

## CORPORATE GOVERNANCE

The Company is committed to fulfilling its responsibilities to shareholders by ensuring that the proper processes for oversight and management of its businesses are in place, in operation and are regularly reviewed. The Board acknowledges its responsibility to ensure that good corporate governance practices and procedures are established.

The Company welcomes the principles-based approach of the Code on Corporate Governance Practices (CG Code) in Appendix 14 of the Listing Rules and the flexibility this provides concerning the adoption and implementation of corporate policies and procedures.

Throughout the year, the Company has complied with all the code provisions and the majority of the recommended best practices as set out in the CG Code. In March 2005, the Company adopted its own code on corporate governance which was updated in October 2005 and which encompassed all code provisions and most of the recommended best practices in the CG Code.

One of the recommended best practices that the Company has deviated from is contained in Section C.1.4 of the CG Code in relation to the production of quarterly statements. The Company has chosen not to comply with this recommended reporting practice as the Board believes that, as a matter of principle and practice, quarterly reports in relation to the Group's business promote an undue short term focus in a business which is long term in nature. The Company would review its position if and when there was a clear demand from shareholders for quarterly reporting.

### THE BOARD

The Company is controlled through the Board, which has the overall responsibility for leadership and control of the Company. The Directors are collectively responsible for promoting the success of the Company by directing and supervising the Company's affairs.

**Board composition** The Board has 14 Directors: three Executive Directors – Mr. Clement K. M. Kwok, Mr. C. Mark Broadley and Mr. Peter C. Borer; seven Non-Executive Directors comprising Chairman The Hon. Sir Michael Kadoorie, Deputy Chairman Mr. Ian D. Boyce, Mr. Ronald J. McAulay, Mr. William E. Mocatta, Mr. Pierre R. Boppe, Mr. John A. H. Leigh, and Mr. Nicholas T. J. Colfer; and four Independent Non-Executive Directors comprising Dr. The Hon. Sir David K. P. Li, Mr. Robert C. S. Ng, Mr. Robert W. Miller and Mr. Patrick B. Paul. The Directors' biographical details are set out on pages 38 and 39 and are also posted on the Company's website at [www.hshgroup.com](http://www.hshgroup.com).

The Board believes that the balance between Executive and Non-Executive Directors is reasonable and adequate to provide sufficient checks and balances that safeguard the interests of shareholders and the Group. The Company already exceeds the minimum required number of Independent Non-executive Directors on the Board, and welcomes the contribution that they make at the Board and other Board Committee levels in the exercise of their experience, knowledge and judgement.

Included in the composition of the Board are two family members of the majority shareholder: the Chairman, The Hon. Sir Michael Kadoorie and his brother-in-law, Mr. Ronald J. McAulay. Several Board members are also directors of other businesses with which the majority shareholder is connected. They are: Mr. Ian D. Boyce, Mr. William E. Mocatta, Mr. John A. H. Leigh and Mr. Nicholas T. J. Colfer.

**Board meetings** The Board meets regularly to review business development and overall strategic policies. Within the Board's purview are matters such as financial statements, dividend policy, major financings, material investments in new projects and existing assets, risk management strategy, acquisitions, treasury policy and changes in accounting policy.

The dates of the 2006 Board meetings were determined in the last quarter of 2005 and any amendments to this schedule were notified to Directors at least 14 days before a regular Board meeting. Suitable arrangements are in place to allow all Directors the opportunity to include matters for discussion in the agenda of each Board meeting. An agenda and accompanying Board papers are sent to all Directors at least three days in advance of every Board meeting.

The Company Secretary assists the Chairman in preparing the agenda for the meeting and ensures that all applicable rules and regulations regarding the meetings are followed.

