

## CORPORATE GOVERNANCE REPORT

### CODE ON CORPORATE GOVERNANCE PRACTICES

The Stock Exchange of Hong Kong Limited (“HKEx”) introduced appendix 14 “Code on Corporate Governance Practices, (the “Code Provisions”) of Rules Governing the Listing of Securities on the HKEx and appendix 23 “Corporate Governance Report” which has become effective for accounting periods commencing on or after 1 January 2005.

The Board of Directors recognizes the importance of and is committed to maintaining good standards of corporate governance so as to enhance corporate transparency and protect the interests of the Company’s shareholders.

On 25 November 2005, the Board of Directors (the “Board”) of China Flavors and Fragrances Company Limited (the “Company”) adopted the Code Provisions as its own code of corporate governance practices. To ensure compliance with the new Code on Corporate Governance Practices (the “New CG Codes”) the Board has undertaken to review and propose the necessary amendments to the Bye-laws of the Company to bring the constitution of the Company in alignment with certain provisions of the New CG codes. Annual General Meeting of the Company will hold to amend the Bye-laws of the Company so that any director appointed to fill a casual vacancy shall be subject to re-election by shareholders at the Company’s first general meeting after the appointment rather than the Company’s next following annual general meeting after the appointment.

This report describes the corporate governance practices of the Company, with reference to the Principles set out in the Code Provisions on Corporate Governance Practices prescribed by the HKEx.

### DIRECTORS’ SECURITIES TRANSACTIONS

On 25 November 2005, the Company adopted the Model Code for Securities Transactions by Directors of Listed Issuers (“Model Code”) set out in Appendix 10 of the Listing Rules as its own code of conduct regarding Directors’ securities transactions.

Having made specific enquiry of all Directors, the Directors of the Company have complied with the required standard set out in the Model Code regarding Directors’ Securities Transactions.

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### BOARD

#### (a) Board Composition

The Board currently comprises three executive Directors and three independent non-executive Directors.

The Board members for the period ended 31 December 2005 were:

##### *Executive Directors*

Mr. Wong Ming Bun, ( <i>Chairman</i> )	(Appointed on 4 April 2005)
Mr. Wang Ming Fan, ( <i>Chief Executive Officer</i> )	(Appointed on 4 April 2005)
Mr. Li Qing Long	(Appointed on 4 April 2005)

##### *Independent Non-executive Directors*

Mr. Goh Gen Cheung	(Appointed on 25 November 2005)
Mr. Leung Wai Man, Roger	(Appointed on 25 November 2005)
Mr. Zhou Xiao Xiong	(Appointed on 25 November 2005)

To the best knowledge of the Company, there is no financial, business and family relationship among our directors except that Mr. Wang Ming Fan, the chief executive officer of the Company, is the brother of Mr. Wong Ming Bun, the Chairman of the Company.

All Directors (including Independent Non-executive Directors) are subject to retirement by rotation at least once every three years in accordance with the Company's Articles of Association. Any Director appointed as an addition to the Board or to fill a casual vacancy on the Board shall hold office until the first general meeting after their appointment and shall then be eligible for re-election.

The Board will constantly examines its size and, with a view to determining the impact of the number upon effectiveness, decide on what it considers an appropriate size for the Board, which facilitates effective decision making. The composition of the Board will be reviewed on a half-yearly basis by the Nomination Committee to ensure that the Board has the appropriate mix of expertise and experience.

The Board, taking into account the nature of operations of the Company, considers its current size to be adequate for effective decision making. Key information regarding the Directors' academic and professional qualifications and other appointments is set out on pages 10 and 13 of this annual report.

**(b) Role and Function**

Prior to their respective appointments to the Board, each of the Directors was given an orientation on the Company's business strategies and operations. The Directors will receive, from time to time, further relevant training, particularly on applicable new laws, regulations and changing commercial risks which are relevant to the business and operations of the Group. The Directors will also be updated on the business of the Group through regular presentations and meetings.

The Board effectively leads and controls the long-term vision and strategic direction of the Group. Apart from its statutory duties and responsibilities, the Board oversees the management and affairs of the Group and approves the Group's corporate and strategic directions. The Board is also responsible for implementing policies in relation to financial matters, which include risk management and internal controls and compliance, if applicable. In addition, the Board reviews the financial performance of the Group, approves investment proposals, and approves nomination of directors to the Board and the appointment of key management personnel. These functions are carried out either directly or through Board Committees such as Audit Committee, Nomination Committee and Remuneration Committee. In the appropriate circumstances and as and when necessary, Directors may obtain independent professional advice at the Group's expenses, ensuring that board procedures, and all applicable rules and regulations, are followed.

