARs in issue at any time during each year. Any further grant of SARs in excess of the above limits is subject to shareholders' approval in general meetings.

The exercise period of all SARs commences after a vesting period and ends on a date which is not later than five years from the date of grant of the SARs. The exercise price of SARs will be equal to the average closing price of the Company's H shares on the HKSE for the five consecutive trading days immediately preceding the date of the grant. On 15 June 2007, 14,939,900 SARs were granted to a total of 109 individuals at an exercise price of HK\$2.98 per share. As at each of the last days of the second, third and fourth anniversaries of the date of grant, the total number of SARs exercisable will not exceed 30%, 70% and 100%, respectively, of the total SARs granted to the respective eligible participants. As at 31 December 2008, all SARs granted remained unexercised and had an aggregate fair value of RMB3,392,294.

The fair value of SARs was estimated as at the date of grant using a binomial model, taking into account the terms and conditions upon which the SARs were granted. The major inputs used in the estimation process include expected life of rights, expected volatility, risk-free interest rate which can be taken from observable markets.

## 47 DISTRIBUTABLE RESERVES

As at 31 December 2008, in accordance with the PRC Company Law, an amount of approximately RMB14,334 million (2007: RMB14,281 million) standing to the credit of the Company's capital reserve account, and an amount of approximately RMB1,554 million (2007: RMB1,290 million) standing to the credit of the Company's reserve funds, as determined in accordance with ASBE, were available for distribution by way of a future capitalisation issue. In addition, the Company had accumulated losses of approximately RMB6,259 million (2007: retained earnings of RMB2,954 million, as restated), as determined in accordance with ASBE. The lesser amount of the retained earnings determined in accordance with ASBE and IFRSs would be available for distribution as dividend.

## 48 MAJOR NON-CASH TRANSACTION

During the year, the Group entered into finance lease arrangements in respect of property, plant and equipment with a total capital value at the inception of the leases of approximately RMB7,721 million (2007: RMB5,112 million).

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 49 BUSINESS COMBINATION

On 3 January 2008, the Group acquired a 25% equity interest in the Air China Cargo in addition to the 51% equity interest it already held. Further details of the transaction are included in note 1 to the financial statements. The purchase consideration for the acquisition in the form of cash of RMB857,003,819 was paid on 3 January 2008.

The fair values of the identifiable assets, liabilities and contingent liabilities of the 25% equity interest in Air China Cargo as at the date of acquisition and the corresponding carrying amounts immediately before the acquisition were as follows:

	<b>Fair value recognised on acquisition</b>	<b>Previous carrying amount</b>
	<i>RMB'000</i>	<i>RMB'000</i>
<b>NON-CURRENT ASSETS</b>		
Property, plant and equipment	674,628	632,016
Lease prepayments	96,818	36,366
Deposits for aircraft under operating leases	2,438	2,438
Deferred tax assets	5,840	29,412
<b>CURRENT ASSETS</b>		
Aircraft held for sale	90,553	90,553
Inventories	2,605	2,605
Accounts receivables	178,088	178,088
Prepayments, deposits and other receivables	24,583	28,928
Cash and cash equivalents	74,109	74,109
<b>CURRENT LIABILITIES</b>		
Air traffic liabilities	(7,911)	(7,911)
Accounts payables	(121,820)	(121,820)
Other payables and accruals	(194,765)	(212,518)
Bank and other loans	(25,749)	(25,749)
<b>NON-CURRENT LIABILITIES</b>		
Bank loans, other loans and corporate bonds	(248,901)	(248,901)
Long term payables	(17,504)	(17,504)
Provision for major overhauls	(22,853)	(22,853)
<b>NET ASSETS</b>	<b>510,159</b>	<b>417,259</b>
Goodwill on acquisition ( <i>note 19</i> )	346,845	
Satisfied by cash	857,004	

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 49 BUSINESS COMBINATION (Continued)

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition of additional 25% equity interest in Air China Cargo is as follows:

	<i>RMB'000</i>
Cash consideration	(857,004)
Net cash acquired with the subsidiary	145,254
Net outflow of cash and cash equivalents in respect of the acquisition of a 25% equity interest in Air China Cargo	<u>(711,750)</u>

Since its acquisition, Air China Cargo has contributed RMB7,017 million to the Group's turnover and RMB27 million to the consolidated profit for the year ended 31 December 2008.

## 50 CONTINGENT LIABILITIES

As at 31 December 2008, the Group had the following contingent liabilities:

- (a) Pursuant to the restructuring of CNAHC, in preparation for the listing of the Company's H shares on the HKSE and the London Stock Exchange, the Company entered into a restructuring agreement with CNAHC and CNACG on 20 November 2004 (the "Restructuring Agreement"). According to the Restructuring Agreement, except for liabilities constituting or arising out of or relating to business undertaken by the Company after the restructuring, no liabilities were assumed by the Company and the Company is not liable, whether severally, or jointly and severally, for debts and obligations incurred prior to the restructuring by CNAHC and CNACG. The Company has also undertaken to indemnify CNAHC and CNACG in respect of any damage suffered or incurred by CNAHC and CNACG as a result of any breach by the Company of any provision of the Restructuring Agreement.
- (b) On 15 April 2002, Flight CA129 crashed on approach to Gimhae International Airport, South Korea. There were 129 fatalities including 121 passengers and 8 crew members aboard the crashed aircraft. An investigation was conducted by the Chinese and the Korean civil aviation authorities, but the investigation has yet to be finished at the date of approval of these financial statements. Certain injured passengers and families of the deceased passengers and crew members have commenced proceedings in Korean courts seeking damages against Air China International Corporation, the predecessor of the Company. The Group cannot predict the timing of the courts' judgements or the possible outcome of the lawsuits nor any possible appeal actions. Up to 31 December 2008, the Company, Air China International Corporation and the Company's insurer had paid an aggregate amount of approximately RMB238 million (2007: RMB220 million) in respect of passenger liability and other auxiliary costs. Included in the RMB238 million (2007: RMB220 million) is an amount of approximately RMB230 million (2007: RMB213 million) borne by the Company's insurer. As part of the above-mentioned restructuring, CNAHC has agreed to indemnify the Group for any liabilities relating to the crash of Flight CA129, excluding the compensation already paid up to 30 September 2004 (being the date of incorporation of the Company). The Directors of the Company believe that there will not be any material adverse impact on the Group's financial position.
- (c) On 26 February 2007, the Federal Judiciary of the United States filed a civil summon against the Company and Air China Cargo claiming that they, together with a number of other airlines, have violated certain anti-trust regulations in respect of their air cargo operations in the United States and the European Union. The status of the proceedings is still in the preliminary stage and therefore the Directors of the Company are of the view that it is not possible to estimate the eventual outcome of the claim with reasonable certainty at this stage. Also, the Directors of the Company are of the view that there would be valid defense against this claim and consider that no provision for this claim is needed accordingly.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 50 CONTINGENT LIABILITIES (Continued)

