

Corporate Governance Report

Corporate Governance Practices

(a) *Application of Corporate Governance Principles*

The Group is committed to promoting and maintaining the highest standard corporate governance, with the objectives of (i) the maintenance of responsible decision making, (ii) the improvement in transparency and disclosure of information to shareholders, (iii) the continuance of respect for the rights of shareholders and the recognition of the legitimate interests of shareholders, and (iv) the improvement in management of risk and the enhancement of performance by the Group. The Group has applied the principles set out in the Code on Corporate Governance Practices (“HKSE Code”) contained in Appendix 14 of the Rules Governing the Listing of Securities on the Main Board of The Stock Exchange of Hong Kong Limited (“Listing Rules”) with these objectives in mind.

(b) *Promulgation of Company’s Corporate Governance Code*

To this end, the Group has promulgated a set of Code on Corporate Governance (“Company Code”) which sets out the corporate standards and practices used by the Group to direct and manage its business affairs. It is prepared by referencing to the principles, Code Provisions and Recommended Best Practices set out in the HKSE Code, which came into effect on 1 January 2005. In addition to formalizing existing corporate governance principles and practices, the Company Code also serves the purpose of assimilating existing practices with benchmarks prescribed by the HKSE Code and ultimately ensuring high transparency and accountability to the Company’s shareholders.

(c) *Compliance of Company and HKSE’s Code’s Provisions*

The Group has complied with all provisions in the Company Code and the HKSE Code throughout the financial year ended 31 December 2005 with one deviation mentioned below.

On 3 August 2005, the Company set up the following board committees (except the Audit Committee) and adopted its own code on corporate governance:–

- (i) Executive Committee;
- (ii) Audit Committee (terms of reference of the audit committee adopted on 24 March 1999 were superseded by the new terms of reference adopted on 3 August 2005);
- (iii) Remuneration Committee;
- (iv) Nomination Committee;
- (v) Finance Committee; and
- (vi) Regulatory Compliance Committee.

The Company Code contains the provisions of the HKSE Code and other provisions, and has been posted on the Company’s website.

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Apart from the audit committee and remuneration committee required by the HKSE Code, the Company has established four additional board committees to ensure maintenance of a high corporate governance standard. Terms of reference of all board committees set up by the Company have been posted on the Company's website, as have (1) division of responsibilities between the Company's Chairman and Managing Director and (2) duties and powers delegated to the Company's Managing Director and matters reserved for decision of the board.

(d) *Deviation from HKSE Code*

Code provision A.4.1 provides that non-executive directors should be appointed for specific term, subject to re-election. The Company has deviated from this provision in that all non-executive directors of the Company are not appointed for specific term. They are, however, subject to retirement and re-election every three years. The reason for the deviation is that the Company does not believe that arbitrary term limits on directors' service are appropriate given that directors ought to be committed to representing the long term interests of the Company's shareholders and the retirement and re-election requirements of non-executive directors have given the Company's shareholders the right to approve continuation of non-executive directors' offices.

Securities Transactions by Directors

The Company has adopted the Model Code for Securities Transactions by Directors as its own code of conduct regarding directors' securities transactions on terms as set out in Appendix 10 of the Listing Rules. Having made specific enquiry of the Directors of the Company, all Directors have complied with the required standard of dealings and code of conduct regarding securities transactions by directors as set out in the Model Code for the year 2005.

The Board of Directors – Function and Composition

The Board of Directors ("Board") of the Company is entrusted with the overall responsibility for promoting the success of the Company by the direction and supervision of the Company's business and affairs and the ultimate responsibility for the day to day management of the Company which is delegated to the Managing Director and the management.

The Board comprised a total of eight Directors, with three Executive Directors, namely, Dr. Ho Hung Sun, Stanley (Chairman) (see Note 1), Mr. Ho, Lawrence Yau Lung (Group Managing Director) (see Note 1) and Mr. Tsui Che Yin, Frank; two Non-executive Directors, namely, Mr. Ho Cheuk Yuet (see Note 2) and Mr. Ng Ching Wo; and three Independent Non-executive Directors, namely, Sir Roger Lobo, Mr. Kwan Chiu Yin, Robert (see Note 3) and Dr. Lo Ka Shui. An Independent Non-executive Director has appropriate professional qualifications, accounting and financial management expertise.

Dr. Ho Hung Sun, Stanley, Chairman of the Board, is the father of Mr. Ho, Lawrence Yau Lung, the Group Managing Director of the Company.

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Each of the Independent Non-executive Directors (see Note 4) has made an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules. The Company is of the view that all Independent Non-executive Directors meet the independence guidelines set out in Rule 3.13 of the Listing Rules and are independent in accordance with the terms of the guidelines.

The Directors acknowledge their responsibility for preparing the financial statements set out in this Annual Report which give a true and fair view and are prepared in accordance with the relevant statutory requirements and applicable accounting standards in force.

