

Corporate Governance Report

In November 2004, the Hong Kong Stock Exchange issued its "Code on Corporate Governance Practices and Corporate Governance Report," which has taken effect for accounting periods commencing on or after 1 January 2005. The Stock Exchange's Code on Corporate Governance Practices (the "Corporate Governance Code") sets out principles of good corporate governance and two levels of recommendation, namely:

- Code Provisions, with which issuers are expected to comply or to give considered reasons for any deviation; and
- Recommended Best Practices, which are for guidance only, save that issuers are encouraged to comply or give reasons for deviation.

The Stock Exchange allows issuers to devise their own codes on corporate governance practices on such terms as they may consider appropriate, provided reasons are given for any deviation from the Code.

COMMITMENT TO CORPORATE GOVERNANCE

The Company is firmly committed to maintaining statutory and regulatory standards and adherence to the principles of corporate governance emphasising transparency, independence, accountability, responsibility and fairness. The Board and the senior management of the Company ensure that effective self-regulatory practices exist to protect the interests of the shareholders of the Company. These include a board comprising high caliber members, board committees and effective internal systems and controls.

The Board of Directors of the Company has adopted the Code on Corporate Governance Practices (the "Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited as its own Code on Corporate Governance Practices.

Throughout the year ended 31 December 2005, the Company was in compliance with the Code of Corporate Governance Practices, save for a deviation from code provision A. 4.1 of the Code in respect of the service term of independent non-executive directors.

Under code provision A. 4.1 of the Code, non-executive directors (including independent non-executive directors) shall be appointed for a specific term and subject to re-election. None of the existing independent non-executive directors of the Company was appointed for a specific term. This constitutes a deviation from code provision A.4.1 of the Code. However, all independent non-executive directors are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the provisions of the Company's Articles of Association.

The Board intends to review its corporate governance practices from time to time to ensure they meet shareholders' expectation, comply with regulatory and professional standards.

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BOARD OF DIRECTORS

The Board of Directors of the Company determines the overall strategies, monitors and controls operating and financial performance and set appropriate policies to manage risks in pursuit of the Group's strategic objectives. Day-to-day management of the Company's business is delegated to the executive directors or officers in charge. The functions and power that are so delegated are reviewed periodically by the Board to ensure that they remain appropriate.

Matters reserved for the Board of Directors are those affecting the Group's overall strategic policies, finances and shareholders, including financial statements, dividend policy, significant changes in accounting policies, material contracts and major investments. All Board members have separate and independent access to the Group's senior management to fulfill their duties. They also have full and timely access to relevant information about the Group and are kept abreast of the conduct, business activities and development of the Group. Independent professional advice can be sought at the Group's expense upon their request.

The Directors are responsible for the preparation of the accounts for each financial period that give a true and fair view of the states of the Group and of the results and cash flows for that period. In preparing these accounts for the year ended 31 December 2005, the Directors have selected suitable accounting policies and applied them consistently; made judgments and estimates that are prudent, fair and reasonable.

The Board of Directors of the Company currently comprises six (6) Directors, as set out below:

- Zhou Ling, Chairman of the Board;
- Lee Sin Pyung, Managing Director;
- Sit Mei, Executive Director;
- Lu Ren Jie, Independent Non-Executive Director;
- Chai Woon Chew, Independent Non-Executive Director; and
- Ho Choi Chiu, Independent Non-Executive Director

All Directors, other than three Executive Directors, are non-executive and independent of Management. The Board includes three active independent Non-Executive Directors to whom shareholders concerns can be conveyed. The Non-Executive Directors also bring a wide range of business and financial experience to the Board, which contributes to the effective direction of the Group.

Under the Company's Articles of Association, every director is subject to retirement by rotation at least once every three years. One-third of the Directors must retire from office at each annual general meeting and their re-election is subject to a vote of shareholders.

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The details of all Directors, including Chairman, Executive Directors and Independent Non-Executive Directors are given on page 11 of this Annual Report.

There were no financial, business, family or other material or relevant relationships among members of the Company's Board of Directors.

