

Corporate Governance Report



The Company has been committed to maintaining and enhancing the level of its corporate governance so as to ensure greater accountability and transparency and bring long-term return to the Shareholders. Except a few deviations set out in the chapter of corporate governance in the interim report of 2005, the Company has complied with the principles and code provisions of the Code on Corporate Governance Practices ("Code") under Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Stock Exchange") ("Listing Rules"). Since April 2005, the Company has remedied the deviations to strictly comply with the code provisions under the Code. The Company's corporate governance practices and deviations from the Code are summarised and discussed below.

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Governance Structure



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Major Corporate Governance Principles and Practices of the Company

A. Board of Directors ("Board")

The power of board is balanced by comprising independent non-executive directors representing at least one-third of the board.

- The Board of the Company currently comprised ten directors, three of which are independent non-executive directors. The directors of the Company are elected by the general meeting to have a three-year term of office, and eligible for re-election upon expiry of the term.
- Pursuant to the Listing Rules, each of the independent non-executive directors has confirmed his/her independence with the Stock Exchange. Each of the independent non-executive directors re-confirmed his/her independence on 31 December 2005. The Company considered that they were independent.

Deviation: Nil

The board should have a balance of skills and experience appropriate for the requirements of the business of the issuer.

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

Deviation: Nil

Distinguished roles of the chairman and chief executive officer

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

Deviation: Nil

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

- The term of office of the existing non-executive directors is three years. Mr. David Muir Turnbull resigned as director of the Company with effect from 13 December 2005. The Company has published an announcement in respect of his resignation.

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Deviation: Nil

The board should assume responsibility for leadership and control of the company and be collectively responsible for promoting the success of the company.

- The Board is accountable to the shareholders' general meeting and determines the investment proposals of the Company and delimits the approval authority regarding disposal of the Company's fixed assets according to the authorisation of the shareholders' general meeting. The Company formulated the *Rules and Procedures for Shareholders' General Meetings, Rules and Procedures for Board Meetings* and *Rules and Procedures for Chief Executive Officer Work Meetings*.
- The Chief Executive Officer shall be authorised by the Board to implement various strategies and oversee the day-to-day operations of the Company.
- The Board shall have independent access to the senior management personnel for enquiries in relation to the Company's management.
- The Board shall have specialised committees, the chairmen of which shall report to the Board on a regular basis.

Deviation: Nil

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

- Board meetings are held regularly throughout the year and shall generally include annual meeting, biannual meetings and meetings for the first and third quarters. Board meetings shall be convened by the Chairman and a 10-day notice shall be served to all directors before each meeting. The meetings may be attended through personal participation or other electronic means of communication.
- The secretary to the Board shall be responsible for the communications and liaison with all directors from the time the notice is served to the commencement of the meeting, and shall provide the necessary information to the directors to facilitate their decision-making concerning matters set out in the agenda.
- For the purpose of considering resolutions or matters during Board meetings, the directors may require presence of the persons in charge of the relevant departments to answer queries, so that the directors can have a thorough understanding of the key issues and the general situation.
- During each Board meeting, the Chief Executive Officer or other relevant departments shall report to the Board in writing in respect of the implementation of resolutions of the previous Board meeting. The Board shall review such implementation at the meeting.
- All directors shall have access to the Board secretary. Under the leadership of the Board and the Chairman, the Board secretary shall take the initiative to acquaint himself or herself with the implementation progress of Board resolutions, and report to and advise the Board in a timely manner on major issues arising in the course of implementation.
- Minutes of Board meetings shall be kept by the Board secretary and available for inspection by any director at anytime.

