



Corporate Governance Report

The Company believes that good corporate governance can increase long-term share value. Therefore, the Company is committed to implementing a high standard of corporate governance and emphasizes good communication with shareholders and investors with a view to continuously improving the Company's transparency. This includes timely, comprehensive and accurate disclosure of information to safeguard the shareholders' interest and to raise long-term share value.

During the reporting period, the Company has complied with all the code provisions of the Code on Corporate Governance Practice (the "Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

BOARD OF DIRECTORS

The board (the "Board") of directors (the "Directors") of the Company manages the Company's affairs on behalf of shareholders and is responsible for any corporate governance mechanism deployed. The Board is also responsible for the Company's business, financial performance and preparation of financial statements. The Board formulates the strategy, policy and business plan of the Group, controls corporate risks, monitors the operation and financial performance of the Company. The Board is directly responsible to shareholders and delegates daily management to the management led by the Chief Executive Officer of the Company. The Board comprises eight members, including four Executive Directors, one Non-Executive Director and three Independent Non-Executive Directors.

The Company has a separate Chairman and Chief Executive Officer. The two positions are assumed by different persons, in order to ensure that their independence, accountability and power are clear. Mr. Zheng Fan, the Chairman, is responsible for the operation of the Board and the formulation of the Company's strategies and policies. Mr. Ni Zheng, the Chief Executive Officer, with the assistance of other members of the Board and senior management, is responsible for the management of the Company's business, the implementation of significant policies, the daily operational decisions as well as the coordination of the overall operation.

Independent Non-Executive Directors (with a term of one or two years) comprise experienced professionals and businessmen. They have comprehensive expertise and experience in the legal, accounting, financial, industrial and commercial aspects. They ensure the Board has attained the strict standards in the financial and other statutory reporting areas and they provide sufficient balance to safeguard the interests of the shareholders and the Company as a whole.

In order to assist the Directors to execute their duties, the Board has set out terms of reference, enabling the Directors to seek independent professional advice upon reasonable request under appropriate circumstances and the fees are payable by the Company.



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As at the date of this Report, the Directors of the Company are as follows:

Executive Directors

Mr. Zheng Fan, the Chairman of the Company

Mr. Ni Zheng, the Chief Executive Officer of the Company

Mr. Liu Danlin

Mr. Zhou Guangneng

The above Executive Directors (except Mr. Liu Danlin) have entered into service agreements with the Company with a term of three years starting from the Listing Date, subject to termination provisions therein. Mr. Liu Danlin has entered into a service agreement with the Company for a term of three years commencing from 11 May 2006, subject to termination provisions therein.

Non-Executive Director

Ms. Xie Mei

Ms. Xie Mei has entered into a service agreement with the Company with a term of three years starting from the Listing Date, subject to termination provisions therein.

Independent Non-Executive Directors

Mr. Lee Kit Wah

Mr. Chen Xiangdong

Mr. Xiao Yongping

The above Independent Non-Executive Directors have entered into service agreements with the Company with a term of two years starting from the Listing Date, subject to termination provisions therein. Mr. Lee Kit Wah is a certified public accountant in Hong Kong and has more than 26 years of experience in accounting and finance.

The biographies of all Directors are set out in the Annual Report on pages 11 to 12.

The Company has not established a nomination committee. The Board will evaluate the independence of all Independent Non-Executive Directors each year and make sure that they comply with the independence requirement of the Listing Rules. All members of the Board are not related to one another in all aspects, including finance, family and business.



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THE APPOINTMENT AND RE-ELECTION OF DIRECTORS

The Company has not established a nomination committee. All members of the Board are responsible for formulating the procedures for appointing Directors, nominating suitable candidates for approval at the annual general meeting so as to fill vacancies due to the resignation of Directors or appoint additional Directors.

When selecting candidates for appointment as Directors, the Board will consider the candidates' integrity, achievements and experience in the relevant industry, expertise, educational background and whether they have sufficient time to assume the post of Directors.

The Board held one meeting (which all Directors were present) in 2006 to determine the policy for the nomination of directors, and to propose the appointment of an additional director in the 2005 annual general meeting of the Company.

PROCEDURES OF BOARD MEETINGS

The Board has established meeting procedures and has complied with the code provisions of the Code. The procedures of board meetings provide that the Board shall meet at least four times each year and can convene additional meeting when necessary. Directors can express different opinions at board meetings. Important decisions will be made only after detailed discussions by the Board. Directors who have conflict of interest or material interests in the relevant transactions will not be counted in the quorum of the meeting and shall abstain from voting on the relevant resolutions. Minutes of board meetings and other committee meeting will be drafted by the Company Secretary and will be sent to all members for their comment and record respectively. Directors are entitled to inspect the minutes at any time.