During the year ended 31 December 2005, the Board at all times exceeded the minimum requirements of the Listing Rules relating to the appointment of at least three independent Non-Executive Directors.

Directors ensure that they can give sufficient time and attention to the affairs of the Company. Directors have disclosed to the Company the number and nature of offices held in public companies or organisations and other significant commitments, with the identity of the public companies or organizations and an indication of the time involved. The Company considers all of the Independent Non-Executive Directors to be independent.

BOARD MEETINGS

The full Board meets at least quarterly and on other occasions when a Board decision is required on major issues. The following table sets out the details of Directors' attendance at the AGM, Board and Board Committee Meetings held in 2005:

Directors	Board Meeting	Audit Committee Meeting	AGM
Mr. Zhou Ling	4/4	N/A	1
Ms. Lee Sin Pyung	4/4	N/A	0
Ms. Sit Mei	4/4	N/A	1
Mr. Lu Ren Jie	3/4	2/3	0
Mr. Chai Woon Chew	3/4	2/3	0
Mr. Ho Choi Chiu	4/4	3/3	0

CHAIRMAN AND MANAGING DIRECTOR

The Chairman of the Board is Mr. Zhou Lin, and the Managing Director is Ms. Lee Sin Pyung, who is the Chief Executive Officer as described in Appendix 14 of the Listing Rules. The Chairman's and the Managing Director's roles are clearly defined to ensure the independence, accountability and responsibility.

The Chairman takes the lead in formulating overall strategies and policies of the Company; ensures the effective performance by the Board of its functions, including compliance with good corporate governance practices; and encourages and facilitates active contribution of Directors in Board activities and constructive relations between Executive and Non-Executive Directors. The Chairman also ensures effective communication with shareholders of the Company and receipt by the Directors of adequate and complete information.

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The Managing Director, supported by other Board members and the senior management, is responsible for the day-to-day business of the Company. She is also accountable to the Board for the implementation of the Company's overall strategies, and coordination of overall business operations.

NON-EXECUTIVE DIRECTORS

Non-Executive Directors are expected to participate in the activities of the Board, particularly in the establishment of a selection process to ensure a mix of competent Directors and officers; adoption of a system of internal check and balances; scrutiny of the Company's performance in achieving agreed corporate goals and objectives; and ensuring that exercise of Board authority is within the powers conferred to the Board under its Articles of Association and applicable laws, rules and regulations.

INDEPENDENCE

The independent Non-Executive Directors of the Company are highly skilled professional with a broad range of expertise and experience in the fields of accounting, finance, laws and business. Their skills and expertise in the Board ensure that strong independent views and judgment are brought in the Board's deliberations and that such views and judgment carry weight in the Board's decision-making process. Their presence and participation also enable the Board to maintain high standards of compliance in financial and other mandatory reporting requirements, and provide adequate checks and balances to safeguard the interests of shareholders of the Company.

Each Independent Non-Executive Directors gives the Company an annual confirmation of his independence. The Company considers such Directors to be independent under the guidelines set out in Rule 3.13 of the Listing Rules.

Each Director, upon reasonable request, is given access to independent professional advice in circumstances he may deem appropriate and necessary for the discharge of his duties to the Company, at the expenses of the Company.

APPOINTMENT OF DIRECTORS

There is currently no Nomination Committee in the Company. Directors of the Company are responsible for making recommendations to the Board for consideration and approval on nominations, appointment of Directors, with a view to appoint to the Board individuals with those experienced, high caliber individuals. The Board formulates the policy, review the size, structure and composition of the Board, and assesses the independence of its Independent Non-Executive Directors in accordance with the criteria prescribed under the Listing Rules and the Code.

All Non-Executive Directors are appointed for a term of not more than three years. This term is subject to curtailment upon that Director's retirement by rotation and re-election by shareholders. One third of the Directors, including both Executive and Non-executive Directors, are required to retire from office at the AGM in each year. A retiring director is eligible for re-election.

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DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in Appendix 10 of the Listing Rules. Specific enquiry has been made of all the Directors of the Company who have confirmed their compliance with the required standard as set out in the Model Code throughout the year of 2005.