- (d) The Group and the Company have issued guarantees to banks in respect of the bank loans granted to the following parties:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Associates	105,770	132,857	105,770	114,129
Subsidiary	–	–	300,712	–
	<b>105,770</b>	132,857	<b>406,482</b>	114,129

## 51 OPERATING LEASE ARRANGEMENTS

The Group and the Company lease certain of its office premises, aircraft and related equipment under operating lease arrangements. Leases for these assets are negotiated for terms ranging from 1 to 20 years.

At the balance sheet date, the Group and the Company had the following future minimum lease payments under non-cancellable operating leases:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Within one year	2,625,969	2,349,599	2,162,269	1,819,561
In the second to fifth years, inclusive	6,752,785	6,599,485	5,471,544	5,372,798
Over five years	4,198,883	3,860,049	3,736,540	3,379,761
	<b>13,577,637</b>	12,809,133	<b>11,370,353</b>	10,572,120



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 52 COMMITMENTS

### (a) Capital commitments

The Group and the Company had the following amounts of contractual commitments for the acquisition and construction of plant, property and equipment as at the balance sheet date:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Contracted, but not provided for:				
Aircraft and flight equipment	65,680,080	53,897,381	65,228,996	53,897,381
Buildings	459,682	1,026,747	311,720	573,112
Others	236,432	248,388	231,378	241,500
	<b>66,376,194</b>	55,172,516	<b>65,772,094</b>	54,711,993
Authorised, but not contracted for:				
Aircraft and flight equipment	88,210	226,874	–	–
Buildings	2,997,790	3,006,501	2,811,190	2,971,164
Others	816,728	471,907	683,760	460,337
	<b>3,902,728</b>	3,705,282	<b>3,494,950</b>	3,431,501
<b>Total capital commitments</b>	<b>70,278,922</b>	58,877,798	<b>69,267,044</b>	58,143,494

### (b) Investment commitments

The Group and the Company had the following amounts of investment commitments as at the balance sheet date:

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
Contracted, but not provided for:				
Joint venture	–	–	–	109,569
Associate	50,680	54,165	50,680	54,165
<b>Total investment commitments</b>	<b>50,680</b>	54,165	<b>50,680</b>	163,734

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 53 FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of the Group's and the Company's financial instruments approximated to their fair value as at the balance sheet date. Fair value estimates are made at a specific point in time and based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Market price has been used to determine the fair value of aircraft held for sale. The fair value of bank loans and other borrowings have been calculated by discounting the expected future cash flows at prevailing interest rates. The fair value of long term deposits and other financial assets has been discounted to present value after calculation based on market interest rates.

The carrying amounts of each of the categories of financial instruments as at the balance sheet date are as follows:

### Group

#### 2008

##### Financial assets

	Financial assets at fair value through profit or loss and held for trading RMB'000	Loans and receivables RMB'000	Available- for-sale financial assets RMB'000	Total RMB'000
Due from associates (note 22)	–	161,219	–	161,219
Deposits for aircraft under operating leases	–	229,899	–	229,899
Long term receivable from ultimate holding company	–	231,813	–	231,813
Available-for-sale investments	–	–	1,997	1,997
Accounts and bills receivable	–	1,851,893	–	1,851,893
Deposits and other receivables (note 29)	–	748,253	–	748,253
Derivative financial instruments	253,406	–	–	253,406
Due from ultimate holding company	–	361,892	–	361,892
Due from related companies	–	7,537	–	7,537
Pledged deposits	–	1,750,460	–	1,750,460
Cash and cash equivalents	–	2,987,358	–	2,987,358
	253,406	8,330,324	1,997	8,585,727

##### Financial liabilities

	Financial liabilities at fair value through profit or loss and held for trading RMB'000	Financial liabilities at amortised cost RMB'000	Total RMB'000
Due to associates (note 22)	–	(472,921)	(472,921)
Accounts and bills payable	–	(8,344,333)	(8,344,333)
Financial liabilities included in other payables and accruals	–	(4,131,226)	(4,131,226)
Derivative financial instruments	(7,727,918)	–	(7,727,918)
Obligations under finance leases (note 37)	–	(20,544,822)	(20,544,822)
Interest-bearing bank and other borrowings (note 38)	–	(32,673,705)	(32,673,705)
Due to related companies	–	(62,924)	(62,924)
	(7,727,918)	(66,229,931)	(73,957,849)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 53 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

### Group

2007 (Restated)

#### Financial assets

	Financial assets at fair value through profit or loss and held for trading RMB'000	Loans and receivables RMB'000	Available- for-sale financial assets RMB'000	Total RMB'000
Due from associates (note 22)	–	183,224	–	183,224
Deposits for aircraft under operating leases	–	257,505	–	257,505
Long term receivable from ultimate holding company	–	331,813	–	331,813
Available-for-sale investments	–	–	1,997	1,997
Accounts and bills receivables	–	2,795,879	–	2,795,879
Deposits and other receivables (note 29)	–	322,405	–	322,405
Derivative financial instruments	6,493	–	–	6,493
Due from ultimate holding company	–	335,129	–	335,129
Due from related companies	–	22,881	–	22,881
Pledged deposits	–	118,624	–	118,624
Cash and cash equivalents	–	3,906,520	–	3,906,520
	6,493	8,273,980	1,997	8,282,470