The Board held four meetings during 2006. The attendance record of each Director is set out below:

Attendance at board meetings	No. of meetings attended	
	2006 (4 meetings in total)	2005 (5 meetings in total)
<b>Non-Executive Directors</b>		
The Hon. Sir Michael Kadoorie (Chairman)	4	4
Mr. Ian D. Boyce (Deputy Chairman)	4	5
Mr. Ronald J. McAulay	2	5
Mr. William E. Mocatta	4	5
Mr. Pierre R. Boppe	3	3
Mr. John A. H. Leigh (appointed 05/06)	2 (of 2)	-
Mr. Nicholas T. J. Colfer (appointed 05/06)	2 (of 2)	-
Sir Sidney Gordon (retired 05/06)	0 (of 2)	1
Mr. James S. Dickson Leach (retired 05/06)	0 (of 2)	5
<b>Independent Non-Executive Directors</b>		
Dr. The Hon. Sir David K. P. Li	4	3
Mr. Robert C. S. Ng	1	2
Mr. Robert W. Miller	3	5
Mr. Patrick B. Paul	4	5
<b>Executive Directors</b>		
Mr. Clement K. M. Kwok (Chief Executive Officer)	4	5
Mr. C. Mark Broadley	4	5
Mr. Peter C. Borer	4	5

The Directors have full access to relevant information both at the meetings and at regular intervals as material information becomes necessary to the exercise of their powers. They also have unrestricted access to the advice and services of the Company Secretary, who is responsible for providing Directors with Board papers and related materials and ensuring that Board procedures are followed.

The Company Secretary also keeps detailed minutes of each meeting, recording all matters considered by the Board, the decisions reached, and any concerns raised or dissenting views expressed by Directors. Draft minutes are sent to all Directors in a timely manner for their comment and final versions of the minutes are available for inspection by all Directors at any time.

Should a potential conflict of interest involving a substantial shareholder or a Director arise, the matter will be discussed in an actual meeting, as opposed to being dealt with by written resolution. Independent Non-Executive Directors with no conflict of interest will be present at meetings dealing with such conflict issues.

***Appointment, re-election and removal*** A new Director appointed by the Board is subject to election by shareholders at the next annual general meeting. All Non-Executive Directors have letters of appointment valid for a period of three years, subject to re-election on retirement by rotation. All Directors are subject to retirement by rotation and may offer themselves for re-election. During 2006, one third of the Directors, comprising Sir Sidney Gordon, Mr. Ronald J. McAulay, Dr. The Hon Sir David K. P. Li and Mr. C. Mark Broadley retired by rotation and, save for Sir Sidney Gordon who had not sought for re-election, were all re-elected. In addition, Non-Executive Director Mr. James S. Dickson Leach retired voluntarily at the annual general meeting and did not seek re-election. Details of the Directors who will offer themselves for re-election in 2007 are set out in the Directors' Report.

***Confirmation of independence*** The Company has received from Dr. The Hon. Sir David K. P. Li, Mr. Robert C. S. Ng, Mr. Robert W. Miller and Mr. Patrick B. Paul, Independent Non-Executive Directors, an annual written confirmation of independence, and the Company considers such Directors to be independent in accordance with the independence guidelines set out in rule 3.13 of the Listing Rules. Although two of the Independent Non-Executive Directors, Dr. The Hon. Sir David K. P. Li and Mr. Robert C. S. Ng have served in this capacity for more than nine years, the Directors are of the opinion that the two Directors continue to bring relevant experience and knowledge to the Board and that, notwithstanding their long service, maintain an independent view of the Company's affairs.

***Chairman and Chief Executive Officer*** The positions of Chairman and Chief Executive Officer are segregated. It is the responsibility of the Chairman to provide leadership for the Board and to ensure that it works effectively and discharges its responsibilities. It is the responsibility of the Chief Executive Officer to effect the policies agreed by the Board, to advise the Board of any material issues which might impact the Company, and to conduct the day-to-day running of the Company.

### **Responsibilities of Directors**

Directors are encouraged to update their skills, knowledge and familiarity with the Group through their initial induction, ongoing participation at Board and Board Committee meetings, and through meeting key people at head office and in various properties.

Each Director ensures that he can give sufficient time and attention to the affairs of the Group. All Directors disclose to the Board on their first appointment their interests as a Director or otherwise in other companies or organisations and such declarations are updated annually.

*Directors' interests in competing business* None of the Directors and their respective associates has any competing interests which need to be disclosed pursuant to rule 8.10 of the Listing Rules.