NUMBER OF BOARD MEETINGS HELD AND THE ATTENDANCE OF DIRECTORS

The Board convened six meetings in the year ended 31 December 2006. The attendances of the meetings of the Board, the Audit Committee and the Remuneration Committee are as follows:

Name of Directors	Number of meetings attended		
	The Board	Audit Committee	Remuneration Committee
Zheng Fan	6/6	N/A	N/A
Ni Zheng	5/6	N/A	N/A
Liu Danlin	2/6 (Note 1)	N/A	N/A
Zhou Guangneng	6/6	N/A	N/A
Xie Mei	6/6	3/3	2/2
Lee Kit Wah	6/6	3/3	2/2
Chen Xiangdong	6/6	N/A	N/A
Xiao Yongping	5/6	3/3	2/2

Note 1: Mr. Liu Danlin has been appointed as an Executive Director of the Company starting from 11 May 2006. Thereafter, three Board meetings have been held in 2006 and Mr. Liu has attended two meetings



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SPECIAL COMMITTEES UNDER THE BOARD OF DIRECTORS

The Board has established the following committees and formulated their terms of reference.

AUDIT COMMITTEE

The Audit Committee consists of three members, including two Independent Non-Executive Directors and one Non-Executive Director. They are Mr. Lee Kit Wah, Mr. Xiao Yongping and Ms. Xie Mei, with Mr. Lee Kit Wah as the Chairman of the Audit Committee.

The main areas of responsibilities of the Audit Committee are as follows:

1. To be primarily responsible for making recommendations to the Board on the appointment, re-appointment or removal of the external auditors, and to approve remuneration and terms of engagement of the external auditors;
2. Reviewing of internal control and monitoring the work of internal audit department;
3. Reviewing the financial reporting statements of the Company, the Company's annual reports and accounts, interim reports and quarterly reports (if any);
4. Examining financial statements and reporting to the Board for any significant opinions in relation to financial reporting;
5. Conferring with the auditors on any problems or matters of doubt arising from the audit process, as well as other issues the auditors may like to discuss (if necessary, such discussions could be undertaken in the absence of the management);
6. Reviewing correspondences addressed to the management by the auditors and responses from the management.

The Audit Committee held three meetings during the year ended 31 December 2006, at which the Audit Committee reviewed and discussed the financial results and reports, compliance procedures, the internal audit department's report regarding the reviewing and procedures of the internal control and risk management of the Company, and the re-appointment of the external auditor.

The Audit Committee has reviewed this annual report, and confirms that it is complete and accurate and complies with the Listing Rules.



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REMUNERATION COMMITTEE

The Remuneration Committee consists of three members, including two Independent Non-Executive Directors and one Non-Executive Director. They are Mr. Lee Kit Wah, Mr. Xiao Yongping and Ms. Xie Mei, with Mr. Lee Kit Wah being Chairman of the Remuneration Committee.

The main areas of responsibilities of the Remuneration Committee are as follows:

1. The Committee should consult Chairman of the Board on remuneration recommendations concerning other Executive Directors;
2. The Committee should put forward recommendations to the Board on matters relating to the overall remuneration policy and structure for the Directors and senior managerial staff of the Company, as well as finalizing a formal and transparent remuneration policy;
3. With authority delegated by the Board, the Committee should finalize the compensation packages for all the Executive Directors and senior managerial staff and put forward recommendations to the Board on remuneration for Non-Executive Directors;
4. Reviewing and approving compensations paid to Executive Directors and senior managerial staff, who have their service contracts terminated or whose contracts are not renewed, in order to ensure that the compensations are paid in accordance with relevant contractual terms.

The Remuneration Committee held two meetings during the year ended 31 December 2006, at which the Remuneration Committee reviewed and discussed the remuneration policy and structure of the Company and the remuneration of the Executive Directors in the year under review.

INTERNAL CONTROL

The Company has an internal audit department which is independent of other departments. The internal audit department has the authority to inspect the Company's risk management network, and the control and governance processes in order to assess the relevant situations. Besides, the department also regularly reviews all the businesses, the supporting teams and matters relating to work approach, procedure, expenses and internal control measures of the Company's subsidiaries. The department will also conduct ad hoc reviews and investigations when necessary. The internal audit department reports directly to the Audit Committee.

During the year under review, the Board examined the effectiveness of the internal control system of the Company through the Audit Committee.



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FINANCIAL REPORTING

The Directors are responsible for overseeing the preparation of the financial statements, to ensure the annual report giving a true and fair view of the Group's state of affairs, the results and cash flow for the year. In preparing the financial statements for the year ended 31 December 2006, the Directors have:

- selected suitable accounting policies and applied them consistently; and
- made judgements and estimates that are prudent and reasonable.