#### Financial liabilities

	Financial liabilities at fair value through profit or loss and held for trading RMB'000	Financial liabilities at amortised cost RMB'000	Total RMB'000
Due to associates (note 22)	–	(123,155)	(123,155)
Accounts and bills payables	–	(5,930,800)	(5,930,800)
Financial liabilities included in other payables and accruals	–	(3,739,607)	(3,739,607)
Derivative financial instruments	(14,826)	–	(14,826)
Obligations under finance leases (note 37)	–	(15,544,873)	(15,544,873)
Interest-bearing bank and other borrowings (note 38)	–	(27,594,126)	(27,594,126)
Due to related companies	–	(45,142)	(45,142)
	(14,826)	(52,977,703)	(52,992,529)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 53 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

### Company

2008

#### Financial assets

	Financial assets at fair value through profit or loss and held for trading RMB'000	Loans and receivables RMB'000	Available- for-sale financial assets RMB'000	Total RMB'000
Due from subsidiaries (note 20)	–	858,658	–	858,658
Due from associates (note 22)	–	35,791	–	35,791
Deposits for aircraft under operating leases	–	166,689	–	166,689
Long term receivable from ultimate holding company	–	231,813	–	231,813
Available-for-sale investments	–	–	3,516	3,516
Accounts and bills receivable	–	1,211,020	–	1,211,020
Deposits and other receivables (note 29)	–	720,716	–	720,716
Derivative financial instruments	253,406	–	–	253,406
Due from ultimate holding company	–	376,894	–	376,894
Pledged deposits	–	2,274	–	2,274
Cash and cash equivalents	–	1,508,947	–	1,508,947
	253,406	5,112,802	3,516	5,369,724

#### Financial liabilities

	Financial liabilities at fair value through profit or loss and held for trading RMB'000	Financial liabilities at amortised cost RMB'000	Total RMB'000
Due to subsidiaries (note 20)	–	(478,738)	(478,738)
Due to associates (note 22)	–	(87,047)	(87,047)
Accounts and bills payables	–	(7,066,037)	(7,066,037)
Financial liabilities included in other payables and accruals	–	(3,439,604)	(3,439,604)
Derivative financial instruments	(7,727,918)	–	(7,727,918)
Obligations under finance leases (note 37)	–	(20,544,822)	(20,544,822)
Interest-bearing bank and other borrowings (note 38)	–	(30,492,490)	(30,492,490)
Due to related companies	–	(24,878)	(24,878)
	(7,727,918)	(62,133,616)	(69,861,534)

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 53 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

### Company

2007 (Restated)

#### Financial assets

	Financial assets at fair value through profit or loss and held for trading RMB'000	Loans and receivables RMB'000	Available- for-sale financial assets RMB'000	Total RMB'000
Due from subsidiaries (note 20)	–	65,367	–	65,367
Due from associates (note 22)	–	40,555	–	40,555
Deposits for aircraft under operating leases	–	192,848	–	192,848
Long term receivable from ultimate holding company	–	331,813	–	331,813
Available-for-sale investments	–	–	3,516	3,516
Accounts and bills receivable	–	2,327,906	–	2,327,906
Deposits and other receivables (note 29)	–	290,614	–	290,614
Derivative financial instruments	6,493	–	–	6,493
Due from ultimate holding company	–	350,377	–	350,377
Pledged deposits	–	2,486	–	2,486
Cash and cash equivalents	–	1,348,887	–	1,348,887
	6,493	4,950,853	3,516	4,960,862

#### Financial liabilities

	Financial liabilities at fair value through profit or loss and held for trading RMB'000	Financial liabilities at amortised cost RMB'000	Total RMB'000
Due to subsidiaries (note 20)	–	(451,419)	(451,419)
Due to associates (note 22)	–	(118,768)	(118,768)
Accounts and bills payables	–	(4,850,304)	(4,850,304)
Financial liabilities included in other payables and accruals	–	(3,059,005)	(3,059,005)
Derivative financial instruments	(6,819)	–	(6,819)
Obligations under finance leases (note 37)	–	(15,544,873)	(15,544,873)
Interest-bearing bank and other borrowings (note 38)	–	(26,543,557)	(26,543,557)
Due to related companies	–	(27,730)	(27,730)
	(6,819)	(50,595,656)	(50,602,475)

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, comprise bank loans, other loans and corporate bonds, obligations under finance leases, cash and cash equivalents and pledged deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as accounts receivable and accounts payable, which arise directly from its operations.

The Group also enters into derivative transactions, including principally swaps and collars contracts. The purpose is to manage the jet fuel price risk and interest rate risk arising from the Group's operations.

The Group operates globally and generates revenue in various currencies. The Group's airline operations are exposed to liquidity risk, jet fuel price risk, foreign currency risk, interest rate risk and credit risk. The Group's overall risk management approach is to moderate the effects of such volatility on its financial performance.

Financial risk management policies are periodically reviewed and approved by the Board of Directors and they are summarised below.

### (a) Liquidity risk

The Group's net current liabilities amounted to approximately RMB32,308 million as at 31 December 2008 (2007: RMB17,276 million). The Group recorded a net cash inflow from operating activities of approximately RMB5,060 million for the year ended 31 December 2008 (2007: RMB7,302 million). For the same period, the Group had a net cash outflow from investing activities of approximately RMB7,269 million (2007: RMB10,212 million). The Group also recorded a net cash inflow from financing activities of approximately RMB2,870 million for the year ended 31 December 2008 (2007: RMB1,839 million). The Group has recorded an increase in cash and cash equivalents of approximately RMB472 million and a decrease in cash and cash equivalents of approximately RMB1,111 million for the years ended 31 December 2008 and 2007, respectively.

Started from 2007, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflows from operations to meet its debt obligations as they fall due, and its ability to obtain external financing to meet its committed future capital expenditure. With regard to its future capital commitments and other financing requirements, the Company has already obtained banking facilities with several PRC banks of up to an aggregate amount of RMB108,390 million as at 31 December 2008 (2007: RMB80,172 million), of which an amount of approximately RMB40,042 million was utilised (2007: RMB32,639 million).

The Directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the year ending 31 December 2009. Based on such forecast, the Directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during 2009. In preparing the cash flow forecast, the Directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loans financing which may impact the operations of the Group prior to the end of 2009. The Directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (a) Liquidity risk (Continued)

The maturity profile of the Group's financial liabilities as at the balance sheet date, based on the contractual undiscounted payments, was as follows:

#### Group

	2008				Total RMB'000
	On demand RMB'000	Within 1 year RMB'000	1 to 5 years RMB'000	Over 5 years RMB'000	
Due to associates (note 22)	373,298	99,623	–	–	472,921
Accounts and bills payables	245,000	8,099,333	–	–	8,344,333
Financial liabilities included in other payables and accruals	918,454	3,212,772	–	–	4,131,226
Derivative financial instruments	–	7,727,918	–	–	7,727,918
Obligations under finance leases (note 37)	–	4,569,762	9,724,062	8,216,543	22,510,367
Interest-bearing bank and other borrowings	–	15,330,837	14,295,240	4,188,598	33,814,675
Due to related companies	–	62,924	–	–	62,924
	<b>1,536,752</b>	<b>39,103,169</b>	<b>24,019,302</b>	<b>12,405,141</b>	<b>77,064,364</b>

	2007 (Restated)				Total RMB'000
	On demand RMB'000	Within 1 year RMB'000	1 to 5 years RMB'000	Over 5 years RMB'000	
Due to associates (note 22)	34,434	88,721	–	–	123,155
Accounts and bills payables	480,639	5,450,161	–	–	5,930,800
Financial liabilities included in other payables and accruals	1,885,387	1,816,172	38,048	–	3,739,607
Derivative financial instruments	–	14,271	555	–	14,826
Obligations under finance leases (note 37)	–	2,839,608	9,802,427	5,521,634	18,163,669
Interest-bearing bank and other borrowings	–	10,978,835	13,180,129	4,923,849	29,082,813
Due to related companies	–	45,142	–	–	45,142
	<b>2,400,460</b>	<b>21,232,910</b>	<b>23,021,159</b>	<b>10,445,483</b>	<b>57,100,012</b>

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (a) Liquidity risk (Continued)

The maturity profile of the Company's financial liabilities as at the balance sheet date, based on the contractual undiscounted payments, was as follows:

#### Company

	2008				Total RMB'000
	On demand RMB'000	Within 1 year RMB'000	1 to 5 years RMB'000	Over 5 years RMB'000	
Due to subsidiaries (note 20)	–	478,738	–	–	478,738
Due to associates (note 22)	–	87,047	–	–	87,047
Account and bills payables	216,057	6,849,980	–	–	7,066,037
Financial liabilities included in other payables and accruals	720,144	2,719,460	–	–	3,439,604
Derivative financial instruments	–	7,727,918	–	–	7,727,918
Obligations under finance leases (note 37)	–	4,569,762	9,724,062	8,216,543	22,510,367
Interest-bearing bank and other borrowings	–	14,636,854	13,274,446	3,623,915	31,535,215
Due to related companies	–	24,878	–	–	24,878
	<b>936,201</b>	<b>37,094,637</b>	<b>22,998,508</b>	<b>11,840,458</b>	<b>72,869,804</b>

	2007 (Restated)				Total RMB'000
	On demand RMB'000	Within 1 year RMB'000	1 to 5 years RMB'000	Over 5 years RMB'000	
Due to subsidiaries (note 20)	–	451,419	–	–	451,419
Due to associates (note 22)	34,434	84,334	–	–	118,768
Account and bills payables	307,159	4,543,145	–	–	4,850,304
Financial liabilities included in other payables and accruals	1,658,673	1,362,284	38,048	–	3,059,005
Derivative financial instruments	–	6,264	555	–	6,819
Obligations under finance leases (note 37)	–	2,839,608	9,802,427	5,521,634	18,163,669
Interest-bearing bank and other borrowings	–	10,605,465	12,733,362	4,568,184	27,907,011
Due to related companies	–	27,730	–	–	27,730
	<b>2,000,266</b>	<b>19,920,249</b>	<b>22,574,392</b>	<b>10,089,818</b>	<b>54,584,725</b>



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (b) Jet fuel price risk

The Group's strategy for managing the risk on jet fuel price aims to provide the Group with protection against sudden and significant increases in prices. In meeting these objectives, the Group allows for the judicious use of approved derivative instruments such as swaps and collars with approved counterparties and within approved limits.

Moreover, counter party credit risk is generally restricted to any gains on changes in fair value at any time, but not the principal amount of the instrument. Therefore, the possibility of material loss arising in the event of non-performance by a counterparty is considered to be unlikely.

The following table demonstrates the sensitivity at the balance sheet date to a reasonably possible change in fuel price, with all other variables held constant and excluding the impact of fuel derivative contracts, of the Group's profit or loss before tax for the year:

	Change in profit/(loss) before tax RMB'000
<b>2008</b>	
If fuel price increased/decreased by RMB1,000 per tonne	<b>(3,038,278)</b>
<b>2007</b>	
If fuel price increased/decreased by RMB1,000 per tonne	<b>(2,928,703)</b>

The following table demonstrates the sensitivity at 31 December 2008 to a reasonably possible change in fuel price, with all other variables held constant, of the Group's profit or loss before tax for the year due to changes in the fair value of fuel derivative contracts:

	Increase/(decrease) in profit/(loss) before tax RMB'000
If fuel price increased by 5%	<b>759,392</b>
If fuel price decreased by 5%	<b>(834,969)</b>

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (c) Foreign currency risk

The Group's finance lease obligations as well as certain bank and other loans are mainly denominated in United States dollars, and certain expenses of the Group are denominated in currencies other than RMB. The Group generates foreign currency revenue from ticket sales made in overseas offices and would normally generate sufficient foreign currencies after payment of foreign currency expenses, to meet its foreign currency liabilities repayable within one year. However, RMB against United States dollar, Hong Kong dollar and Japanese yen have experienced a significant level of fluctuation during the year which is the major reason for the significant exchange difference recognised by the Group for the year.