*Directors' responsibilities for the financial statements* The Directors are responsible for the preparation of the financial statements for each financial period which gives a true and fair view of the state of affairs of the Group and of the results and cash flows for that period. In preparing these financial statements for the year ended 31 December 2006, the Directors have selected suitable accounting policies and applied them consistently, made judgements and estimates that are prudent, fair and reasonable and prepared the financial statements on a going concern basis. The Directors are responsible for ensuring that the Group keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group.

*Dealing in Company's securities by Directors* In February 2004, the Company adopted its Code for Dealing in the Company's Securities by Directors (the "Securities Code") on terms no less exacting than the required standard set out in the Stock Exchange's Model Code for Securities Transactions by Directors of Listed Issuers in Appendix 10 of the Listing Rules ("Model Code"). The Company has also extended this code to specified employees.

A copy of the Securities Code is sent to each Director of the Company first on his appointment. Thereafter, one month before the date of the Board meetings to approve the Company's half-year result and annual result, each Director is reminded of his duties not to deal in the securities of the Company until after such results have been published, and that all his dealings must be conducted in accordance with the Securities Code.

Under the Securities Code, Directors and specified employees of the Company are required to notify the Chief Executive Officer or in his absence, the Chief Financial Officer and receive a dated written acknowledgement before dealing in the securities of the Company, and in the case of the Chief Executive Officer himself, he must notify the Chairman and receive a dated written acknowledgement before any dealing.

The Company has made specific enquiry of all Directors regarding any non-compliance with the Model Code and the Securities Code during the year, and they have confirmed that they have fully complied with the required standard set out in both Codes.

In July 2006, the Company was informed by Sir Elly Kadoorie & Sons Limited (“SEK”) that The Hon. Sir Michael Kadoorie, Messrs. Ian D. Boyce, Ronald J. McAulay, William E. Mocatta, John A. H. Leigh and Nicholas T. J. Colfer, Directors of the Company (in their capacities as directors of trustee companies or fiduciaries of a number of trust structures), would be involved in a complex trust restructuring which would trigger a number of filings under the Securities and Futures Ordinance and related notifications to the Company (“Kadoorie Family Trust Restructuring”) during the month before the Company’s result announcement (“Blackout Period”) and the Stock Exchange had granted a conditional waiver to the foregoing Directors of the Company from strict compliance with the provisions of the Model Code during the Blackout Period. Part of the Kadoorie Family Trust Restructuring took place during the Blackout Period in September 2006. SEK confirmed to the Company that the Kadoorie Family Trust Restructuring did not involve acquisition of the Company’s new shares, or any outside consideration or changes to the beneficiaries.

### THE BOARD COMMITTEES

As part of good corporate governance practice, a number of Board Committees have been established. These Committees include representation from Non-Executive and Independent Non-Executive Directors whose objective views are important to the execution of the controls expected of a publicly listed company. Each Committee operates within defined terms of reference; these terms of reference are posted on the Company’s website at [www.hshgroup.com](http://www.hshgroup.com). All Committees report to the Board in relation to their decisions, findings or recommendations, and in certain specific situations, to seek the Board’s approval before taking any action. Draft minutes of all Board Committee meetings are sent to their respective members in a timely manner for their comments and final versions of the minutes are available for inspection by the respective members at any time.

The Board delegated certain authorities to the Executive, Audit, Finance and Remuneration Committees. The day-to-day management of the Company’s business has been delegated to the Chief Executive Officer who exercises his authority in consultation with the Group Management Committee.

*Executive Committee* The Executive Committee meets at least twice per month. The Committee is responsible for recommending general policy and direction for the Company to the Board and as such, it interacts with the Audit, Finance and Remuneration Committees in respect of their policy submissions. The members of the Executive Committee comprise The Hon. Sir Michael Kadoorie, Committee chairman, Mr. Ian D. Boyce, Mr. Clement K. M. Kwok, and Mr. John A. H. Leigh.