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- All directors have actively participated in the business operations of the Company. Attendance of all directors at Board meetings in 2005 is as follows:

Attendance of individual director at Board meetings in 2005

No. of meetings	5	
Non-executive director:		
Li Jiaxiang (<i>Chairman</i>)	4/5	80%
Kong Dong	4/5	80%
Wang Shixiang	4/5	80%
Yao Weiting	4/5	80%
Executive Director:		
Ma Xulun (<i>Chief Executive Officer</i>)	5/5	100%
Cai Jianjiang	5/5	100%
Fan Cheng	4/5	80%
Independent non-executive director:		
Hu Hung Lick, Henry	5/5	100%
Wu Zhipan	4/5	80%
Zhang Ke	3/5	60%
Average attendance rate:	84%	

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Deviation: A 10-day notice is served to all directors before Board meetings are convened. However, the Code requires a notice of at least 14 days before each meeting. The reason for the Board's practice is that service of a 10-day notice to the directors is deemed sufficient under the PRC laws.

Remedy: Article 98 of the articles of association of the Company has been amended so that a notice of at least 14 days must be serviced to all directors before a meeting of the Board, except for extraordinary meeting. The amendment to the articles of association of the Company has been approved by the extraordinary general meeting held on 28 March 2006 and will become effective upon approval by the relevant authorities.

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

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

Deviation: Nil

The company should arrange appropriate insurance in respect of legal action against its directors.

- the Company has purchased liability insurance for its directors.

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Deviation: Nil

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

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

Deviation: The Company did not adopt any special code of conduct regarding securities transactions by directors, supervisors and relevant employees before 5 September 2005.

Remedy: the Company has adopted the Model Code set out in Appendix 10 of the Listing Rules, and on 5 September 2005 adopted a code of conduct regarding securities transactions by directors, supervisors and relevant employees on terms not less exacting than the required standards of the Model Code.

B. Remuneration of Directors and Senior Management

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Issuers should establish a remuneration committee with specific written terms of reference. A majority of the members of the remuneration committee should be independent non-executive directors.

- the Company has established a nomination and remuneration committee to make recommendation to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management.
- A majority of the members of the nomination and remuneration committee are independent non-executive directors. The current members of the nomination and remuneration committee are Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.
- Attendance at the meetings of the nomination and remuneration committee in 2005 is as follows:

Attendance at the meetings of the nomination and remuneration committee in 2005

No. of meeting	1	
Wu Zhipan	1/1	100%
Hu Hung Lick, Henry	1/1	100%
Zhang Ke	1/1	100%
Li Jiaxiang	1/1	100%
Kong Dong	1/1	100%
Average attendance rate:		100%

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- The articles of association of the Company provides that a shareholder holding 5% or more of the total shares of the Company is entitled to nominate a director through the nomination and remuneration committee, which will scrutinize the candidates for directorship and senior management according to the standards set out in the articles of association of the Company and report to the Board.
- On a meeting of the nomination and remuneration committee on 25 January 2005, the Board received a recommendation letter from Cathay Pacific Airways Limited nominating Mr. David Muir Turnbull as a non-executive director of the Company. The nomination and remuneration committee confirmed that the nomination conformed to the articles of association of the Company and the strategic placing agreement and, therefore, recommended that the Board nominate Mr. David Muir Turnbull as a non-executive director of the Company for a term up to the expiry of the term of the current session of the Board. It was also proposed that Mr. David Muir Turnbull shall be nominated before the next general meeting for official election. The Board received the resignation of Mr. Fan Cheng as the Board secretary and joint company secretary. It received a recommendation letter from CNAHC, the controlling shareholder, nominating Mr. Zheng Baoan as Board secretary of the Company. The nomination and remuneration committee of the Board confirmed that Mr. Zheng Baoan conformed to the requirements of the articles of association of the Company and the applicable laws regarding qualifications of board secretary and joint company secretary. The committee recommended the Board to engage Mr. Zhang Baoan as the Board secretary and joint company secretary of the Company until the expiry of the term of the current session of the Board. The resignation and appointment were subject to approval of the Stock Exchange.
- Remuneration payable to directors shall be determined according to the terms of their respective employment contract, if any, and recommendation of the nomination and remuneration committee. Details of the remuneration of the directors are set out in the financial statements.