Board Operation

The Board meets regularly over the Company's affairs and operations. In 2005, the Board held six meetings. The attendance record of each member of the Board is set out below:

Executive Directors	Attendance
Ho Hung Sun, Stanley (<i>Chairman</i>)	5/6
Ho, Lawrence Yau Lung (<i>Group Managing Director</i>)	6/6
Tsui Che Yin, Frank	6/6
Non-executive Directors	
Ho Cheuk Yuet	1/6
Ng Ching Wo	4/6
Independent Non-executive Directors	
Kwan Chiu Yin, Robert	4/6
Sir Roger Lobo	6/6
Lo Ka Shui	5/6

Remuneration Committee

As mentioned above, a remuneration committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to make recommendations to the Board on policies and structure for remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;
- (b) to determine the remuneration packages for executive directors and senior management and to make recommendations to the board on the remuneration of non-executive directors.

Other details of the role and function of the remuneration committee are given at the Company's website under the section "Corporate Governance".

The Remuneration Committee is made up of the Company's Non-executive Director and Independent Non-executive Directors, namely Dr. Lo Ka Shui (Chairman), Sir Roger Lobo and Mr. Ng Ching Wo.

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No meeting has been held in 2005 to review the remuneration packages of Executive Directors, which are modest by market standards, as the Company does not see a need to review them. The directors' fees of the Company's Independent Non-executive Directors have been increased in August 2005 according to market levels and the additional work they are requested to take on, following the formation of the remuneration committee, the nomination committee and the regulatory compliance committee on which they sit. The remuneration committee held a meeting on 31 March 2006 to consider and approve (a) bonus payments to employees of the Group, (b) salary increases of senior management of the Group and (c) range of salary increase for employees of the Groups. Dr. Lo Ka Shui, Sir Roger Lobo and Mr. Ng Ching Wo attended this meeting.

The remuneration committee will meet and determine the emoluments policy and long-term incentive schemes as well as the basis of determining the emoluments payable to the Company's directors in 2006.

Nomination Committee

As mentioned above, a nomination committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to review the structure, size and composition (including the skills, knowledge and experience) of the Board;
- (b) to identify individuals suitably qualified to become Board members and make recommendations to the Board on the selection of individuals nominated for directorship; and
- (c) to make recommendations to the Board on relevant matters relating to the appointment or re-appointment of directors and succession planning for directors.

The Nomination Committee is made up of the Company's Non-executive Director and Independent Non-executive Directors, namely Sir Roger Lobo (Chairman), Mr. Robert Kwan and Mr. Ng Ching Wo. The Nomination Committee held its first meeting on 28 March 2006 to review the structure, size and composition of the Company's board of directors and to recommend a replacement for Mr. Robert Kwan. Sir Roger Lobo and Mr. Ng Ching Wo attended this meeting.

The nomination committee will meet and determine the nomination procedures and the process and criteria to select and recommend candidates for directorship in 2006.

Executive Committee

As mentioned above, an executive committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to oversee the implementation of the Company's strategic objectives and risk management policies; and
- (b) to oversee the business and operations of all of the business units of the Group.

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The Executive Committee is made up of the Company's Executive Directors, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank and members of the Company's senior management. The Executive Committee held meetings from time to time to discuss operational matters of the Company's business and new projects.

Finance Committee

As mentioned above, a finance committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to conduct review on matters such as Group wide financial, accounting, treasury and risk management policies, major financing transactions, corporate plans and budgets; and
- (b) to review major acquisitions and investments and their funding requirements.

The Finance Committee is made up of the Company's Executive Directors, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank and the Group Chief Financial Officer. The Finance Committee held meetings from time to time to discuss financial matters of the Company's new and existing business.

Regulatory Compliance Committee

As mentioned above, a regulatory compliance committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to review and advise upon matters in respect of the present or future regulation of the Company's gaming and financial services businesses; and
- (b) to comply with applicable laws and regulations, including the Listing Rules.

The Regulatory Compliance Committee is made up of the Company's Executive Directors, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank, Dr. Lo Ka Shui and the Group Legal Counsel. The Regulatory Compliance Committee held meetings from time to time to discuss the ongoing compliance matters of the Group.

Audit Committee

The Company's Audit Committee was formed on 24 March 1999 and is composed of a Non-executive Director and two Independent Non-executive Directors of the Company as at 31 December 2005, namely, Mr. Robert Kwan (Chairman), Sir Roger Lobo and Mr. Ng Ching Wo. The primary duties of the Audit Committee are (a) to review the Group's annual reports, financial statements and interim reports, (b) to provide advice and comments thereon to the Board and (c) to review and supervise the financial reporting process and internal control procedures of the Group. Other details of the role and function of the Audit Committee are available on the Company's website under the section "Corporate Governance".

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In 2005, the Audit Committee held two meetings. The attendance records of each member of the Committee is set out below:

	Attendance
Kwan Chiu Yin, Robert (<i>Chairman</i>)	2/2
Sir Roger Lobo	2/2
Ng Ching Wo	1/2

The Audit Committee has carefully reviewed the Company's half-yearly and annual results and its system of internal control and has made suggestions to improve them. The Committee also carried out and discharged its duties set out in HKSE Code. In the course of doing so, the Committee has met the company's management, qualified accountant and external auditors several times during 2005.

