

Corporate Governance Report

Overview of Corporate Governance

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

1. "Articles of Association of China Shenhua Energy Company Limited"; ("Articles of Association")
2. "Rules and Procedures of Shareholders' General Meetings of China Shenhua Energy Company Limited";
3. "Rules and Procedures of Meetings of the Board of Directors of China Shenhua Energy Company Limited";
4. "Rules and Procedures of Meetings of the Supervisory Committee of China Shenhua Energy Company Limited";
5. "Rules and Procedures of Meeting of the Strategic Planning Committee of the Board of China Shenhua Energy Company Limited";
6. Rules and Procedures of Meetings of the Audit Committee of the Board of China Shenhua Energy Company Limited";
7. "Rules and Procedures of Meetings of the Remuneration Committee of the Board of China Shenhua Energy Company Limited";
8. "Rules and Procedures of Meetings of the Safety, Health and Environmental Committee of the Board of China Shenhua Energy Company Limited";
9. "Rules and Procedures of Meetings of the Nomination Committee of China Shenhua Energy Company Limited";
10. "Information Disclosure Policy of China Shenhua Energy Company Limited";
11. "Rules of Information Disclosure Committee and its members of China Shenhua Energy Company Limited";
12. "Connected Transaction Decision making System of China Shenhua Energy Company Limited";
13. "Methods of Monitoring Connected Transactions of China Shenhua Energy Company Limited";
14. "Investor Relations Policy of China Shenhua Energy Company Limited"; and
15. "Model Code of Securities Transaction for Directors of China Shenhua Energy Company Limited".

The resolution to amend the Articles of Association was passed by way of special resolution at the Shareholders' Annual General Meeting for 2005 held on 17 May 2006. The amendments to the Articles of Association were made in respect of the successful public offering of the shares of the Company for listing on The Stock Exchange of Hong Kong Limited on 15 June 2005 to reflect the relevant laws and regulations of "The Company Law of the People's Republic of China" and "The Securities Law of the People's Republic of China" which came into effect on 1 January 2006. Please refer to the "Notice of Annual General Meeting" and the "Voting Results of Annual General Meeting for 2005" released by the Company respectively on 24 March 2005 and 12 May 2005 for details. In addition, pursuant to the mandate granted by way of special resolution at the Annual General Meeting for 2005, the directors of the Company made amendments to other relevant documents including the "Rules and Procedures of Shareholder's General Meetings of China Shenhua Energy Company Limited" pursuant to the relevant laws and regulations, the Listing Rules of Hong Kong (the "Listing Rules") and the revised Articles of Association of the Company.

The Board has reviewed the relevant corporate governance documents adopted by the Company, and is of the view that the documents comply with all the code provisions of the Code on Corporate Governance Practices (hereinafter referred to as the "Code on Corporate Governance Practices") of the Listing Rules. The Company has complied with the recommended corporate practices set out in the Code on Corporate Governance Practices in many aspects.

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

1. In addition to the Audit Committee and Remuneration Committee, the Company has also established a Strategic Planning Committee, a Safety, Health and Environmental Committee and a Nomination Committee.
2. All members of the Audit Committee are independent non-executive directors, including Dr. Chen Xiaoyue who is also Director of the Accounting Research Institute of Tsinghua University, advisor to the Beijing National Accounting Institute and member of the Standing Committee of China Accounting Institute and this complies with the requirements stated in the Code on Corporate Governance Practices.

Code on Corporate Governance Practices

For the year ended 31 December 2006, the Company has fully complied with the code provisions of the Code of Corporate Governance Practices set out in Appendix 14 to the Listing Rules.

Securities Transactions of Directors

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Listing Rules, requiring the securities transactions of the directors of the Company to be carried out in accordance with the Model Code. The Model Code is also applicable to the senior management of the Company. After a special inquiry conducted by the Company, all the directors have confirmed that they have fully complied with the Model Code throughout 2006.