Deviation: The Company did not adopt any terms of reference for the remuneration committee before 12 April 2005.

Remedy: The Company adopted the terms of reference for the remuneration committee (the nomination and remuneration committee) on 12 April 2005 in accordance with the requirements of the Code.

C. Accountability and Audit

The board should present a balanced, clear and comprehensible assessment of the company's performance, position and prospects.

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

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Deviation: Nil

The board should ensure that the issuer maintains sound and effective internal controls to safeguard the shareholders' investment and the Company's assets.

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

Deviation: Nil

The board should establish formal and transparent arrangements for how to apply the financial reporting and internal control principles and for how to maintain an appropriate relationship with the company's auditors.

- The audit and risk control committee comprises 2 independent non-executive directors and 1 non-executive director, who are proficient in financial matters. The audit and risk control committee is primarily responsible for:
 - making recommendations to the Board on the appointment and replacement of the external auditor;
 - reviewing and monitoring the internal audit system of the Company and its implementation;
 - liaison between the internal auditor and external auditor;
 - reviewing the financial information of the Company and the relevant disclosure;
 - reviewing the internal controls of the Company;
 - other matters designated by the Board of the Company.
- The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as chairman of the committee.
- Attendance at the meetings of the audit and risk control committee in 2005 is set out as follows:

Attendance at meetings of the audit and risk control committee in 2005

No. of meetings	2	
Zhang Ke	2/2	100%
Yao Weiting	2/2	100%
Wu Zhipan	1/2	50%
Average attendance rate:	83%	

- The audit and risk control committee passed the following resolutions at the first meeting held on 8 April 2005: the auditors' report for 2004 was considered and approved and would be submitted to the 8th meeting of the first session of the Board for consideration and approval; accounting system of the Company was considered and approved and would be submitted to the 8th meeting of the first session of the Board for consideration and approval after further amendments; the distribution policy and the distribution proposal for 2004 were agreed upon in principle and would be submitted to the 8th meeting of the first session of the Board for consideration and approval; the *Working Procedures of the Audit and Risk Control Committee of the Board* was considered and approved.

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- At the second meeting of the audit and risk control committee held on 19 August 2005, the 2005 interim financial report of the Company was approved.

Deviation: The Company did not adopt any terms of reference for the audit and risk control committee before 12 April 2005.

Remedy: The Company adopted the terms of reference for the audit and risk control committee on 12 April 2005 in accordance with the requirements of the Code.

The responsibility of the directors in relation to the financial statements

The company prepares annual reports and interim reports each year. The responsibilities of the directors in relation to the financial statements are set out below and shall be read together with the Report of the Auditors set out on page 54.

- *annual report and account*

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

- *accounting policy*

When preparing the financial statements of the Group, the directors have consistently applied appropriate accounting policies under the international accounting standards and observed all applicable accounting standards.

- *accounting records*

The directors shall be responsible for keeping accounting records of the Company, which shall reflect the financial position of the Company with reasonable accuracy, enabling the Group to prepare the financial statements in accordance with the requirements of the Companies Ordinance and applicable accounting standards.

- *ongoing operation*

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

The statement of reporting responsibility of the auditors is set out in the Auditors' Report on page 54.

Auditor's Remuneration

The international and domestic auditors of the Company are Ernst & Young and Ernst & Young Hua Ming respectively. Breakdown of the remuneration to the Company's external auditors for audit service provided and other non-audit service assignment for the year ended 31 December 2005 are as follows:

Audit service

RMB7,400,000 for the audit of the Group's financial statements for the year ended 31 December 2005, subject to adjustments based on the actual time incurred for the audit.

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Non-audit service assignment

RMB2,000,000 for agreed-upon procedure review on the Group's financial statements prepared in accordance with International Financial Reporting Standards for the six months ended 30 June 2005.