The Board gives clear directions as to the powers delegated to the management for the management and administration function of the Group, in particular, with respect to the circumstances where management should report back and obtain prior approval from the board before making decisions or entering into any commitments on behalf of the Group. Matters which are specifically reserved to the full Board for decision are those involving a conflict of interest for a substantial shareholder or a director, material acquisitions and disposal of assets, corporate or financial restructuring, share issuance and dividends, and financial results and corporate strategies. The Board will review those arrangements on a periodic basis to ensure that they remain appropriate to the needs of the Group.

Formal Board meetings will be held at least four times a year after listing on 9 December 2005 at approximately quarterly intervals to oversee the business affairs of the Group, and to approve, if applicable, any financial or business objectives and strategies. Ad-hoc meetings are convened when the circumstances require. The Company's Bye-laws allow a Board meeting to be conducted by way of teleconference and videoconference.



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### (c) Accountability and Audit

The Management provides such explanation and information to the Board so as to enable the Board to make an informed assessment of the financial and other information put before the approval by the Board.

The Directors acknowledge their responsibility to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Group and in presenting the interim and annual accounts, and announcements to shareholders. The Directors aim to present a balanced and understandable assessment of the Group's position and prospects. The Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Group's ability to continue as a going concern, the Board therefore continues to adopt the going concern approach in preparing the accounts.

The Board acknowledges its responsibility to present a balanced, clear and understandable assessment in the Company's annual and interim reports, other price-sensitive announcement and other financial disclosures required under the Listing Rules, and reports to the regulators.

### (d) Supply of and Access to Information

Board papers will be circulated not less than three days before the Board meetings to enable the Directors to make informed decisions on matters to be raised at the Board meetings. The Company Secretary and the Qualified Accountant shall attend all formal Board meetings to advise on corporate governance, statutory compliance, accounting and financial matters when necessary.

The management has the obligation to supply the Board and its committees with adequate information in a timely manner to enable it to make informed decisions. Where any Director requires more information than is volunteered by the management, each Director has separate and independent access to the Company's senior management to make further enquires if necessary.

Directors shall have full access to information on the Group. The Company Secretary shall prepare minutes and keep records of matters discussed and decisions resolved at all Board meetings.



**(e) Meeting Records**

The Board shall meet at least four times a year after listing on 9 December 2005 at approximately quarterly intervals. There was one meeting held in the financial period ended 31 December 2005.

	<b>Attendance</b>
Mr. Wong Ming Bun	0/1
Mr. Wang Ming Fan	1/1
Mr. Li Qing Long	1/1
Mr. Goh Gen Cheung	1/1
Mr. Leung Wai Man, Roger	1/1
Mr. Zhou Xiao Xiong	0/1

**(f) Independent Non-executive Directors**

All Independent Non-executive Directors are financially independent from the Company and any of its subsidiaries.

The Company confirmed with all Independent Non-executive Directors as to their independence with reference to the factors as set out in Rule 3.13 of the Listing Rules.

**CHAIRMAN AND CHIEF EXECUTIVE OFFICER**

The Chairman and Chief Executive Officer of the Company are Mr. Wong Ming Bun and Mr. Wang Ming Fan respectively.

The Board recognizes power is not concentrated in any one individual both on the management of the board and the day-to-day management of the Group's business. In order to meet this aim, the responsibilities between the Chairman and Chief Executive Officer are separate.

The Chairman is responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues are discussed by the Board in a timely and constructive manner.

The Chief Executive Officer is responsible for running the Group's Business, and implementation of the Group's strategy in achieving the overall commercial objectives.

There are sufficient safeguards and checks to ensure that the process of decision making by the Board is independent and based on collective decisions without any individual exercising any considerable concentration of power or influence.