The Company recognises that high quality corporate reporting is important in reinforcing the trustworthy relationship with the Company's stakeholders and aims at presenting a balanced, clear and comprehensible assessment of the Company's performance, position and prospects in all corporate communications. The annual results of the Company are announced in a timely manner within the limits of 4 months after the financial year end.

The auditors' responsibilities are set out in the Auditors' Report on page 36.

Through the Audit Committee, the Board has reviewed the internal control system in respect of finance, operations and compliance of the Company and its subsidiaries. The Audit Committee considers that the Company and its subsidiaries have established all necessary mechanisms. The above control mechanism has ensured compliance in respect of the Company's operations. The Board considers that the Company has complied with the code provisions on internal control of the Code.

DIRECTORS' REMUNERATION

The Group paid total Directors' remuneration amounts of approximately RMB819,000, RMB530,000, RMB707,000, RMB122,000, RMB1 and RMB122,000 to Mr. Ni Zheng, Mr. Liu Danlin, Mr. Zhou Guangneng, Mr. Lee Kit Wah, Mr. Chen Xiangdong and Mr. Xiao Yongping respectively for the year ended 31 December 2006. Mr. Zheng Fan and Ms. Xie Mei did not receive any basic remuneration from the Group for the year ended 31 December 2006.

Directors' remuneration is determined based on a variety of factors such as market conditions and responsibilities assumed by each Director. As at 31 December 2006, there was no arrangement in which Directors waived their remuneration.

SECURITIES TRADING BY DIRECTORS

The Board has adopted the Model Code for Securities Transactions by Directors of Listed Companies set out in Appendix 10 of the Listing Rules ("Model Code"). The Board confirms that, having made detailed enquiry of all Directors, the Directors have complied with the required standard set out in the Model Code and its code of conduct regarding directors' securities transactions.



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SECURITIES TRANSACTIONS BY SENIOR MANAGEMENT AND STAFF

Senior management and those staff who are more likely to be in possession of unpublished price-sensitive information or other relevant information in relation to the Group have adopted rules based on the Model Code. These senior management and staff have been individually notified and advised about the Model Code by the Company.

FINANCIAL OFFICER

The Financial Officer of the Company is responsible for preparing interim and annual financial statements based on accounting principles generally accepted in Hong Kong and ensures that the financial statements truly reflect the Group's results and financial position as well as in compliance with the Companies Ordinance, the Listing Rules and other relevant laws and regulations. The Financial Officer reports directly to the Chairman of the Audit Committee and co-ordinates with external auditors on a regular basis. In addition, the Financial Officer will review the control of financial risks of the Group and provide advices thereon to the Board.

COMPANY SECRETARY

The Company Secretary reports directly to the Board. All the Directors have easy access to the Company Secretary and the responsibility of the Company Secretary is to ensure the board meetings are properly held and are in compliance with the relevant laws and regulations. The Company Secretary is also responsible for giving advices with respect to the Directors' obligations on securities interest disclosure, disclosure requirements of discloseable transactions, connected transactions and price-sensitive information. The Company Secretary shall provide advices to the Board with respect to strict compliance with the laws, requirements and the Company's articles of association at appropriate times. As the Company's principal channel of communication with the Stock Exchange, the Company Secretary assists the Board in implementing and strengthening the Company's corporate governance code so as to bring the best long-term value to shareholders. In addition, the Company Secretary also provides relevant information updates and continuous professional development to the Directors with respect to legal, supervisory and other continuous obligations for being a director of a listed company at appropriate times. The Company Secretary is also responsible for supervising and managing the Group's investors relationship.

EXTERNAL AUDITORS

The Group's external auditors are KPMG. The remuneration paid to the external auditors in 2006 comprised fees for audit services of RMB1.77 million and fees for tax compliance work of RMB8,000.

The responsibilities of the auditors to the shareholders are set out on page 36 in this annual report.



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INVESTORS RELATIONSHIP

The Company places great emphasis on its relationship and communication with investors. The Company has numerous communication channels such as seminars with the media, analysts and fund managers. Designated senior management holds regular dialogue with institutional investors and analysts which enables them to keep abreast of the Group's latest developments. In addition, the Group set up a company website (www.hualiholdings.com) in 2006, timely presenting the most updated information and the status of the business development of the Group.

COMMUNICATION WITH SHAREHOLDERS

The Board and senior management recognize the responsibility of safeguarding the interest of shareholders of the Company. The Company reports its financial and operating performance to shareholders through annual reports and interim reports. Shareholders of the Company can also obtain information of the Group in time through annual reports, interim reports, announcements, circulars, press releases and the Group's company website. Shareholders can raise questions directly to the Board in respect of the performance and future development of the Group at annual general meetings.