

Report of Corporate Governance

(I) Overview of Corporate Governance

The Company has always regarded the consistent maintenance of an excellent, solid and reasonable corporate governance structure as top priority. Currently, the Company's code on corporate governance practices includes, but is not limited to the following documents:

1. "Articles of Association of China Shenhua Energy Company Limited";
2. "Rules and Procedures of Shareholders' General Meetings of China Shenhua Energy Company Limited";
3. "Rules and Procedures of Meetings of the Board of China Shenhua Energy Company Limited";
4. "Rules and Procedures of Meetings of the Supervisory Committee of China Shenhua Energy Company Limited";
5. "Rules and Procedures of Meetings of the Audit Committee of the Board of China Shenhua Energy Company Limited";
6. "Rules and Procedures of Meetings of the Remuneration Committee of the Board of China Shenhua Energy Company Limited";
7. "Rules and Procedures of Meetings of the Strategic Planning Committee of the Board of China Shenhua Energy Company Limited";
8. "Rules and Procedures of Meetings of the Safety, Health and Environmental Committee of the Board of China Shenhua Energy Company Limited";
9. "Information Disclosure Policy of China Shenhua Energy Company Limited";
10. "Connected Transaction Decision Making System of China Shenhua Energy Company Limited";
11. "Investor Relations Management System of China Shenhua Energy Company Limited";
12. "Model Code of Securities Transaction for Directors of China Shenhua Energy Company Limited".

The Board has reviewed the relevant corporate governance documents adopted by the Company, and is of the opinion that the documents contain all the provisions of the Code on Corporate Governance Practices (hereinafter referred to as ("Code on Corporate Governance Practices")) of the Listing Rules.

In respect of the following areas, our internal corporate governance rules are more stringent than the Code on Corporate Governance Practices:

1. In addition to the audit committee and remuneration committee, the Company has also established a strategy planning committee and a safety, health and environmental committee.
2. All members of the audit committee are independent non-executive directors, of whom Dr. Chen Xiaoyue holds the relevant professional qualification or professional knowledge related to accounting or financial management.

(II) Code on Corporate Governance Practices

After our listing on the Hong Kong Stock Exchange on 15 June 2005, the Company has fully complied with the requirements under the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules.

(III) Securities Transactions of the Directors

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Listing Rules, requiring the securities transactions of the directors of the Company to be carried out in accordance with the Model Code, which is also applicable to the senior management of the Company. After a special inquiry conducted by the Company, all directors have confirmed that they have fully complied with the Model Code throughout the year of 2005.

(IV) Share Interests of Directors, Supervisors, and Senior Management

As at 31 December 2005, none of the directors, supervisors, or senior management had any interest or short position in the shares or underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Future Ordinance (the "SFO"), Chapter 571 of the Laws of Hong Kong) which was required to be entered in the register required to be kept by the Company pursuant to Section 352 of the SFO or which was otherwise required to be notified by the directors and supervisors to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

As at 31 December 2005, the Company had not granted any equity securities or warrants to its directors, supervisors and senior management or their respective spouses or children under the age of 18.

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(V) Substantial Shareholders' Interests and Short Positions in the Company

As at 31 December 2005, persons set out in the table below had an interest or short position in the Company's shares as recorded in the register required to be kept under section 336 of the SFO (Chapter 571 of the Laws of Hong Kong):