The following table demonstrates the sensitivity at the balance sheet date to a reasonably possible change in the USD exchange rate, with all other variables held constant, of the Group's profit or loss before tax (due to changes in the fair value of monetary assets and liabilities) for the year:

	Change in profit/(loss) before tax RMB'000
<b>2008</b>	
If RMB strengthens against USD by 1%	<b>331,304</b>
<b>2007</b>	
If RMB strengthens against USD by 1%	263,839

### (d) Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long term debt obligations with a floating interest rate.

The Group's policy is to manage its interest cost using a mix of fixed and variable rate debts. To manage this mix in a cost-effective manner, the Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (d) Interest rate risk (Continued)

The following table sets out the carrying amounts, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

#### Year ended 31 December 2008

##### Fixed rate

	Within one year RMB'000	In the second year RMB'000	In the third to fifth years, inclusive RMB'000	Over five years RMB'000	Total RMB'000
Obligations under finance leases (note 37)	2,554,488	2,081,901	–	–	4,636,389
Interest-bearing bank and other borrowings (note 38)	1,026,272	1,653,611	758,533	3,137,269	6,575,685
Time deposits (note 33)	2,069,090	–	–	–	2,069,090

##### Floating rate

	Within one year RMB'000	In the second year RMB'000	In the third to fifth years, inclusive RMB'000	Over five years RMB'000	Total RMB'000
Obligations under finance leases (note 37)	1,509,550	1,517,612	5,109,696	7,771,575	15,908,433
Interest-bearing bank and other borrowings (note 38)	14,304,565	6,347,833	4,674,051	771,571	26,098,020
Cash at bank (note 33)	2,668,728	–	–	–	2,668,728

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (d) Interest rate risk (Continued)

Year ended 31 December 2007

#### Fixed rate

	Within one year RMB'000	In the second year RMB'000	In the third to fifth years, inclusive RMB'000	Over five years RMB'000	Total RMB'000
Obligations under finance leases (note 37)	891,011	1,521,260	2,139,876	–	4,552,147
Interest-bearing bank and other borrowings (note 38)	1,198,656	1,543,601	2,479,295	3,164,637	8,386,189
Time deposits (note 33)	2,050,802	–	–	–	2,050,802

#### Floating rate

	Within one year RMB'000	In the second year RMB'000	In the third to fifth years, inclusive RMB'000	Over five years RMB'000	Total RMB'000
Obligations under finance leases (note 37)	1,325,669	1,300,258	3,344,476	5,022,323	10,992,726
Interest-bearing bank and other borrowings (note 38)	9,780,179	2,495,928	5,702,693	1,229,137	19,207,937
Cash at bank (note 33)	1,974,342	–	–	–	1,974,342

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as a fixed rate is fixed until the maturity of the instrument. The other financial instruments of the Group that are not included in the above tables are non-interest-bearing and are therefore not subject to interest rate risk.

The interest-bearing loans subject to floating interest rate are predominately USD borrowings. The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit or loss before tax (through the impact on floating rate borrowings) for the year.

	Change in basis point	Change in profit/(loss) before tax RMB'000
<b>2008</b>		
USD	50	4,637
<b>2007</b>		
USD	50	5,004

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (e) Credit risk

The following table set forth the maximum credit exposure of the Group, within which, loans and receivables granted and deposits placed to be the carrying amount, net of any impairment losses, and for derivatives to be the current fair value. For financial guarantees and loan commitments, the maximum exposure represents the maximum amount the Group could be required to pay without consideration of the probability of the actual outcome.

	<b>31 December 2008 RMB'000</b>	31 December 2007 RMB'000
Due from associates	<b>161,219</b>	183,224
Deposits for aircraft under operating leases	<b>229,899</b>	257,505
Long term receivable from ultimate holding company	<b>231,813</b>	331,813
Available-for-sale investments	<b>1,997</b>	1,997
Accounts and bills receivables	<b>1,851,893</b>	2,795,879
Deposits and other receivables	<b>748,253</b>	322,405
Derivative financial instruments	<b>253,406</b>	6,493
Due from ultimate holding company	<b>361,892</b>	335,129
Due from related companies	<b>7,537</b>	22,881
Pledged deposits	<b>1,750,460</b>	118,624
Cash and cash equivalents	<b>2,987,358</b>	3,906,520
Guarantee (note 50(d))	<b>105,770</b>	132,857
Commitments (note 52)	<b>70,329,602</b>	58,931,963
Operating lease arrangements (note 51)	<b>13,577,637</b>	12,809,133
	<b>92,598,736</b>	80,156,423

The above-mentioned financial assets are mainly neither past due nor impaired. Further quantitative data in respect of the Group's exposure to credit risk arising from accounts receivable are disclosed in note 28 to the financial statements.

The Group's cash and cash equivalents are deposited with banks in Mainland China, overseas banks and an associate. The Group has policies in place to limit the exposure to any single financial institution.

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlements Plan (the "BSP"), a clearing system between airlines and sales agents organised by the International Air Transportation Association. The balance due from the BSP agents amounted to approximately RMB627 million as at 31 December 2008 (2007: RMB872 million).

Except for the above, the Group has no significant concentration of credit risk, with the exposure spreading over a number of counter parties.

# Notes to Financial Statements

31 December 2008

(Prepared under International Financial Reporting Standards)

## 54 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### (f) Capital management

The primary objectives of the Group's capital management are to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes for managing capital during the years ended 31 December 2008 and 31 December 2007.