Directors are required to declare their direct or indirect interests, if any, in any proposals or transactions to be considered by the Board of Directors at Board Meetings and withdraw from the meetings as appropriate. At each financial reporting period, the Company seeks confirmation from Directors in respect of any transactions of the Company or its subsidiaries that are related to Directors or their associates.

At 31 December 2005, the directors of the Company held following long position in the ordinary share of the Company:

Name	Number of Ordinary Shares held		Approximate % of shareholding
	Personal Interests	Corporate Interests	
Zhou Ling	–	32,000,000 (<i>Note 1</i>)	5.49
Lee Sin Pyung	–	500,000 (<i>Note 2</i>)	0.07

Notes:

1. Mr. Zhou Ling was holding 32,000,000 shares in the Company through Palmsville Equities Inc., a company beneficially owned by him.
2. Ms. Lee Sin Pyung was holding 500,000 shares in the Company through Bondic Holdings Limited, a company beneficially owned by her.

Save as disclosed above, as at 31 December 2005, none of the directors and executive officers of the Company and their respective associates had any interest or short position in the shares, underlying shares and debentures of the Company or any of its associated corporations that were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein or which were required, pursuant to the Model Code contained in the Listing Rules, to be notified to the Company and the Stock Exchange.

All Directors have confirmed that throughout the year ended 31 December 2005 they complied with the required standard set out in the Model Code.

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REMUNERATION OF DIRECTORS

A Remuneration Committee, comprising three independent non-executive directors, has been established in 2005. The committee was set up to review and approve the remuneration packages of the directors.

The main elements of the Company's remuneration policies are:

- No individual should determine his or her own remuneration;
- Remuneration should be broadly aligned with companies with whom the Company competes for human resources; and
- Remuneration should reflect performance, complexity and responsibility with a view to attracting, motivating and retaining high performing individuals and promoting the enhancement of the value of the Company to its shareholders.

NON-EXECUTIVE DIRECTORS' REMUNERATION

The role of non-executive directors has become more complex and demanding due to regulatory changes and the increasing part they play in the governance of listed companies. The Company believes that the level of remuneration for any particular non-executive directors should reflect the likely workload, the scale and complexity of the business and the responsibility involved.

Non-executive directors of the Company are paid fees in line with market practice. Executive Directors serving on the Board and Board Committee are not entitled to any Directors' fees. The fee paid by the Company to each of our non-executive directors in 2005 for their services on the Company's Board of Directors are as below:

Name of Independent Non-Executive Directors	Fees per Annum (US\$'000)
Mr. Lu Ren Jie	20
Mr. Chai Woon Chew	15
Mr. Ho Choi Chiu	15

The non-executive Directors of the Company received no other compensation from the Company except for the fees disclosed above.

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EXECUTIVE DIRECTORS' REMUNERATION

In determining the remuneration of Executive Directors, the remuneration data of comparable positions in the market, including local and regional companies of comparable size, complexity and business scope, are referenced.

The remuneration paid to the Executive Directors of the Company in 2005 was as below:

Name of Executive Directors	Compensation Per Annum (US\$'000)
Mr. Zhou Ling	107
Ms. Lee Sin Pyung	155
Ms. Sit Mei	49

No Executive Directors has a service contract with the Company or any of its subsidiaries with a notice period in excess of one year or with provisions for predetermined compensation on termination that exceeds one year's salary and benefits in kind.

The Company does not have a share option scheme.

AUDIT COMMITTEE

As of 31 December 2005, the Audit Committee consists of the following three directors: Mr. Ho Choi Chiu, Mr. Lu Ren Jie and Mr. Chai Woon Chew. Mr. Ho was the Committee Chairman. All of the Committee members were independent non-executive Directors.

It is the practice of the Audit Committee to meet twice each year. Special meetings may be called at the discretion of the Chairman or at the request of the Managing Director to review significant control or financial issues.

During 2005, the Audit Committee met three times and discharge its responsibilities in its review of the half-yearly and annual results and system of internal control, and its other duties as set out in Listing Rules of the Hong Kong Stock Exchange.