Name of shareholder	Capacity	H/domestic shares	Nature of interest	No. of H/domestic shares held	Percentage of H/domestic shares over all issued H/domestic shares respectively (%)	Percentage of total share capital of the Company (%)
Shenhua Group Corporation Limited	Beneficial owner	Domestic	Long Position	14,691,037,955	100.00	81.21
Kerry Group Limited ¹	Interest of controlled corporation	H	Long Position	138,750,350	4.08	0.77
Alliance Capital Management L.P.	Interest of controlled corporation	H	Long Position	408,590,000	12.02	2.26
Genesis Fund Managers, LLP	Investment manager	H	Long Position	170,808,500	5.03	0.94
China International Capital Corporation Limited	Interest held jointly with another	H	Long Position	124,442,500	3.66	0.69
China Jianyin Investment Limited	Interest of controlled corporation	H	Long Position	124,442,500	3.66	0.69
China Safe Investment Limited	Interest of controlled corporation	H	Long Position	124,442,500	3.66	0.69
Deutsche Bank Aktiengesellschaft	Interest held jointly with another	H	Long Position	128,966,500	3.79	0.71
Merrill Lynch & Co., Inc.	Interest of controlled corporation	H	Long Position	124,442,500	3.66	0.69
Merrill Lynch Far East Limited	Interest held jointly with another	H	Long Position	124,442,500	3.66	0.69
Morgan Stanley	Interest held jointly with another	H	Long Position	130,577,500	3.84	0.72
Kerry Holdings Limited ²	Interest of controlled corporation	H	Long Position	207,582,000	6.11	1.15
Merrill Lynch International	Other(s)	H	Long Position	59,180,000	1.74	0.33
			Short Position	518,705,000	15.26	2.87

Name of shareholder	Capacity	H/domestic shares	Nature of interest	No. of H/domestic shares held	Percentage of H/domestic shares over all issued H/domestic shares respectively (%)	Percentage of total share capital of the Company (%)
Taurus Investments SA ³	Beneficial owner	H	Long Position	155,612,000	4.58	0.86
Merrill Lynch (Asia Pacific) Limited	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
Merrill Lynch (Asia Pacific) Limited	Physically settled unlisted derivatives of controlled corporation	H	Long Position	459,525,000	13.52	2.54
Merrill Lynch Europe Intermediate Holdings	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
Merrill Lynch Europe PLC	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
Merrill Lynch Holdings Limited	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
Merrill Lynch International Holdings Inc.	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
Merrill Lynch International Holdings Inc.	Physically settled unlisted derivatives of controlled corporation	H	Long Position	459,525,000	13.52	2.54
Merrill Lynch International Incorporated	Physically settled unlisted derivatives of controlled corporation	H	Long Position	459,525,000	13.52	2.54
Merrill Lynch International Incorporated	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87
ML UK Capital Holdings	Interest of controlled corporation	H	Long Position	518,705,000	15.26	2.87
			Short Position	518,705,000	15.26	2.87

Note 1: Kerry Group Limited controlled 100% of Kerry Holdings Limited which in turn, directly controlled 35%, 100%, 100%, 100%, 44.14% and 100% interests in Perfex Overseas Limited, Aim High Profits Limited, Beat All International Limited, Bright Side International Limited, Kerry Asset Management Limited and Velmar Company Limited respectively. As at 31 December 2005, Kerry Group Limited was deemed through its interest in Kerry Holdings Limited to have a long position in respect of an aggregate of 138,750,350 H shares of the Company held by Kerry Holdings Limited and the companies mentioned above in which Kerry Holdings Limited had a controlling interest.

Note 2: Kerry Holdings Limited controlled 35% interest in Perfex Overseas Limited and Toprange Investments Limited respectively, and 44.14% interest in Kerry Asset Management Limited. As at 31 December 2005, Kerry Holdings Limited had a long position in an aggregate amount of 207,582,000 H shares of the Company, of which 103,741,000 H shares were held by Perfex Overseas Limited, 103,741,000 H shares were held by Toprange Investments Limited and 100,000 H shares were held by Kerry Asset Management Limited.

Note 3: Taurus Investments SA was a wholly-owned subsidiary of Anglo American PLC which held an indirect interest in the 155,612,000 shares through Taurus Investments SA.