The Group monitors capital using a gearing ratio, which is total liabilities divided by total assets. The gearing ratios as at the balance sheet dates were as follows:

#### Group

	2008 RMB'000	2007 RMB'000 (Restated)
Total Liabilities	79,944,718	60,548,027
Total assets	100,401,224	91,300,277
Gearing ratio	79.63%	66.32%

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 55 RELATED PARTY TRANSACTIONS

The Group had the following significant transactions between the Group and (i) CNAHC, its subsidiaries (other than the Group) and joint ventures (collectively, the "CNAHC Group"); (ii) its joint ventures; and (iii) associates:

	Group	
	2008 RMB'000	2007 RMB'000
(a) Included in air traffic revenue		
Sale of cargo space:		
CNAHC Group	149,162	223,493
Charter flights:		
CNAHC	481,372	493,645
(b) Included in other operating revenue		
Aircraft engine lease income:		
Joint venture	105	–
Associate	989	3,374
	1,094	3,374
Aircraft engineering income:		
Associates	48,941	24,584
Ground services income:		
CNAHC Group	–	321
Joint ventures	314	2,743
Associates	69,681	68,875
	69,995	71,939
Bellyhold income:		
Joint venture (note 5)	–	1,579,185
Others:		
CNAHC Group	29,285	27,391
Joint ventures	7,168	19,614
Associates	24,152	48,416
	60,605	95,421

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 55 RELATED PARTY TRANSACTIONS (Continued)

	Group	
	2008 RMB'000	2007 RMB'000
(c) Included in finance revenue and finance costs		
Interest income:		
Associate	8,363	3,559
Interest expense:		
Associate	29,340	6,794
(d) Included in operating expenses		
Airport ground services, take-off, landing and depot expenses:		
CNAHC Group	98,557	88,615
Associates	178,334	170,947
	<b>276,891</b>	259,562
Air catering charges:		
CNAHC Group	56,497	56,248
Joint ventures	65,048	136,700
Associates	20,667	25,620
	<b>142,212</b>	218,568
Repair and maintenance costs:		
Joint ventures	649,657	422,301
Associates	265,346	212,857
	<b>915,003</b>	635,158
Sale commission expenses:		
CNAHC Group	4,559	7,136
Joint venture	–	1,768
Associates	3,287	12,226
	<b>7,846</b>	21,130
Management fees:		
CNAHC Group	8,465	9,307
Aircraft leasing fees:		
Associate	661,825	519,176
Others:		
CNAHC Group	156,979	215,816
Joint venture	3,172	–
Associates	17,862	24,709
	<b>178,013</b>	240,525



# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 55 RELATED PARTY TRANSACTIONS (Continued)

	Group		Company	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
(e) Deposits, loans and bills payable:				
Deposits placed with an associate ( <i>note 33</i> )	385,243	387,962	349,756	357,016
Loans from an associate	1,046,619	238,098	806,007	151,321
(f) Outstanding balances with related parties:				
Long term receivable from ultimate holding company	231,813	331,813	231,813	331,813
Due from related companies	7,537	22,881	–	–
Due from associates ( <i>note 22</i> )	161,219	183,224	35,791	40,555
Due to associates ( <i>note 22</i> )	(472,921)	(123,155)	(87,047)	(118,768)
Due from a joint venture	12,080	306,831	155	585,703
Due to related companies	(62,924)	(45,142)	(24,878)	(27,730)
Due to a joint venture	(164,968)	(141,419)	(299,276)	(334,047)
Due from ultimate holding company	361,892	335,129	376,894	350,377
Due from subsidiaries ( <i>note 20</i> )	–	–	858,658	65,367
Due to subsidiaries ( <i>note 20</i> )	–	–	(478,738)	(451,419)

The long term receivable from CNAHC is unsecured, interest-free and is not repayable within one year from the balance sheet date. Except for the long term receivable from CNAHC, the outstanding balances with other related parties are unsecured, interest-free and repayable within one year or have no fixed terms of repayment.

	Group	
	2008 RMB'000	2007 RMB'000
(g) Compensation of key management personnel:		
Short term employee benefits	7,891	8,363
Post – employment benefits	257	259
Equity-settled share option expense	(5,016)	5,728
	3,132	14,350

Further details of the remuneration of the Directors and Supervisors are included in note 10 to the financial statements.

- (h) On 25 August 2004, CNACG entered into two licences agreements with CNAC pursuant to which CNACG has agreed to grant licences to CNAC, free of royalty, for the rights to use certain trademarks in Hong Kong and Macau, respectively, so long as CNAC is a direct or indirect subsidiary of CNAHC. No royalty charge was levied in respect for the use of these trademarks during each of the two years ended 31 December 2008.

# Notes to Financial Statements

31 December 2008  
(Prepared under International Financial Reporting Standards)

## 55 RELATED PARTY TRANSACTIONS (Continued)

- (i) The Company entered into several agreements with CNAHC which govern the use of trademarks granted by the Company to CNAHC; the provision of financial services by CNAF; the provision of construction project management services by China National Aviation Construction and Development Company; the subcontracting of charter flight services to CNAHC; the leasing of properties from and to CNAHC; the provision of air ticketing and cargo services; media and advertising services arrangement to China National Aviation Media and Advertising Co., Ltd.; the tourism services co-operation agreement with CNAHC; the comprehensive services agreement with CNAHC; and the provision of maintenance by China Aircraft Services Limited.

The Group operates in an economic environment predominated by enterprises directly or indirectly owned or controlled by the PRC government through its numerous authorities, affiliates or other organisations (collectively, "State-owned Enterprises"). During the year, the Group had transactions with State-owned Enterprises including, but not limited to, the provision of air passenger and air cargo services and purchases of services. The Directors consider that transactions with these State-owned Enterprises are activities in the ordinary course of the Group's business and that the dealings of the Group have not been significantly or unduly affected by the fact that the Group and these State-owned Enterprises are ultimately controlled or owned by the PRC government. The Group has also established pricing policies for products and services, and such pricing policies do not depend on whether or not the customers are State-owned Enterprises. Having due regard to the substance of the relationships, the Directors are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

## 56 EVENTS AFTER THE BALANCE SHEET DATE

In January 2009, the Ministry of Finance and Civil Aviation Administration of China ("CAAC") jointly issued "Caijian [2009] No.4 Document – Implementation Notice from Ministry of Finance and Civil Aviation Administration of China regarding the refund of CAAC Infrastructure development Fund after collection" (the "Refund Document"). According to the Refund Document, the CAAC Infrastructure Development Fund collected during the period from 1 July 2008 to 30 June 2009 will be refunded to the Company. In February 2009, the Company received the refund of CAAC Infrastructure Development Fund of approximately RMB397 million for the period from 1 July 2008 to 31 December 2008.