Share Interests of Directors, Supervisors and Senior Management

As at 31 December 2006, none of the directors, supervisors or senior management had any interest or short position in the shares or underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Future Ordinance (the "SFO"), Chapter 571 of the Laws of Hong Kong) which was required to be entered in the register required to be kept by the Company pursuant to Section 352 of the SFO or which was otherwise required to be notified by the directors and supervisors to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

As at 31 December 2006, the Company had not granted any equity securities or warrants to its directors, supervisors and senior management or their respective spouses or children under the age of 18.

Substantial Shareholders' Interests and Short Positions in the Company

As at 31 December 2006, persons set out in the table below had an interest or short position in the Company's shares as recorded in the register required to be kept under section 336 of the SFO (Chapter 571 of the Laws of Hong Kong):

Name of shareholder	Capacity	H/domestic shares	Nature of Interests	No. of H/domestic shares held	Percentage of H/domestic shares over all issued H/domestic shares respectively (%)	Percentage of total share capital of the Company (%)
Shenhua Group Corporation Limited	Beneficial owner	Domestic	Long position	14,691,037,955	100.00	81.21
Merrill Lynch Europe Intermediate holdings	Interest of controlled corporation	H	Long position	518,705,000	16.93	2.87
		H	Short position	518,705,000	16.93	2.87
Merrill Lynch Europe PLC	Interest of controlled corporation	H	Long position	518,705,000	16.93	2.87
		H	Short position	518,705,000	16.93	2.87
Merrill Lynch Holdings Limited	Interest of controlled corporation	H	Long position	518,705,000	16.93	2.87
		H	Short position	518,705,000	16.93	2.87
ML UK Capital Holdings	Interest of controlled corporation	H	Long position	518,705,000	16.93	2.87
		H	Short position	518,705,000	16.93	2.87
Merrill Lynch (Asia Pacific) Limited	Interest of controlled corporation	H	Long position	459,525,000	15.00	2.54
Merrill Lynch International Holdings Inc.	Interest of controlled corporation	H	Long position	459,525,000	15.00	2.54
Merrill Lynch International Incorporated	Interest of controlled corporation	H	Long position	459,525,000	15.00	2.54
AllianceBernstein L.P. (formerly known as Alliance Capital Management L.P.)	Interest in controlled corporation	H	Long position	340,900,530	10.03	1.88
JPMorgan Chase & Co.	Interest in controlled corporation	H	Long position	339,737,642	10.00	1.88
		H	Lending Pool	120,977,692	3.56	0.66
Merrill Lynch & Co., Inc.	Interest in controlled corporation	H	Long position	218,980,866	6.44	1.21
Kerry Holdings Limited	Interest in controlled corporation	H	Long position	207,582,000	6.11	1.15
Genesis Asset Managers, LLP	Investment manager	H	Long position	204,000,500	6.00	1.13
Genesis Fund Managers, LLP	Investment manager	H	Long position	204,000,500	6.00	1.13
Taurus Investments SA	Beneficial owner	H	Long position	155,612,000	5.08	0.86

Board of Directors

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

Name	Sex	Age	Position in the Company	Term of office	Salaried
Chen Biting	Male	61	Chairman of the Board and Executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	No
Zhang Xiwu	Male	48	Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	No
Zhang Yuzhuo	Male	45	Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	No
Ling Wen	Male	44	Executive Director and President	Executive Director: from 6 November 2004 to the third shareholders' annual meeting of the Company President: from 25 August 2006 to the expiration of the first session of the Board of the Company	Yes
Han Jianguo	Male	48	Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	No
Huang Yicheng	Male	80	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	Yes
Anthony Francis Neoh	Male	60	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	Yes
Chen Xiaoyue	Male	60	Independent Non-executive Director	From 6 November 2004 to the third shareholders' annual meeting of the Company	Yes

The Board is a standing decision-making organisation of the Company. It leads and supervises the Company in a responsible and cost-effective manner. All directors are requested to act in the best interest of the Company. All members of the Board understand that they are jointly and severally accountable to all shareholders regarding matters of management, supervision and operation of the Company.