The Company does not have a separate Nomination Committee; the nomination and appointment of new Directors are functions of the Executive Committee. The Executive Committee reviews on a regular basis the need to appoint Directors with specific business acumen in appropriate sectors that would further enhance the present skill set, or add expertise in a developing business sector.

Nominations of suitable candidates are invited from all Directors, and nominees are considered by the Executive Committee and then by the Board. In May 2006, Messrs. John A. H. Leigh and Nicholas T. J. Colfer were appointed as Non-Executive Directors of the Company.

*Audit Committee* The Audit Committee oversees the Company's financial reporting and audit processes through liaison and reviews with management and the internal and external auditors. The composition of the Audit Committee includes only Non-Executive Directors of which the majority are independent. The Audit Committee members are Mr. Patrick B. Paul, Committee chairman, Mr. Ian D. Boyce, and Mr. Robert C. S. Ng.

All members of the Committee have financial and/or legal backgrounds that enable them to assess the fiscal well-being of the Company, compliance and risk assessment as well as to act impartially in discharging their duties and responsibilities. No former partner of the Company's existing auditing firm acted as a member of the Audit Committee within one year from ceasing to be a partner or having any financial interest in the auditing firm.

During 2006, activities undertaken by the Audit Committee included the following:

- ◆ reviewed the completeness and accuracy of the 2005 annual report and the 2006 interim report;
- ◆ oversight of the financial reporting and audit processes and policies;
- ◆ reviewed the Group's financial controls, internal control and risk management systems;
- ◆ reviewed connected transactions of the Company;
- ◆ agreed the scope of internal audit for 2006, discussed the internal audit reports and matters arising from the reports and reviewed progress against recommendations made in the internal audit reports;
- ◆ conducted discussions with the external auditors on financial reporting, compliance, accounting treatment and impact on the Company of accounting standards;
- ◆ assessed the independence of external auditors and reviewed their policies for maintaining independence;
- ◆ approved the external auditors' remuneration and considered its re-appointment;
- ◆ approved the audit plan for 2007; and
- ◆ reported all relevant matters to the Board.

The Audit Committee invited the Company's external auditors to attend all its meetings and also met with the valuers of the principal assets of the Group. In addition, the chairman of the Audit Committee met with the external auditors with no Executive Directors present. He also met with the Chief Executive Officer, the Chief Financial Officer and divisional heads within the Company.

The Audit Committee held five meetings during 2006. The attendance record of each member appears below:

Attendance at audit committee	No. of meetings attended	
	2006 (5 meetings in total)	2005 (5 meetings in total)
Mr. Patrick B. Paul (Committee chairman)	5	5
Mr. Ian D. Boyce	5	5
Mr. Robert C. S. Ng	2	2

**Finance Committee** The Finance Committee meets at least twice per month to review all aspects of the Company's finances, including such items as new investments or project commitments, establishment of budget parameters, major treasury policies (including debt levels, gearing and foreign exchange risk), granting of guarantees and indemnities and reviewing the annual insurance programme of the Group. It exercises the delegated authority granted to it by the Board and reports to the Executive Committee and to the Board as necessary. Members of the Finance Committee are: Mr. Ian D. Boyce, Committee chairman, Mr. Clement K. M. Kwok, Mr. C. Mark Broadley and Mr. John A. H. Leigh.

**Remuneration Committee** The Remuneration Committee is composed solely of Non-Executive Directors of which the majority is independent. Committee members are Mr. Ian D. Boyce (chairman), Mr. Robert W. Miller, and Mr. Patrick B. Paul.

The Remuneration Committee meets at appropriate intervals to formulate and recommend remuneration policy to the Board, including group-wide remuneration policies, reviewing the competitive terms and conditions of employment of the Chief Executive Officer and the Executive Directors, and making recommendations on compensation-related and human resource issues. No Director plays a part in any discussions about his own remuneration.

The Committee is provided with benchmark reports from internal and external sources for evaluation of market trends and the competitive levels of remuneration being offered to Executive Directors and staff. The Committee weighs compensation, performance-related bonuses and retirement provisions against market norms and sets parameters on what is fair for the Company to support, and competitive within the appropriate markets in which it operates. Fees and benefits for Non-Executive Directors are evaluated given the pool of qualified candidates, the demand for their services, their potential contribution to the development and oversight of the Company, and market practice.



