

CORPORATE GOVERNANCE REPORT

(A) CORPORATE GOVERNANCE PRACTICES

The Company and the Board of Directors of the Company (the "Board") have applied the principles in the provisions of the Code on Corporate Governance Practices (the "Code") contained in Appendix 14 of the Rules Governing the Listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Ltd. (the "Stock Exchange") by adopting the Code by way of Board resolutions.

During the year, the Board has adopted and complied with the Code with the exception that the roles of the Chairman and the Chief Executive Officer of the Company are performed by Mr. Han Jingyuan.

The Board believes that there is no need to segregate the roles of the Chairman and the Chief Executive Officer of the Company because the role of the chief executive officer/general manager of the Company's major operating subsidiaries are performed by other persons and apart from acting as the listing vehicle of the Group, the Company has no real operating activities or business.

Depending on the future development of the operating activities or business of the Company, eventually the Board will actively consider the issue of replacing Mr. Han Jingyuan by an appropriate candidate as the Chief Executive Officer of the Company.

(B) DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding Directors of the Company's (the "Directors") securities transactions on terms no less exacting than the required standard set out in the Model Code of Appendix 10 of the Listing Rules (the "Model Code").

The Company has made specific enquiry of all Directors and all Directors have confirmed with the Company that they have complied with the required standard set out in the Model Code and its code of conduct regarding Directors' securities transactions during the year.

(C) BOARD OF DIRECTORS

The directors of the Company during the year were as follows:

Executive Directors

Mr. Han Jingyuan (*Chairman and Chief Executive Officer*)

Ms. Chen Ningning (*Vice Chairman*)

Mr. Zhu Jun

Mr. Tang Chi Fai

Mr. Liu Lei

Mr. Shen Xiaoling

Independent non-executive Directors

Mr. Yu Tung Ho

Mr. Gao Qingju

Mr. Wong Man Chung, Francis

(with professional qualification in accordance with the Listing Rules)

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(C) BOARD OF DIRECTORS *(Continued)*

A total of 6 Board meetings were held during the year. The individual attendance of each Director was as follows:

Number of Attendance

Mr. Han Jingyuan	6
Ms. Chen Ningning	1
Mr. Zhu Jun	6
Mr. Tang Chi Fai	6
Mr. Liu Lei	6
Mr. Shen Xiaoling	6
Mr. Yu Tung Ho	6
Mr. Gao Qingju	6
Mr. Wong Man Chung, Francis	6

The Board operates and exercises its power in accordance with the Bye-laws of the Company. In addition, the Board has also specifically resolved that all transactions/contracts/other matters of the Group that are subject to the disclosure requirement in accordance with the Listing Rules should be approved by the Board in advance.

The Board considers all the independent non-executive Directors are independent during the year.

Save as disclosed in the section of "Biographical Details of Directors and Senior Management" in the annual report of the Company, there are no relationships (including financial, business, family or other material/relevant relationships) among members of the Board.

(D) CHAIRMAN AND CHIEF EXECUTIVE OFFICER

During the year, the roles of the Chairman and the Chief Executive Officer of the Company are performed by Mr. Han Jingyuan.

(E) INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Gao Qingju and Mr. Yu Tung Ho have service contracts for a period of one year commencing from 23 December 2006. Mr. Wong Man Chung, Francis has service contract for a period of one year commencing from 25 August 2006.

The annual fee specified in each of Mr. Gao Qingju, Mr. Yu Tung Ho and Mr. Wong Man Chung, Francis's existing service contracts are HK\$300,000, HK\$350,000 and HK\$300,000 respectively.

(F) REMUNERATION OF DIRECTORS

The role and function of the remuneration committee of the Company (the "Remuneration Committee") are as follows:

- (a) to make recommendations to the Board on the Company's policy and structure for all remuneration of Directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;

(F) REMUNERATION OF DIRECTORS

(Continued)

- (b) to have the delegated responsibility to determine the specific remuneration packages of all executive Directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the Board of the remuneration of non-executive Directors;
- (c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the Board from time to time;
- (d) to review and approve the compensation payable to executive Directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the Company;
- (e) to review and approve compensation arrangements relating to dismissal or removal of Directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate; and

- (f) to ensure that no Director or any of his/her associates is involved in deciding his/her own remuneration.