Auditors' Remuneration

For the year ended 31 December 2005, the Group provided its auditors, around HK\$4.4 million for their audit and non-audit services provided to the Group. Of this sum, HK\$2.5 million is for audit services. The balance of HK\$1.9 million is for non-audit services such as interim review of the Group's financial statements, agreed-upon procedures in relation to agreeing the Company's final results announcement and tax services.

Internal Controls

The Group's system of internal control is designed to provide reasonable assurance against material misstatement or loss. The sound system is developed to safeguard the Group's assets and resources against unauthorized use or disposition, ensure the transactions are executed in accordance with management's authorization and ensure the accounting records are reliable for preparing financial information internally or publicly.

Evaluation of the Group's internal control is independently conducted by the Internal Audit Department on an on-going basis. The tasks include:

- review and access selected aspects of the Group's activities and internal controls with unrestricted right of access;
- conduct comprehensive audits of the practices, policies and procedures, income and expenditure, and internal controls of selected business units of the Group periodically;
- perform special reviews and investigations on areas identified by management or the Audit Committee;
- examine and investigate any violation of business ethics or conflict of interests; and
- report the results of review to the management and suggest recommendations.

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The Internal Audit Department reports directly to the Managing Director/Chief Executive Officer and the Audit Committee and brings appropriate matters identified during the course of audits to the Audit Committee's attention. The Internal Audit Department also has the right to consult the Audit Committee without reference to management. This reporting structure allows the Internal Audit Department to maintain its independence.

The internal audit adopts a risk and control based audit approach. The annual audit plan of Internal Audit Department is reviewed by the Audit Committee. In addition to the audit plan, Internal Audit Department conducts other projects and investigative work as may be required.

The Directors have reviewed and are satisfied with the effectiveness of the Group's internal control system, including, in particular, financial, operational and compliance controls and risk management functions.

Shareholders' Rights

Pursuant to Article 66 of the Articles of Association of the Company, the Board may, whenever it thinks fit, convene an extraordinary general meeting, and extraordinary general meetings shall also be convened on requisition, as provided by the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) ("Companies Ordinance"). In accordance with Section 113 of the Companies Ordinance, members holding at the date of the deposit of the requisition not less than one-twentieth of such of the paid-up capital of the Company as at the date of the deposit carries the right of voting at general meetings of the Company can request the Company to convene an extraordinary general meeting. The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the Company.

The Company regards the annual general meeting of the Company ("AGM") an important event as it provides an opportunity for the Board to communicate with the shareholders. Active participation by the shareholders at the AGM is highly welcomed. Notices of AGM and related papers are sent to the shareholders no less than 21 days before the meeting.

The Company Secretarial Department and the Public Relations Department respond to letters and telephone enquiries from shareholders/investors. Whenever a shareholder has any enquiries on matters in relation to the Company, he or she may put such enquires in writing and address the same to the Company Secretary at the registered office of the Company at 38th Floor, The Centrium, 60 Wyndham Street, Central, Hong Kong or through an email contact info@melco.hk.cn. The website of the Company at www.melco.hk.cn also provides a medium to make information of the Company and the Group available to the shareholders with a section on "Corporate Governance" included.

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Notes:

- (1) With effect from 15 March 2006, Dr. Ho Hung Sun, Stanley resigned as Chairman and as an executive director of the Company. Mr. Ho, Lawrence Yau Lung, was appointed as the Chairman and Chief Executive Officer of the Company effective 15 March 2006. Pursuant to HKSE Code Provision A.2.1, the roles of chairman and chief executive officer of a listed company should be separate and should not be performed by the same individual. However, in view of the present composition of the Board, the in depth knowledge of Mr. Lawrence Ho of the operations of the Group and of the gaming and entertainment sector in Macau in general, his extensive business network and connections in that sector and the scope of operations of the Group, the Board believes it is in the best interests of the Company for Mr. Lawrence Ho to assume the roles of chairman and chief executive officer at this time and that such arrangement be subject to review by the Board from time to time.
- (2) Mr. Ho Cheuk Yuet resigned as non-executive director with effect from 5 September 2005.
- (3) With effect from 15 March 2006, Mr. Kwan Chiu Yin, Robert resigned as an independent non-executive director of the Company. Following the resignation of Mr. Robert Kwan as an independent non-executive director of the Company, the Company will temporarily have only two independent non-executive directors and will temporarily not be compliant with Rule 3.10(1) and (2) of the Listing Rules. The Company is in the process of identifying a suitable replacement for Mr. Robert Kwan to serve as an independent non-executive director of the Company and an appointment will be made and announced as soon as practicable (and in any event not later than the three-month period stipulated by Rule 3.11 of the Listing Rules), in order to ensure compliance by the Company with Rule 3.10 of the Listing Rules.
- (4) Save and except Mr. Robert Kwan who resigned as an independent non-executive director of the Company with effect from 15 March 2006.