The Remuneration Committee met twice during 2006. The attendance record of each member appears below:

Attendance at remuneration committee	No. of meetings attended	
	2006 (2 meetings in total)	2005 (2 meetings in total)
Mr. Ian D. Boyce (Committee chairman)	2	2
Mr. Robert W. Miller	1	1
Mr. Patrick B. Paul	2	2

During 2006, the Remuneration Committee reviewed matters relating to remuneration for Directors and senior management, as well as discussed the Group's remuneration policy.

The Group does not have any long-term incentive schemes other than the retirement scheme described in note 30 to the financial statements. Additional information on the basis of determining the emoluments payable to the Directors and senior management is set out in note 8 to the financial statements.

The Company has not adopted any share option scheme during the year.

### INTERNAL CONTROLS, AUDIT AND RISK MANAGEMENT

The Board has overall responsibility for the Company's system of internal control over financial, operational and compliance issues, risk management processes and physical and information systems security. The Board has reviewed the effectiveness of the Group's internal control system, to ensure that appropriate levels of protection are in place. No significant areas of concern were identified.

**Internal controls** The Company Management Authority Manual that was introduced in 2003, dealing with the Company's approval processes and the limits of authority for managers and Board Committees, is reviewed and updated from time to time to ensure its continuing relevance and effectiveness in controlling expenditure and approving the strategic direction of the Company.

The Chief Executive Officer reviews the effectiveness of the internal audit function and the systems of internal control of the Company on an annual basis. The annual review considers the following:

- ◆ the changes since the last annual review in the nature and extent of significant risks and the Group's ability to respond to changes in its business and the external environment;
- ◆ the scope and quality of management's ongoing monitoring of risks and of the systems of internal control, and where applicable, the work of its internal audit function and other providers of assurance;
- ◆ the extent and frequency of the communication of the results of monitoring to the Audit Committee or the Board which enables it to build up a cumulative assessment of the state of control in the Company and the effectiveness with which risk is being managed;



- ◆ the incidence of significant control failings or weakness that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the Company's financial performance or condition; and
- ◆ the effectiveness of the Company's public reporting processes.

On an annual basis, general managers and financial controllers of each business unit are required to submit a general representation letter to the Chief Executive Officer and the Chief Financial Officer giving certification of compliance by themselves and their subordinates of successful implementation of all internal systems of control and procedures in their respective units, and to provide supplementary information should there be any departure from the internal control systems. These general representation letters reinforce personal responsibility for good governance and controls at all levels within the Group.

***Internal audit and risk management*** The Company's Internal Audit and Risk Management Department assists the Board in conducting internal reviews of the Company and its subsidiaries in respect of all material controls, including operational and compliance controls, financial controls and risk management functions. It further assists in complying with the Company's own code on corporate governance.

The head of the Department reports to the Chief Executive Officer and has access to the chairman of the Audit Committee. He is supported by four qualified professionals, a majority of whom are members of the Institute of Internal Auditors. The Department provides the Board and all levels of Company management with an independent assessment of the quality of the internal controls, risk assessments, and governance issues and provides recommendations for continuous improvement.

The Department's three-year audit plan is annually revised to reflect organisational changes as well as new business activities introduced in the previous year. The audit plan, designed to cover all auditable areas whether of a financial, legal, reputational, environmental, information technology, safety or security nature, is reviewed and approved by the Audit Committee annually.

The Department follows a risk-and-control-based approach. Different audit areas are assigned risk ratings and an audit plan is formulated in a risk-weighted manner so that priorities and appropriate audit frequency is given to areas with higher risks. During 2006, the Department conducted audits and reviews of ten business units, four projects, nine head office functions and one overseas corporate-owned entity. Summaries of major audit findings and control weaknesses, if any, are discussed with management.