D. Delegation by the Board

The company should formalise the functions reserved to the board and those delegated to management. There shall be division of responsibility between the board committees, and each committee should be formed with specific terms of reference.

- To regulate the operations of the Board of the Company, the Company has formulated the *Rules and Procedures for Board Meetings*, setting out the powers and duties of the Board. The terms of reference of the Chief Executive Officer, who shall be accountable to the Board, are set out in the articles of association of the Company.
- For general investment projects where the five ratios, namely total investment to total assets, consideration to total market value, income from investment to total income of the Company, gain from investment to total gain of the Company and proportion of nominal value of shares as consideration to the total capitalisation of the issuer, are higher than 3% but lower than 25%, they will be subject to examination and approval by the Board. Upon approval of the investment plan and relevant budget, the Board may delegate the management to be in charge of the details and implementation. Where the above ratios do not exceed 3%, the management will directly approve the project.
- For projects involving connected transactions, the Board has the right to approve projects with four of the ratios, namely total investment to total assets, consideration to total market value, income from investment to total income of the Company and proportion of nominal value of shares as consideration to the total share capital of the issuer, lower than 2.5% and a consideration of less than HK\$10 million. For projects with the above four ratios lower than 0.1% or not lower than 0.1% but lower than 2.5% and a consideration of less than HK\$1 million, the approving power may be delegated to the management's working meeting.
- Investment projects involving an investment amount beyond the approving power of the Board as well as risky investment projects, including but not limited to investments in bonds, shares, futures, options and other financial derivatives, shall be submitted by the Board to the shareholders' general meeting for approval.
- In respect of the fixed assets of the Company, if the expected value of fixed assets proposed to be disposed, together with the amount received from the disposal of fixed assets within four months preceding the proposed disposal, does not exceed 33% of the fixed assets value as set out in the latest balance sheet approved by the general meeting, such proposed disposal may be approved by the Board. Otherwise, the Board may not dispose or agree to dispose such fixed assets prior to obtaining approval from the general meeting.
- The Company has established an audit and risk control committee in compliance with the Code as set out in Appendix 14 of the Listing Rules. The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as chairman of the committee.
- The Company has established a nomination and remuneration committee to make recommendations to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management. The current members of the nominations and remuneration committee are Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.

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- The Company has established a strategy and investment committee to analyse and identify our development strategy and to decide on matters related to our investment as authorised by the Board. The current members of the strategy and investment committee are Mr. Kong Dong, Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang, with Mr. Ma Xulun as chairman of such committee.

The Supervisory Committee is responsible for monitoring our financial matters and supervising the conduct of our Board and the management. The functions and authority of the Supervisory Committee include: reviewing the financial reports and other financial information prepared by the Board and proposed to be tabled before the shareholders' general meeting, as well as supervise the work of the directors, Chief Executive Officer, Deputy Chief Executive Officer and other senior personnel so as to prevent abuse of power or actions detrimental to the Company's interests. The current members of the Supervisory Committee are Mr. Zhang Xianlin, Mr. Liao Wei, Ms. Zhang Huilan and Mr. Liu Feng, with Mr. Zhang Xianlin acting as the chairman. In the event that any director has conflict of interests with the Company, the Supervisors may negotiate with the director concerned or bring the case to court on behalf of the Company. Resolution of meetings of the Supervisory Committee shall be passed by at least two-thirds of all Supervisors.

Deviation: Nil

E. Communications of the Company

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

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

Deviation: Mr. Li Jiexiang, being the Chairman of the Company, failed to attend the annual general meeting of the Company on 30 May 2005 as required by the Code.

Reason for deviation: Mr. Li Jiexiang, the Chairman of the Company, is a member of the Chinese government delegation and was required to attend the annual meeting of the International Air Transport Association. As such, he was unable to attend the annual general meeting of the Company on 30 May 2005.