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### REMUNERATION OF DIRECTORS

The Company established a Remuneration Committee on 25 November 2005 with terms of reference in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules. The Remuneration Committee comprises Mr. Wong Ming Bun, an Executive Director and the three Independent Non-executive Directors, namely Mr. Goh Gen Cheung, Mr. Leung Wai Man, Roger and Mr. Zhou Xiao Xiong. Mr. Wong Ming Bun is the Chairman of the Remuneration Committee. Each member of the Remuneration Committee shall abstain from voting on any resolutions in respect of his remuneration package. The Remuneration Committee shall meet at least twice a year after listing on 9 December 2005. The Company has scheduled the first Remuneration Committee Meeting to be held on 3 April 2006.

The role and functions of the Remuneration Committee are mainly as follows:

- Recommending to the Board a framework of remuneration for the Board and the key executives of the Group and on the establishment of a formal and transparent procedure for developing policy of such remuneration;
- Determining the specific remuneration packages of all executive directors and senior management;
- Reviewing and approving performance-based remuneration by reference to corporate goals and objectives resolved by the Board from time to time;
- Reviewing and approving the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment;
- Reviewing and approving compensation arrangements relating to dismissal or removal of directors for misconduct; and
- Recommending to the shareholders how to vote the service agreements of Directors in accordance with Rule 13.68 of the Listing Rules.

All Executive and Independent Non-executive Directors have service agreements for a term of 3 years and 2 years respectively, all commencing from the Listing Date. The remuneration of the Independent Non-executive Directors is in the form of a fixed fee while the remuneration of Executive Directors consists of salary, commission, housing reimbursement and allowances, bonus and performance awards that are dependent on the performance of the Group and Directors.

In order to attract, retain, and motivate executives and key employees serving for the Group, the Company has adopted a Share Option Scheme in 2005. Such incentive scheme enables the eligible persons to obtain an ownership interest in the Company and thus to rewards to the participants who contribute to the success of the Group's operations.

Details of the amount of Directors emoluments are set out in note 18 to the accounts.

## NOMINATION OF DIRECTORS

The Company established a Nomination Committee on 25 November 2005 with written terms of reference. The Nomination Committee comprises Mr. Wong Ming Bun, an Executive Director and the three Independent Non-executive Directors, namely Mr. Goh Gen Cheung, Mr. Leung Wai Man, Roger and Mr. Zhou Xiao Xiong. Mr. Wong Ming Bun is the Chairman of the Nomination Committee. Each member of the Nomination Committee shall abstain from voting on any resolutions in respect of the assessment of his performance or re-nomination as Director. The Nomination Committee shall meet at least twice a year after listing on 9 December 2005. The Company has scheduled the first Nomination Committee Meeting to be held on 3 April 2006.

The role and functions of the nomination committee are mainly as follows:

- Proposing a nomination policy to the Board and implementation;
- Reviewing the structure, size and composition (including the skills, knowledge and experience) of the Board on a regular basis and make recommendations to the Board regarding any proposed changes;
- Identifying individuals suitably qualified to become Board members and select or make recommendations to the Board on the selection of individuals nominated for directorships;
- Assessing the independence of Independent Non-executive Directors; and
- Recommending to the Board on relevant matters relating to the appointment or re-appointment of Directors and succession planning for Directors in particular the Chairman and the Chief Executive Officer.

The committee identified suitable individual qualified to become board members and makes recommendation to the Board on relevant matters relating to the appointment or reappointment of directors if necessary, in particular, candidates who can add value to the management through their contributions in the relevant strategic business areas and which appointments will result on the constitution of strong and diverse Board.

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### AUDITORS' REMUNERATION

During the year under review, the remuneration paid to the Company's auditors, Messrs PricewaterhouseCoopers, is set out as follows:

	<b>Fee paid/payable</b> HK\$'000
Services rendered	
Audit services	
Annual audit of accounts	800
Reporting accountants	<u>1,307</u>
	<u>2,107</u>

### AUDIT COMMITTEE

The Company established an Audit Committee on 25 November 2005 with written terms of reference in compliance with the Code on Corporate Practices as set out in Appendix 14 of the Listing Rules. The Audit Committee comprises three Independent Non-executive Directors, namely Mr. Goh Gen Cheung, Mr. Leung Wai Man, Roger and Mr. Zhou Xiao Xiong. Mr. Goh Gen Cheung is the Chairman of the Audit Committee. Each members of the Audit Committee shall abstain from voting on any resolutions in respect of matters in which he is interested. The Audit Committee shall meet at least twice a year after listing on 9 December 2005. The Company has scheduled the first Audit Committee Meeting to be held on 3 April 2006.