In 2005, the Audit Committee discharged its responsibilities by:

- Making recommendations to the Board on the reappointment of the external auditor and approval of the remuneration and terms of engagement of the external auditor;
- Monitoring the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard, and discussing with external auditor the nature and scope of the audit and reporting obligations;

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- Reviewing, and monitoring the integrity of, the financial statements of the Company and the Company's annual and interim reports and the auditor's report to ensure that the information presents a true and balance assessment of the Company's financial position;
- Reviewing the Company's financial controls, internal control and risk management systems to ensure that management has discharged its duty to have an effective internal control system;
- Reviewing the Company's financial and accounting policies and practices;
- Reviewing the external auditor's management letter, material queries raised by the external auditor to the management in respect of the accounting records, financial accounts or systems of control and the management's response to such queries; and;
- Reporting to the Board on the matters set out in the Code on Corporate Governance Practices on the Audit Committee.

The Audit Committee oversees the financial reporting process and the adequacy and effectiveness of the Company's system of internal control. During the year, the Committee carried out their own independent review of the interim and annual financial statements and financial reports and statements included in circulars of the Company published during the year. The Audit Committee is authorised by the Board to obtain external legal or other independent professional advice and to ensure the attendance of outsiders with relevant experience and expertise if it considers necessary in the performance of its functions. The Audit Committee is provided with sufficient resources by the Company to discharge its duties.

None of the members of the Committee has any personal financial interests, conflicts of interest in the business of the Company and its subsidiaries.

AUDITORS' REMUNERATION

The Company's independent auditors are Johnny Chan & Co. Limited. In order to maintain their independence, Johnny Chan & Co. Limited will not be employed for non-audit work unless it is permissible under the Listing Rules of the Hong Kong Stock Exchange and has been pre-approved by the Audit Committee of the Company.

The following is a summary of the fees billed to us by our principal independent auditors during the financial years ended 31 December 2005 and 2004:

Fee Category	2005 (US\$'000)	2004 (US\$'000)
Audited fees	124	124
Other Services	23	11

The Audit Committee has resolved the re-appointment of Johnny Chan & Co. Limited for statutory audits for the financial year 2006. This resolution has been approved by the Board of Directors and is subject to final approval and authorization by the shareholders at the 2006 AGM.

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INTERNAL CONTROLS

The Company's internal control system is designed to facilitate the effectiveness and efficiency of operations, safeguard assets against unauthorised use and disposition, ensure the maintenance of proper accounting records and the truth and fairness of the financial statements, and ensure compliance with relevant rules and regulations.

The Board is responsible for maintaining an adequate system of internal control and for reviewing its effectiveness. The Board Audit Committee conducts reviews of the effectiveness of the Company's system of internal control, including those of its subsidiaries twice a year, and reports annually to the Board on such reviews.

For the year ended 31 December 2005, based on the evaluation of the Company's internal control, the Board considered its internal control system effective and adequate. No significant areas of concern that might affect shareholders were identified.

FINANCIAL REPORTING

The Directors acknowledge their responsibility for preparing all information and representations contained in the financial statements of the Company for the year under review. The Directors consider that the financial statements have been prepared in conformity with the generally accepted accounting standards published by the Hong Kong Institute of Certified Public Accountants, and reflect amounts that are based on the best estimates and reasonable, informed and prudent judgment of the Board and Management with an appropriate consideration to materiality. As at 31 December 2005, the Directors, having made appropriate enquiries, are not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Company's ability to continue as a going concern. Accordingly, the Directors have prepared the financial statements of the Company on a going concern basis.

In 2005, the Company has made some changes of its accounting policies following the adoption of new and revised Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and applicable Interpretations which came into effect on 1 January 2005. The new and revised accounting standards that have been adopted by the Company are set out in the Significant Accounting Policies of the Notes to the Accounts on pages 33 to 41.

The responsibilities of the external auditors with respect to financial reporting are set out in the Report of the Auditors on page 23.

By Order of the Board
South Sea Petroleum Holdings Limited

Lee Sin Pyung
Managing Director

Hong Kong, 24 April 2006