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

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

The Board is responsible for preparing the financial statements for each accounting year to give a true and fair view of the Company's financial position, its results and cash flow for the relevant period. In preparing the financial statements for the year ended 31 December 2006, the Board has adopted and applied the appropriate accounting policies in arriving at a prudent, fair and reasonable judgement and estimates, and has prepared the financial statements on a going concern basis. The Board is responsible for duly maintaining accounting records which disclose the financial position of the Company reasonably and accurately. The Board as a whole shall meet at least quarterly and as and when major decisions are required.

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

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

Attendance of Directors at Board Meetings in 2006

Number of meetings	six	
	Attendance in person Number of times	Attendance by proxy Number of times
Executive Directors		
Chen Biting	6	–
Ling Wen	6	–
Non-executive Directors		
Zhang Xiwu	6	–
Zhang Yuzhuo	6	–
Han Jianguo	5	1
Independent Non-executive Directors		
Huang Yicheng	6	–
Anthony Francis Neoh	6	–
Chen Xiaoyue	6	–

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

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

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

Other than their own service contracts, none of the directors and supervisors has any actual personal interest, directly or indirectly, in the material contracts with the Company or any of its subsidiaries in 2006.

Directors' Remuneration

The Board of the Company established a Remuneration Committee consisting of two independent non-executive directors and one executive director. The Chairman is Mr. Anthony Francis Neoh, and the members are Dr. Chen Xiaoyue and Dr. Ling Wen. The committee would, when it is necessary, engage external professional advisers to give assistance and/or suggestions in relation to the matters concerned. Details of the principal duties and the work done by the Remuneration Committee during the year are set out in the section "Board Committees' Reports" of this report.

Attendance of Individual Remuneration Committee Members in 2006

Number of meetings	four	
	Attendance in person Number of times	Attendance by proxy Number of times
Anthony Francis Neoh	4	–
Ling Wen	4	–
Chen Xiaoyue	4	–

Nomination of Directors

The Board established a Nomination Committee on 7 July 2006.

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

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

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

Attendance of Individual Nomination Committee Members in 2006

Number of meetings	one	
	Attendance in person Number of times	Attendance by proxy Number of times
Chen Biting	1	–
Huang Yicheng	1	–
Anthony Francis Neoh	1	–
Chen Xiaoyue	1	–

Auditors' Remuneration

The Company's external auditors are KPMG and KPMG Huazhen. They are appointed after being considering and approved at the annual general meeting held in May 2006. The Board is authorised to determine the fees of the auditor. The audit fee of the Company for the year ended 31 December 2006 was approximately RMB29.59 million, including the audit fee for conducting an audit on financial statements in relation to the acquisition of Jinjie Energy.

Audit and Audit Committee

The Board of the Company established an Audit Committee consisting of three independent non-executive directors. The Chairman is Dr. Chen Xiaoyue, and the members are Mr. Huang Yicheng and Mr. Anthony Francis Neoh. The committee would, when it is necessary, engage an external professional advisers to give assistance and/or suggestions in relation to the matters concerned. Details of the principal duties and the work done by the Audit Committee during the year are set out in the section "Board Committees' Reports" of this report.

Attendance of Individual Remuneration Committee Members in 2006

Number of meetings	four	
	Attendance in person Number of times	Attendance by proxy Number of times
Chen Xiaoyue	4	–
Huang Yicheng	4	–
Anthony Francis Neoh	4	–

Since its listing on the Hong Kong Stock Exchange, the Company has been in full compliance with the requirements of Rule 3.21 of the Listing Rules up to 31 December 2006.

The directors of the Company are responsible for overseeing the preparation of financial statements for each financial period which should truly and fairly reflect the business conditions, results and cash flows during the period. In preparing the financial statements for the year ended 31 December 2006, the directors adopted and applied consistently appropriate accounting policies; approved the adoption of all standards which are in compliance with the International Financial Reporting Standards ("IFRS"); and made prudent and reasonable judgments and estimates in the preparation of those financial statements which were prepared on a going concern basis.

The audited results for 2006 have been reviewed by the Audit Committee.