Every quarter, the Department submits a summary of these internal audit findings, the recommendations and the status of implementation of recommendations to the Audit Committee for its review. The head of the Department also attended two of the five Audit Committee meetings held during 2006; and attended regular meetings with the chairman of the Audit Committee and the external auditors without the presence of management. In the opinion of the Audit Committee, nothing of a material nature arose in the Department's reports requiring that it be brought to the attention of shareholders.

### EXTERNAL AUDITORS

It is important to the Group that the independence of its external auditors is not compromised. Contracts for substantial non-audit work to be awarded to the external auditors must, therefore, be pre-approved by the Audit Committee and the scope of work determined to provide only efficiencies of scale and added value, with no adverse effect on actual or perceived independence of the audit work itself. During the year, the Company's auditors, KPMG, provided audit services to the value of HK\$6.6 million. KPMG also provided taxation services to the value of HK\$0.7 million.

### CODE OF CONDUCT

The Company has a detailed code of conduct, to which employees are signatories, governing the standards of behaviour expected in dealing with colleagues, customers, suppliers, contractors, consultants and professional firms.

A broad summary of the code of conduct is published on the Group's website at [www.hshgroup.com](http://www.hshgroup.com), covering the Group's policies on the following areas: bribery, illegal gifts and commissions, accepting/offering advantages, entertainment and hospitality industry practice, use of proprietary information, handling conflict of interest situations, insider trading, misuse of the Company's assets and resources, loans, personal conduct outside hours of work including outside employment, monitoring of compliance and the means of enforcement, understanding and compliance of the code of conduct, violation of the code of conduct, and complaints.

In addition to the values to which the Company expects its staff to adhere in their daily business practices, the code sets out the process for resolution of internal ethical problems that may arise within the workplace. The code is reviewed regularly and benchmarked against emerging mores and standards as the work environment becomes more sophisticated, and as technological advances create new behavioural dynamics.

### INVESTOR RELATIONS

The Company is keen to promote two-way communications both with its institutional and its private investors. The Annual General Meeting ("AGM") is the principal occasion at which the Chairman and Directors may interface directly with the shareholders. An AGM circular is distributed to all shareholders at least 21 days prior to the AGM, setting out details of each proposed resolution, voting procedures (including procedures for demanding and conducting a poll) and other relevant information. All Directors are usually present at the AGM to which all shareholders are invited and during which they have the opportunity to raise questions with the Board.

During the year, continuous dialogue between investors and the Company on the Company's business is encouraged. As part of a regular programme of investor relations, Executive Directors and our General Manager of Corporate Finance and Treasurer hold briefings and attend road-shows with investors and financial analysts to engage in two-way communications on the Company's performance and objectives. Archived webcasts and copies of presentation materials from such briefings, and webcasts of the meetings announcing the interim and final results of the Company are made available to investors and public through the corporate website.

Communication with shareholders is a high priority. The annual report and accounts and the interim report are distributed to individual and institutional investors and are also available for download from the Company's website at [www.hshgroup.com](http://www.hshgroup.com). General enquiries from shareholders are handled by designated employees within the Company.

At the 2006 AGM, held at noon on Thursday, May 18 at The Peninsula Hong Kong, separate resolutions were proposed on the following issues:

- ◆ to receive the audited financial statements and the reports of the Directors and auditors, for the year ended 31 December 2005;
- ◆ to declare a final dividend;
- ◆ to re-elect three Directors and to elect two Directors;
- ◆ to re-appoint KPMG as auditors of the Company at a fee to be agreed by the Directors;
- ◆ to grant a general mandate to issue new shares;
- ◆ to grant a general mandate for share repurchase; and
- ◆ to add shares repurchased to the general mandate given to issue new shares.

Each resolution was voted on by poll and passed and the results of the poll voting were posted on the Company website as well as published in the media the following day.

In addition to the shareholders, media are also invited to attend and report on the AGM.

The key dates in the corporate results and meetings calendar are also posted on the Company's website in advance. The important dates for 2007 are:

- ◆ Annual General Meeting: Friday, 11 May 2007
- ◆ Interim Results 2007 Announcement: Wednesday 12 September 2007.

Details of the public float are set out in the Directors' Report on page 84.