On 26 February 2009, the Company issued its first tranche of medium-term notes (the "Notes") with a total offering size of RMB3,000 million. The first tranche will be matured in 3 years with a coupon rate of 3.32%. The second tranche of the Notes was issued on 19 March 2009 with a total offering size of RMB3,000 million. The second tranche of the Notes will be matured in 5 years with a coupon rate of 3.48%. The proceeds of both tranches of the Notes were received by the Company on 27 February 2009 and 20 March 2009, respectively.

On 2 April 2009, the Company entered into a sale and purchase agreement with Capital Airports Holding Company ("Capital Airports"), pursuant to which the Company has agreed to purchase from Capital Airports its 24% equity interest in the registered capital of Air China Cargo. The aggregate consideration payable by the Company for the transaction amounted to approximately RMB718 million. Upon the completion of the transaction, the Company's interest in Air China Cargo (including an indirect interest through CNAC) will increase from 76% to 100%.

## 57 COMPARATIVE AMOUNTS

As further explained in note 2 to the financial statements, due to the early adoption of IFRIC 13 during the current year, the accounting treatment and presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain prior year and opening balance adjustments have been made and certain comparative amounts have been reclassified and restated to conform with the current year's presentation and accounting treatment.

## 58 APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 16 April 2009.

# Consolidated Balance Sheet

31 December 2008  
(Prepared under China Accounting Standards for Business Enterprises)

	<b>31 December 2008 RMB'000</b>	31 December 2007 RMB'000 (Restated)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and bank balances	<b>4,663,792</b>	3,787,152
Financial assets held for trading	<b>253,406</b>	6,493
Bills receivable	<b>1,604</b>	1,599
Accounts receivable	<b>2,074,178</b>	2,812,327
Other receivables	<b>1,110,524</b>	997,205
Prepayments	<b>309,945</b>	311,784
Inventories	<b>812,941</b>	755,340
<b>Total current assets</b>	<b>9,226,390</b>	8,671,900
<b>NON-CURRENT ASSETS</b>		
Long term receivables	<b>231,586</b>	255,340
Long term equity investments	<b>7,323,075</b>	11,404,643
Fixed assets	<b>66,244,815</b>	55,000,376
Construction in progress	<b>10,887,225</b>	10,967,888
Intangible assets	<b>2,563,887</b>	1,396,620
Goodwill	<b>349,055</b>	131,945
Long term deferred expenses	<b>141,601</b>	80,684
Deferred tax assets	<b>1,930,109</b>	629,843
<b>Total non-current assets</b>	<b>89,671,353</b>	79,867,339
<b>Total assets</b>	<b>98,897,743</b>	88,539,239

# Consolidated Balance Sheet

31 December 2008

(Prepared under China Accounting Standards for Business Enterprises)

	31 December 2008 RMB'000	31 December 2007 RMB'000 (Restated)
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short term loans	9,379,700	6,546,088
Financial liabilities held for trading	7,727,918	14,826
Bills payable	1,493,815	–
Accounts payable	7,792,638	6,338,341
Domestic air traffic liabilities	744,804	666,207
International air traffic liabilities	1,517,530	1,888,548
Receipts in advance	56,022	53,778
Employee compensations	163,918	145,792
Taxes payable	300,198	1,677,332
Interest payable	303,066	273,824
Other payables	3,030,210	2,141,939
Non-current liabilities repayable within one year	10,186,078	6,658,319
<b>Total current liabilities</b>	<b>42,695,897</b>	<b>26,404,994</b>
<b>NON-CURRENT LIABILITIES</b>		
Long term loans	14,109,828	12,938,092
Corporate bonds	3,000,000	3,000,000
Long term payables	1,307,706	1,301,844
Obligations under finance leases	16,480,784	13,328,193
Accrued liabilities	112,754	97,015
Deferred income	689,232	780,895
Deferred tax liabilities	214,000	5,000
<b>Total non-current liabilities</b>	<b>35,914,304</b>	<b>31,451,039</b>
<b>Total liabilities</b>	<b>78,610,201</b>	<b>57,856,033</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	12,251,362	12,251,362
Capital reserve	11,676,739	11,852,408
Reserve fund	1,563,914	1,299,214
Retained earnings/(accumulated losses)	(4,107,603)	6,144,164
Including: Discretionary reserve fund proposed by Board of Directors	–	264,700
Dividend proposed by Board of Directors	–	837,987
Foreign exchange translation reserve	(1,610,522)	(1,001,990)
<b>Equity attributable to equity holders of the Company</b>	<b>19,773,890</b>	<b>30,545,158</b>
Minority interests	513,652	138,048
<b>Total shareholders' equity</b>	<b>20,287,542</b>	<b>30,683,206</b>
<b>Total liabilities and shareholders' equity</b>	<b>99,897,743</b>	<b>88,539,239</b>

# Consolidated Income Statement

Year ended 31 December 2008

(Prepared under China Accounting Standards for Business Enterprises)

	2008 RMB'000	2007 RMB'000 (Restated)
Revenue from operations	52,969,998	49,490,046
Less: Cost of operations	48,606,512	40,307,624
Business taxes and surcharges	1,085,137	1,205,082
Selling expenses	3,281,648	3,200,032
General and administrative expenses	1,574,236	1,311,598
Finance costs/(revenue)	375,713	(52,619)
Impairment losses in assets	258,888	52,821
Add: Gains/(loss) from changes in fair value	(7,706,894)	133,840
Investment income/(loss)	(1,152,139)	1,235,655
Including: Share of profits and losses of associates and joint ventures	(1,182,141)	1,131,024
Profit/(loss) from operations	(11,071,169)	4,835,003
Add: Non-operating income	363,999	333,608
Less: Non-operating expenses	145,016	123,424
Including: Loss on disposal of non-current assets	14,549	45,212
Profit/(loss) before tax	(10,852,186)	5,045,187
Less: Tax	(1,591,898)	1,457,284
Net profit	(9,260,288)	3,587,903
Attributable to:		
Equity holders of the Company	(9,149,080)	3,698,564
Minority interests	(111,208)	(110,661)
Earnings/(loss) per share (RMB):		
(I) Basic	(0.77)	0.31
(II) Diluted	NA	NA