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(VI) Board of Directors

The composition and other information on the Board are listed as follows:

Name	Sex	Age	Position in the Company	Term of office	Salaried or non-salaried
Chen Biting	Male	60	Chairman of the Board of Directors and Executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes
Zhang Xiwu	Male	47	Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	No
Wu Yuan	Male	60	Executive Director and President	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes
Zhang Yuzhuo	Male	44	Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	No
Ling Wen	Male	43	Executive Director, Executive Vice President and Chief Financial Officer	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes
Han Jianguo	Male	47	Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	No
Huang Yicheng	Male	79	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes
Anthony Francis Neoh	Male	59	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes
Chen Xiaoyue	Male	59	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual general meeting of the Company	Yes

The Board is a standing decision-making organisation of the Company. It leads and supervises the Company in a responsible and cost-effective manner. All directors are required to act in the best interest of the Company. All members of the Board are jointly and severally liable to all shareholders with regards to matters of management, supervision and operation of the Company.

The Board is primarily responsible for making decisions on the following:

1. devising strategies of the Company;
2. establishing objectives of the management;
3. monitoring the performance of the management; and
4. ensuring that the Company implements a prudent and effective control system, so as to assess and manage risks.

The Board is responsible for preparing the financial statements for each accounting year to give a true and fair view of the financial position of the Company and its results and cash flow for the relevant period. In preparing the financial statements for the year ended 31 December 2005, the Board has adopted and applied the appropriate accounting policies in arriving at a prudent, fair and reasonable judgement and estimates, and has prepared the financial statements on a going concern basis. The Board is responsible for duly maintaining accounting records which disclose the financial position of the Company reasonably and accurately. The Board as a whole shall meet at least quarterly and as and when major decisions are required.

The Chairman and the President of the Company are Mr. Chen Biting and Mr. Wu Yuan respectively. The roles of the Chairman and the President are two distinctively separate positions. The Chairman shall not be the President of the Company concurrently and their respective duties are clearly defined in writing. The Chairman is responsible for managing the operation of the Board whereas the President is responsible for business operations. The Articles of Association of the Company sets out in detail the respective duties of the Chairman and the President. The senior executives other than the Directors and the Supervisors, are responsible for the daily business operations and their duties are set out in section "Directors, Supervisors, Senior Management and Employees" of this report.

In considering any matters and transactions at any Board meeting, the Directors shall declare any interests whether direct or indirect, and shall refrain from attending a meeting as appropriate. The Company shall, during each financial period, require the Directors to confirm any connected transactions entered into by them or any of their associates with the Company or any of its subsidiaries.

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Attendance of Directors at Board Meetings in 2005

Number of meetings	4	
	Attendance in person <i>number of times</i>	Attendance by proxy <i>number of times</i>
Independent Non-executive Directors		
Huang Yicheng	4	–
Anthony Francis Neoh	3	1
Chen Xiaoyue	4	–
Executive Directors		
Chen Biting	4	–
Wu Yuan	4	–
Ling Wen	4	–
Non-executive Directors		
Zhang Xiwu	4	–
Zhang Yuzhuo	4	–
Han Jianguo	4	–

Throughout the period since the establishment of the Company in November 2004, the Board has been in compliance with the Rule 3.10(1) of the Listing Rules, which requires a company to maintain at least three independent non-executive directors, and with the Rule 3.10(2) of the Listing Rules, which requires one of those independent non-executive directors to possess professional qualifications or to be specialised in accounting or relevant financial management.

Pursuant to the requirements of the Hong Kong Stock Exchange, the Company has conducted verifications on its independent directors in respect of their independence as follows: the Company has accepted the written confirmation of each of the independent non-executive directors ascertaining that they are in compliance with Rule 3.13 of the Listing Rules in respect of their independence. The Company is of the opinion that all of the independent non-executive directors are independent.

Other than their working relationships with the Company, none of the directors, supervisors or the senior management has any financial, business or family relationships or any relationships in other material aspects with each other.

Other than the service contract entered into by each of them, none of the directors or the supervisors has any personal and substantive interest, direct or indirect, in the material contracts entered into by the Company or any of its subsidiaries during 2005.

(VII) Directors' Remuneration

The Board of the Company established a remuneration committee consisting of two independent non-executive directors and one executive director. The Chairman is Anthony Francis Neoh, and the members are Chen Xiaoyue and Ling Wen.

The committee would, when it is necessary, engage external professional advisers to give assistance and/or suggestions in relation to the matters concerned.