The basis of the emolument payable to the Directors is determined with reference to the range of prevailing directors' fee for Director of listed companies in Hong Kong and is subject to the approval of the Remuneration Committee. The Remuneration Committee will consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the Directors, employment conditions elsewhere in the Group and desirability of performance-based remuneration.

The Chairman of the Remuneration Committee is Mr. Han Jingyuan. The remaining members are the three independent non-executive Directors, Mr. Gao Qingju, Mr. Yu Tung Ho and Mr. Wong Man Chung, Francis.

A total of 5 Remuneration Committee meetings were held during the year to discuss remuneration related matters. The individual attendance of each member was as follows:

Number of Attendance

Mr. Han Jingyuan	5
Mr. Gao Qingju	5
Mr. Yu Tung Ho	5
Mr. Wong Man Chung, Francis	5

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(F) REMUNERATION OF DIRECTORS

(Continued)

During the year, the work performed by the Remuneration Committee was as follows:

- reviewed and revised the Directors' fee;
- reviewed and approved the Directors and senior management's remuneration in the Company and subsidiaries of the Company; and
- reviewed and approved the granting of options to Directors and senior management of the Company.

(G) NOMINATION OF DIRECTORS

The Company did not have a nomination committee. The candidates for directorship during the year were selected by the senior management of the Company subject to the review and approval of the Board in accordance with the Bye-laws of the Company. The criteria adopted by the Board in selecting and approving candidates for directorship are based on whether the candidates are appropriate in term of experience and the potential contribution to the Group associated with the candidates' appointment.

(H) AUDITORS' REMUNERATION

The audit fee of the Group for 2006 was RMB3,300,000.

During the year, there were no significant non-audit service assignments being performed by the auditors of the Group.

(I) AUDIT COMMITTEE

The Company has set up an audit committee and the terms of reference adopted complied with the requirement of the Listing Rules.

The audit committee comprises all of the three independent non-executive Directors of the Company, Mr. Yu Tung Ho, Mr. Gao Qingju and Mr. Wong Man Chung, Francis. The chairman of the audit committee was elected by the members each time when it was held during the year.

The role and function of the audit committee are as follows:

- (a) to be primarily responsible for making recommendation to the Board on the appointment, reappointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor;
- (b) to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard. The audit committee should discuss with the auditor the nature and scope of the audit and reporting obligations before the audit commences;

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(I) AUDIT COMMITTEE *(Continued)*

- (c) to develop and implement policy on the engagement of an external auditor to supply non-audit services. The audit committee should report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;
- (d) to monitor integrity of financial statements of the Company and the Company's annual report and accounts, half-year report and, if prepared for publication, quarterly reports, and to review significant financial reporting judgements contained in them;
- (e) members of the committee must liaise with the Board, senior management and the qualified accountant and the committee must meet, at least once a year, with the Company's auditors and the committee should consider any significant or unusual items that are, or may need to be, reflected in such reports and accounts and must give due consideration to any matters that have been raised by the Company's qualified accountants, compliance officer or auditors;
- (f) to review the Company's financial controls, internal control and risk management systems;
- (g) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system;
- (h) to consider any findings of major investigations of internal control matters as delegated by the Board or on its own initiative and management's response;
- (i) where an internal audit function exists, to ensure co-ordination between the internal and external auditors, and to ensure that the internal audit function is adequately resourced and has appropriate standing within the Company, and to review and monitor the effectiveness of the internal audit function;
- (j) to review the Group's financial and accounting policies and practices;
- (k) to review the external auditor's management letter, any material queries raised by the auditor to management in respect of the accounting records, financial accounts or systems of control and management's response;
- (l) to ensure that the Board will provide a timely response to the issues raised in the external auditor's management letter;

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(I) AUDIT COMMITTEE *(Continued)*

- (m) to report to the Board on the matters set out in the above role and function; and
- (n) to consider other topics, as defined by the Board.