# Supplementary Information

31 December 2008

## EFFECTS OF SIGNIFICANT DIFFERENCES BETWEEN IFRS AND ASBE

The effects of significant differences between the consolidated financial statements of the Group prepared under ASBE and IFRS are as follows:

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
Net profit/(loss) attributable to the equity holders of the Company under ASBE		<b>(9,149,080)</b>	3,698,564
Deferred tax	(i)	<b>39,000</b>	(40,916)
Additional depreciation from restatement of costs of fixed assets	(ii)	<b>(150,481)</b>	(149,060)
Reversal of depreciation and amortisation arising on revaluation	(iii)	<b>278,195</b>	446,936
Government grant	(iv)	<b>15,016</b>	16,900
Effect of component accounting	(v)	<b>(288,463)</b>	57,635
Others		<b>(9)</b>	16,154
<b>Net profit attributable to equity holders of the Company under IFRS</b>		<b>(9,255,822)</b>	4,046,213

	Notes	2008 RMB'000	2007 RMB'000 (Restated)
Equity attributable to the equity holders of the Company under ASBE		<b>19,773,890</b>	30,545,158
Deferred tax	(i)	<b>(86,000)</b>	(62,319)
Restatement of costs of fixed assets	(ii)	<b>567,205</b>	743,768
Reversal of revaluation surplus	(iii)	<b>(333,720)</b>	(972,848)
Government grant	(iv)	<b>(395,226)</b>	(410,242)
Effect of component accounting	(v)	<b>248,565</b>	603,038
Others	(vi)	<b>168,138</b>	167,645
<b>Equity attributable to the equity holders of the Company under IFRS</b>		<b>19,942,852</b>	30,614,200

# Supplementary Information

31 December 2008

## Notes:

- (i) The differences in deferred tax were mainly caused by the other differences under ASBE and IFRS as explained below.
- (ii) The differences in the costs of fixed assets mainly relate to fixed assets acquired in foreign currencies prior to 1 January 1994 and translated at the equivalent amount of RMB at the then prevailing exchange rates prescribed by the government (i.e. the government prescribed rates) under ASBE. Under IFRS, the costs of fixed asset acquired in currencies prior to 1 January 1994 should be translated at the then prevailing market rates (i.e. the swap rates) and therefore resulted in differences in the costs of fixed asset in the financial statements prepared under ASBE and IFRS. Such differences are expected to be eliminated gradually through depreciation or disposals of the related fixed assets in future.
- (iii) In accordance with the accounting policies under IFRS, all assets are recorded at historical costs. Therefore the revaluation surplus or deficit (and the related depreciation/amortisation or impairment) recorded under ASBE should be reversed in the financial statements prepared under IFRS. Such differences are expected to be eliminated gradually through depreciation or disposals of the related fixed assets in future.
- (iv) Under both ASBE and IFRS, government grant or government subsidies should be debited as government grant/subsidiaries receivable or the relevant assets and credited as deferred income, which will then be charged to the income statement on a straight line basis over the useful lives of the relevant assets. As the accounting for government grant or government subsidies have had no significant impact on the Group's financial statements, no adjustment has been made to unify the accounting treatments of government grants or government subsidies under ASBE and IFRS. Therefore in the Group's financial statement prepared in accordance with ASBE, government grant received was debited as the relevant assets and credited as capital reserve; government subsidies were debited as cash and bank balances and credited as subsidy income in the income statement. Such differences are expected to be eliminated gradually through amortisation of deferred income to the income statement in future.
- (v) The differences were caused by the adoption of component accounting in different years under ASBE and IFRS. Component accounting was adopted by the Group on a prospective basis under IFRS in 2005 and under ASBE in 2007. Such differences are expected to be eliminated through depreciation and disposal of fixed assets in future.
- (vi) The difference was mainly caused by the disposal of Hong Kong Dragon Airlines Limited to Cathay Pacific Airways Limited ("Cathay") and is expected to be eliminated when the Group's interest in Cathay is disposed of.

# Glossary of Technical Terms

## CAPACITY MEASUREMENTS

“available seat kilometres” or “ASKs”	the number of seats available for sale multiplied by the kilometres flown
“available freight tonne kilometres” or “AFTKs”	the number of tonnes of capacity available for the carriage of cargo and mail multiplied by the kilometres flown
“available tonne kilometres” or “ATKs”	the number of tonnes of capacity available for the transportation of revenue load (passengers and cargo) multiplied by the kilometres flown
“tonne”	a metric ton, equivalent to 2,204.6 pounds

## TRAFFIC MEASUREMENTS

“revenue passenger kilometres” or “RPKs”	the number of revenue passengers carried multiplied by the kilometres flown
“passenger traffic”	measured in RPKs, unless otherwise specified
“revenue freight tonne kilometres” or “RFTKs”	the revenue cargo and mail load in tonnes multiplied by the kilometres flown
“cargo traffic”	measured in RFTKs, unless otherwise specified
“revenue tonne kilometres” or “RTKs”	the revenue load (passenger and cargo) in tonnes multiplied by the kilometres flown

## YIELD MEASUREMENTS

“passenger yield”	revenues from passenger operations divided by RPKs
“cargo yield”	revenues from cargo operations divided by RFTKs

## LOAD FACTORS

“cargo load factor”	RFTKs expressed as a percentage of AFTKs
“passenger load factor”	RPKs expressed as a percentage of ASKs
“overall load factor”	RTKs expressed as a percentage of ATKs

## UTILISATION

“block hours”	each whole or partial hour elapsing from the moment the chocks are removed from the wheels of the aircraft for flights until the chocks are next again returned to the wheels of the aircraft
---------------	---