The role and functions of the audit committee are mainly as follows:

- Recommending to the board on the appointment, reappointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor;
- Reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard;
- Developing and implementing policy on the engagement of an external auditor to supply non-audit services;



- Monitoring integrity of financial statements and reviewing significant financial reporting judgments contained in them;
- Reviewing the Group's financial controls, internal control and risk management systems;
- Discussing with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system;
- Considering any findings of major investigations of internal control matters as delegated by the Board or on its own initiative and management's response;
- Where an internal audit function exists, to ensure coordination between the internal and external auditors, and to ensure that the internal audit function is adequately resourced and has appropriate standing within the Company, and to review and monitor the effectiveness of the internal audit function;
- Reviewing the group's financial and accounting policies and practices;
- Reviewing the external auditor's management letter, any material queries raised by the auditor to management in respect of the accounting records, financial accounts or systems of control and management's response;
- Ensuring that the Board will provide a timely response to the issues raised in the external auditor's management letter; and
- Other functions as required by the law or the Code.

The Audit Committee shall have full discretion to invite any Director or Executive Officer to attend its meetings. In addition, the Audit Committee shall have independent access to external auditors without the presence of management at least once a year.

## **INTERNAL CONTROLS**

Proper internal controls not only facilitate the effectiveness and efficiency of operations, ensuring compliance with laws and regulations, but most importantly, it helps to minimize risk exposure for the group. The Group is committed to the identification, monitoring and management of risks associated with its business activities and has implemented practical and effective control systems. The board acknowledges that it is responsible for the Company's overall internal control framework and will continue to review its effectiveness on a regular basis.

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### COMMUNICATION WITH SHAREHOLDERS

The Company recognises that effective communication can highlight transparency and enhance accountability to its shareholders. The Company provides information to its shareholders via *HKExNET* announcements and news releases. The Company ensures that price-sensitive information is publicly released, and is announced on an immediate basis where required under the Listing Rules of The Stock Exchange of Hong Kong Limited. Where an immediate announcement is not possible, the announcement is made as soon as possible to ensure that shareholders and the public have fair access to the information.

All shareholders of the Company will receive the annual report and the notice of the AGM. The notice is also advertised in a local newspaper and made available on *HKExNET*. The Company encourages shareholders' participation at AGMs and all shareholders are given the opportunity to voice their views and to direct queries regarding the Group to Directors, including the chairperson of each of the Board Committees. The Company ensures that there are separate resolutions at general meetings on each distinct issue.

The Company's Bye-laws allow a member of the Company to appoint one or two proxies to attend and vote at general meetings. The external auditors are also present to assist the Directors in addressing any relevant queries from the shareholders.

First AGM will be held on 4 May 2006.

### VOTING BY POLL

The Company informs the shareholders (in its circulars convening a general meeting) the procedures for voting by poll and the rights of shareholders to demand a poll to ensure compliance with the requirements on the poll voting procedures. In accordance to article 66 of the Articles of Association of the Company, at any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands unless a poll is (before or on the declaration of the result of the show of hands) demanded:

- (a) by the Chairman of such Meeting;
- (b) by at least three members present in person or in the case of a member being a corporation by its duly authorised representative or by proxy for the time being and entitled to vote at the meeting; or
- (c) by a member or members present in person or in the case of a member being a corporation by its duly authorised representative or by proxy and representing not less than one-tenth of the total voting rights of all members having the right to vote at the meeting; or



- (d) by a member or members present in person or in the case of a member being a corporation by its duly authorised representative or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one tenth of the total sum paid up on all shares conferring that right; or
- (e) if required by the rules of the designated Stock Exchange, by any Director or Directors who, individually or collectively, hold proxies in respect of shares representing five per cent. (5%) or more of the total voting rights at such meeting.

A demand by a person as proxy for a member or in the case of a member being a corporation by its duly authorised representative shall be deemed to be the same as a demand by a member.

Unless a poll is duly demanded and the demand is not withdrawn, a declaration by the chairman that a resolution has been carried, or carried unanimously, or by a particular majority, or not carried by a particular majority, or lost, and an entry to that effect made in the minute book of the Company, shall be conclusive evidence of the facts without proof of the number or proportion of the votes recorded for or against the resolution.