Details of the principal duties and work done of the remuneration committee during the year are set out in the section "Reports of the Board Committees" of this report.

Attendance of Individual Remuneration Committee Members in 2005

Number of meetings	2	
Name	Attendance in person number of times	Attendance by proxy number of times
Anthony Francis Neoh	2	-
Chen Xiaoyue	2	-
Ling Wen	2	-

(VIII) Nomination of Directors

No nomination committee exists in the Company.

The Company appoints new directors in accordance with a transparent procedure which has been formally established after prudent consideration. Generally, the candidates for directorship are proposed at general meetings of shareholders by the Board. Shareholders and the supervisory committee of the Company can nominate candidates according to the Articles of Associations of the Company.

Written notice containing the intention to nominate a candidate and the candidate's expressly willingness to accept the nomination shall be delivered to the Company not earlier than the day when the notice of the shareholders' general meeting has been dispatched and not later than seven days prior to the convening of such meeting. The period between nomination and the acceptance of nomination shall not be less than seven days.

The tenure of each independent non-executive director is three years. Each of the independent non-executive directors is eligible for re-election; however, the combined term of an independent non-executive director shall not exceed six years. Prior to the expiry of his term, an independent non-executive director shall not be deposed without good reasons. For those who are deposed prior to the expiry of their term of office, the Company shall disclose it as a special disclosable matter.

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(IX) Auditors' Remuneration

The Company's external auditors are KPMG and KPMG Huazhen. After considering and passing at the fifth meeting of the first session of the audit committee held by the Company on 9 March 2005 and approval by the relevant board panel, the audit fee of the Company for the year ended 31 December 2005 shall be approximately RMB21.72 million.

The Company also incurred approximately RMB85.8 million for the services provided by the reporting accountants in respect of the IPO and listing of the Company's shares on the Hong Kong Stock Exchange and the amount has been charged to the share premium account. The services commenced in April 2004 and it was not practicable to separate the amount payable for those services between the years 2004 and 2005.

(X) Audit and Audit Committee

The Board of the Company established an audit committee consisting of three independent non-executive directors. The Chairman is Chen Xiaoyue, and the members are Huang Yicheng and Anthony Francis Neoh.

The committee would, when it is necessary, engage an external professional adviser to give assistance and/or suggestions in relation to the matters concerned.

Details of the principal duties and work done of the audit committee during the year are set out in the section "Reports of the Board Committees" of this report.

Attendance of Individual Audit Committee Members in 2005

Number of meetings	3	
Name	Attendance in person number of times	Attendance by proxy number of times
Chen Xiaoyue	3	–
Huang Yicheng	2	1
Anthony Francis Neoh	3	–

Since its listing on the Hong Kong Stock Exchange, the Company has been in full compliance with the requirements of Rule 3.21 of the Listing Rules up to 31 December 2005.

The directors of the Company are responsible for overseeing the preparation of financial statements for each financial period which should truly and fairly reflect the business conditions, results and cash flows during the period. In preparing the financial statements for the year ended 31 December 2005, the directors adopted and applied consistently appropriate accounting policies; approved the adoption of all standards which are in compliance with the IFRSs; made prudent and reasonable judgments and estimates in the preparation of those financial statements which were prepared on a going concern basis.

The results of the year have been reviewed by the audit committee.

(XI) Shareholders' Rights

The Board and senior management of the Company are aware that they act on behalf of the interests of all shareholders; therefore, their important tasks are to maintain the long-term stability and an increase in shareholders' value and returns on investments, and to improve the competitiveness of our business.

In accordance with the Articles of Association of the Company, shareholders who solely or in aggregate hold 10% or more of the voting shares issued by the Company, have the right to call for an extraordinary general meeting in writing (the number of shares held by the shareholders is calculated on the day the relevant shareholders submit their written request), the extraordinary general meeting shall be convened within two months. The relevant documents shall state the purpose of the general meeting and shall be delivered to all the shareholders. Shareholders may propose to the Board procedures for making enquiries and put forth the proposed procedures at shareholders' general meetings.