Shareholders' Rights

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

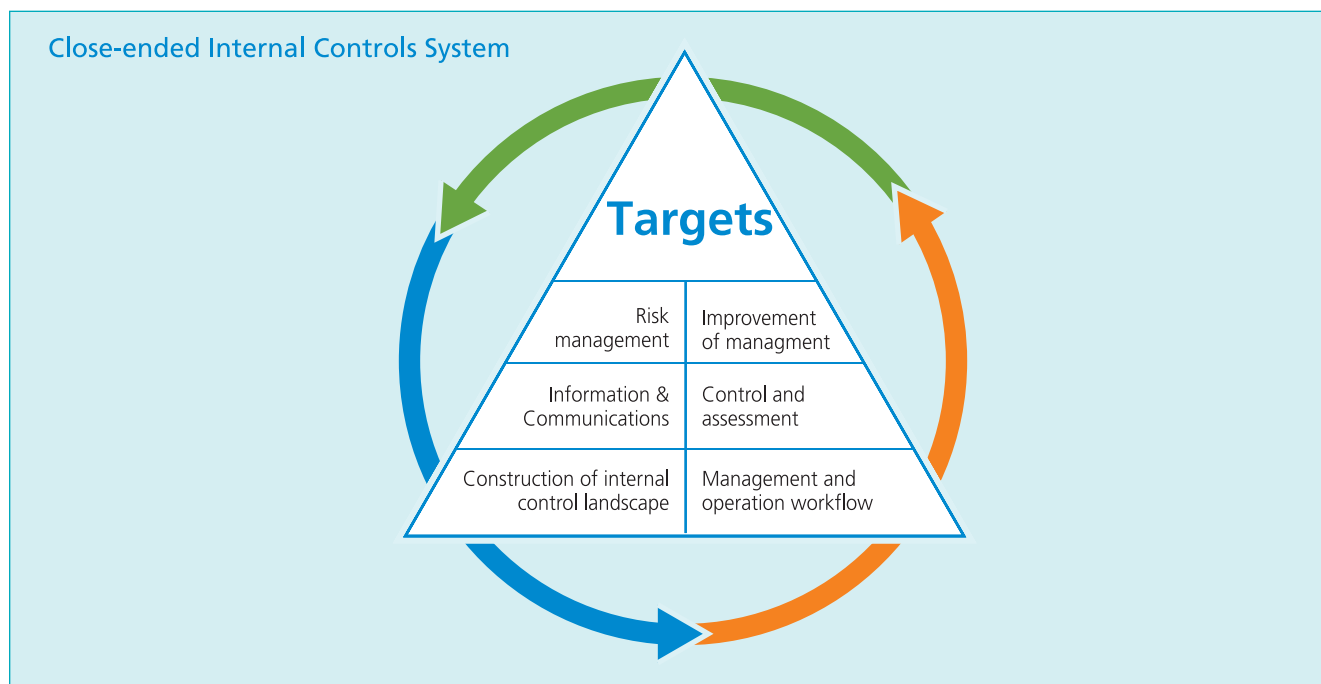
In accordance with the Articles of Association of the Company, shareholders who solely or in aggregate hold 10% or more of the voting shares issued by the Company, have the right to call for an extraordinary general meeting in writing (the number of shares held by the shareholders is calculated on the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

The Internal Controls System

The Board is aware of the responsibility to ensure the soundness, appropriateness and effectiveness of the internal control system of the Company. The Board will review the efficiency of the internal controls system through the Audit Committee.

Since the establishment of the Company, we have been committed to constructing and improving our internal controls system and continuously improving the control workflow with a view to enhancing our operational efficiency and reducing our operational risks. We have established a series of internal controls rules and systems in respect of important aspects such as asset supervision and management, capital management, investment management and human resources management. We have been continuously optimising our internal organisational structure to form a scientific decision-making, implementation and supervision mechanism. Our Internal Management Authorisation Manual (Provisional) strictly defines the scope of authorisations granted to the relevant departments, senior management and decision-making organisations. Persons or departments that have received authorisations are required to duly discharge their responsibilities within their scope of authorisation. If any approval exceeds the authorisation granted, the relevant people or departments dealing with the matter may refuse to implement such approval.