A total of 2 audit committee meetings were held during the year. The individual attendance of each member was as follows:

	Number of Attendance	Number of acting as chairman
Mr. Gao Qingju	2	1
Mr. Yu Tung Ho	2	0
Mr. Wong Man Chung, Francis	2	1

During the year, the work performed by the audit committee was mainly as follows:

- discussed and reviewed the interim and annual financial statements and internal control matters of the Group with senior management of the Company and the external auditors;
- communicated with the external auditors concerning the auditing procedures of the Group; and
- recommended to the Board on the reappointment of the external auditor, and to review and approve the remuneration and terms of engagement of the external auditor.

(J) DIRECTORS' RESPONSIBILITY IN PREPARING THE ACCOUNTS

The Directors acknowledge that they are responsible for the preparation of accounts which give a true and fair view of the Company and the Group.

(K) ANNUAL REVIEW OF THE EFFECTIVENESS OF THE INTERNAL CONTROL OF THE GROUP

The Directors have conducted a review of the effectiveness of the system of internal control of the Group during the year and have resolved that the system of internal control of the Group was effective during the year except for the following:

As stated in the announcement dated 11 April 2007, the Board announced that Hebei Jinxi Iron and Steel Company Limited ("Jinxi Limited") has signed a guarantee dated April 2006 to provide financial assistance in the form of guarantee to its fellow subsidiary, Foshan Jin Xi Jin Lan Cold Rolled Sheet Co., Ltd., which is a connected person (as defined in the Listing Rules) of the Group. Due to oversight and inadvertent misunderstanding of the Listing Rules by some of the management of the Group involved in the issuance of the guarantee, Jinxi Limited's entry into the guarantee and the provisions of the guarantee dated April 2006 was not being reported to the Company. As a result, the failures by the Company to notify the Stock Exchange and announce Jinxi Limited's entry into the guarantee and the provisions of the guarantee and to seek shareholders of the Company's approval as required under Chapter 14A of the Listing Rules constitutes a breach of Rule 14A.63 of the Listing Rules.

(K) ANNUAL REVIEW OF THE EFFECTIVENESS OF THE INTERNAL CONTROL OF THE GROUP *(Continued)*

Each of the Directors is aware and understands that each has undertaken to the Stock Exchange that in exercising each of their powers and duties as a director, each of them would comply to the best of his or her ability (and to procure the Company to comply) with the Listing Rules. However, in view of the facts surrounding the provision of the guarantee and in particular, the fact the Directors (other than the two executive Directors involved in issuing the guarantee, being Mr. Han and Mr. Shen) were not aware of Jinxi Ltd. entering into the guarantee, after discussion amongst the members of the Board, the Board considers that Mr. Han and Mr. Shen, as executive Directors of the Company and also more importantly as the directors and in respect of Mr. Shen only, deputy general manager of Jinxi Ltd. are mainly accountable for this breach of the Listing Rules.

In order to minimize the chance of breaching the Listing Rules by the Group in the future, the Company has adopted the following measures:

1. As preventive control, a letter has been issued by the Company to the general manager, deputy general manager and financial controller of subsidiaries of the Group to remind them to consult the financial controller and company secretary of the Company directly/indirectly for any possible transactions which may constitute notifiable transactions, connected transaction and/or other disclosures under the Listing Rules. In addition, they are urged to study

the previous training materials of the Listing Rules again and pay attention to the previous faxes/correspondence issued by the Company regarding compliance with the Listing Rules. Re-training of the Listing Rules will be given to the management who was involved in the granting of the existing guarantee so as to refresh their memory in due course.

2. In addition, the Board will, as soon as practicable and following further investigation and consideration of the Group's internal control needs, engage an appropriately experienced professional company to review and suggest ways to enhance the Group's overall internal control system.
3. As detective control, all subsidiaries of the Group are required to copy signed bank facilities agreement, guarantee agreement and asset pledge agreement to the Company for record unless waived by the Company.

The Company has set up the internal audit department in October 2006 and it is expected that the internal audit department will further enhance and strengthen the internal control system of the Group.

On Behalf of the Board
China Oriental Group Company Limited

Han Jingyuan
Chairman and Chief Executive Officer

Hong Kong, 3 April 2007