(XII) Internal Control

The Board takes ultimate responsibility for the Company's internal control system. During the year, the audit committee reviewed the efficiency of the relevant system.

Since our incorporation, the Company has been focusing on the establishment and perfection of the internal control system, continuously improving the control workflow, striving to raise operating efficiency and reducing operating risk. A set of complete internal control system was established within the Company. In addition, a series of comparatively well-established internal control systems were developed in respect of asset supervision and management, capital management, investment management and human resources management. Through a scientific organisational structure and reasonable design of internal control system, the Company has established a scientific decision-making mechanism, implementation mechanism and supervision mechanism. "Internal Control Authorisation Manual of China Shenhua Energy Company Limited (Provisional)" specifies strictly the scope of authorisations of the business department, finance department, strategic planning department, section leaders, executive vice president, President, and the standing conference of the President. Personnel and departments that have accepted the authorisation should fulfill the responsibility earnestly within the scope of authorisation. Relevant departments have the right to refuse to act on instructions which exceed the relevant authorisation level.

The effective implementation of the internal control system ensured the orderly development of the Company's operating and management activities as well as the effective control of risks, safeguarded the security and integrity of the Company's property and guaranteed the realisation of the Company's operating and management objectives.

Each department in the Company has the channel to submit requests for information to the Board. Being the most senior point of contact to each department, the President of the Company has the duty to effectively report to the Board in relation to the operations of each department, and to coordinate and mobilise the demands of each department to promote reasonable decision making within the Company. Accordingly, any possible significant matter (if subject to disclosure) discovered by the staff can be reported to the Company's decision makers in a timely, accurate and effective manner and the decisions from the management can be implemented accurately and timely, and be exercised with supervision.

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In May 2005, the Board earnestly reviewed the internal control system which was established and implemented from November 2004, and was of the view that the internal control system had met the following objectives: it had effectively guaranteed the orderly conduct of the Company's operating activities in accordance with proper authorisation; it had ensured the authenticity, legality and integrity of all transactions, financial statements and relevant information; and it had ensured that these financial statements sufficiently disclosed all relevant information to the public; it had safeguarded the security and integrity of the Company's assets.

Accordingly, the Board is of the view that the internal control system of the Company is relatively developed, reasonable and effective, and reasonably ensures that the Company and its directors perform their prescribed obligations under the Listing Rules and relevant laws and regulations in Hong Kong. It also ensures that the directors of the Company may reasonably evaluate the financial position and prospects of the Company and its subsidiaries.

On 10 November 2005, the Company announced the "Provisional Measures for Administration of Connected Transactions of China Shenhua Energy Company Limited" which expressly stipulates the system of management of continuing connected transactions and new connected transactions, as well as the ordinary management procedures of connected transactions.

The Company has set up an internal audit department, which is mainly responsible for checking and evaluating the internal control system of the Company. The internal audit department reports to the audit committee. The internal audit department has one officer and 8 professionals. The branches and subsidiaries under the Company have also mostly established internal audit department, and have 34 professionals in total. The internal audit department of each branch or subsidiary performs its duties under the supervision of the Company's internal audit department and is accountable to the internal audit department of the Company.

The principal tasks of the internal audit department specified in the "Administrative Measures for Internal Audit of China Shenhua Energy Company Limited (Provisional)" issued in September 2005 are: to examine and evaluate the establishment, perfection and implementation of internal control system and to scrutinise the Company's compliance with relevant laws and regulations inside or outside China as well as its implementation of corporate plan and procedures; scrutinise the corporate operations and management activities related to financial income and expenses and evaluate corporate economic benefits and the security and integrity of corporate assets.

Since its establishment in November 2004, the internal audit department has done a great deal of foundation work. In addition, the internal audit department is also responsible for contacts with external auditors. At the same time, it actively reviews internal control policies and internal audit work.

We will continuously review and improve the Company's practice of corporate governance with reference to the Listing Rules, our accumulation of practical experience and shareholders' feedback in accordance with the trends developed in China and internationally as well as changes in internal and external risk factors.