In 2006, with reference to the "Internal Control and Risk Management - A Basic Framework" issued by the Hong Kong Institute of Certified Public Accountants and with the assistance of reputable international consultancy institutions which have extensive experience in internal controls, the Company analysed and reviewed its existing internal controls system in light of the actual management situation of the Company and constructed a basic platform for our internal controls system. Our basic platform complies with the requirements of the Hong Kong Stock Exchange and the State-owned Assets Supervision and Administration Commission of the State Council. This has further defined the scope of responsibilities of the Board, all levels of management and the staff within the internal controls system and established basic procedures and methods in respect of key management control workflows, supervision and assessment as well as management improvements. The Company proposed specific requirements for the internal controls support system in respect of construction of our internal control landscape, full-range risk management and information and communications. The Company has adopted a "bottom-up" approach to ensure the achievement of our targets, and a "top-down closed-ended" control system to enable the creation of an internal controls culture. Please refer to the following diagram:



Review of the Year

The management of the Company reviewed its internal controls system in 2006 and the scope of the review covered supervision and control over financial, operational and compliance matters as well as risk management. Based on the targets set by the Company, internal and external risks were identified and assessed, so that the management was able to define and ascertain the significant risks faced by the Company. With this understanding of our significant risks, the management analysed the key internal control workflow, identify risks in such workflow and digout key control activities, the Company made improvements to the internal control measures in respect of key control points. The Company also organised appraiser to conduct tests on the improved key control workflow and control activities to determine whether the improved internal controls system can function properly. Based on the results of the tests, the Company can make improvements on any weakness and defects discovered. In 2006, the Company also examined the internal controls system with the management and staff at different levels so as to make comparisons with international energy corporations and determine the direction for the continued improvement of the Company. Furthermore, the internal audit department also placed great emphasis on the effectiveness of the internal controls system during their audit for the year. The management of the Company reported to the Audit Committee of the Board on the effectiveness of the internal controls system based on risk analysis, self-assessment, examination on the key elements of the internal controls system and internal audit results.

The Board made a thorough review of the procedures, methods, and assessment results of the internal controls system according to the requirements of the Hong Kong Stock Exchange and no material adverse matters were discovered. The internal controls system of the Company can ensure the safety and completeness of our assets and improve the results and efficiency of the operations of the Company. The Company has the appropriate information records and procedures to ensure the financial statements and related information of the Company is timely, relevant and reliable and to ensure that the relevant information is sufficiently disclosed in the financial statements in compliance with the relevant laws and regulations.

Internal Audit Organisation

The Company has an internal audit department which is accountable to the Board and which reports to the Audit Committee. The internal audit department carries out its work under the leadership of the President. The internal audit department has a department head and eight other professional staff. The subsidiaries of the Company have their own auditing departments in place in accordance with their relevant requirements which carry out their audit work under the leadership of the audit department of the Company. There are 45 professionals in total. The scope of auditing covers all the subsidiaries and branches of the Company.

Pursuant to the requirements of the "Measures for the Administration of Internal Auditing of China Shenhua Energy Company Limited (Provisional)", the internal audit department duly discharges its duties. Its main duties are to examine and assess the establishment, integrity and implementation of the internal controls system; examine the full enforcement of domestic and overseas laws and regulations and corporate planning and procedures; examine the operation and management of the Company relating to financial incomes and expenses; assess the cost-effectiveness of the Company; and examine the safety and completeness of the assets of the Company.

In 2006, the internal audit department mainly focused on the conformity to the norms of the operation activities of the Company and the efficiency and results of the operational activities of the Company, in particular the major risks of the Company, concerns of the management and major construction projects, and the scope of the internal audit department covers the Company and all the subsidiaries. It advises on management, follows up improvements to the management in a timely manner and reports to the senior management and the Audit Committee.

In the meantime, the internal audit department reinforces the construction of its basic foundation to have a sound internal audit system. Moreover, it takes the initiative to review the internal control system and coordinates and liaises with external auditors.

The Company has remained committed to improving its internal controls system. We will continue to review and improve our internal controls system pursuant to the Listing Rules based on our practical experience, views of shareholders, domestic and international development trend as well as changes of external and internal risks.