

The Company is committed to upholding good corporate governance practices. The corporate governance principles of the Company emphasise on an effective board, prudent internal and risk control, transparency and quality disclosure and accountability to shareholders.

The board of directors (the “Board”) and the management of the Company have been continually reviewing and enhancing the corporate governance practices with reference to local and international standards. The Board believes that its continued efforts in enhancing the Company’s corporate governance practices have, directly and indirectly, contributed to the strong business growth of the Company and its subsidiaries (the “Group”) in the past years. The Company is honoured to have received numerous awards from independent bodies recognising the Group’s achievements in business and management which include the following:

#### ***AsiaMoney***

- Year 2004, 2005 “Best Managed Companies (China, Medium Cap)”
- Year 2002, 2003 “Best Small Cap Company (China)”
- Year 2001, 2003 “Overall Best Managed Company (China)”

#### ***Yazhou Zhoukan***

- Year 2001, 2002, 2003, 2004, 2005, 2006 “Chinese Business 500”
- Year 2003, 2004, 2005 “Top 20 Chinese Enterprises of Assets Growth”
- Year 2002, 2003 “Top 20 Chinese Enterprises of Revenue Growth”

#### ***FinanceAsia***

- Year 2005 “The Best Small Cap”
- Year 2002 “Best Financial Management”
- Year 2001 “The Best Small Cap IPO”

#### ***Forbes Global***

- Year 2001, 2002, 2003 “The 200 Best Under a Billion”

#### ***EuroWeek***

- Year 2005 “Best Asian High Yield Bond Issue”

#### **The Hong Kong Management Association**

- Year 2006 “Honourable Mention, The Best Annual Reports Awards”

#### **Code on Corporate Governance Practices**

The Company has complied with the code provisions in the Code on Corporate Governance Practices (the “CG Code”) set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”). In addition, the Company has also further complied with those recommended best practices in the CG Code as set out herein.

The Group, having engaged a business consultancy firm to review the system of internal control and risk management, has implemented its recommendations and aimed to establish an integrated and comprehensive control platform for:

1. internal risks identification, reporting, assessment and management;
2. knowledge management and sharing;
3. internal auditing systems with emphasis on operation and financial audit as well as management control; and
4. standardisation of work flow with reference to established best practices.

**Code on Corporate Governance Practices (continued)**

Starting from 2006, the Group has engaged IBM Global Services (China) Company Limited (“IBM”) to implement Enterprise Resource Planning (“ERP”) and install SAP business software solutions. During the course of SAP development, all control points in our current operational and financial systems have been recognised, improved and implemented into SAP to ensure effective internal control. SAP also enhances the financial reporting system by providing more accurate and timely information.

In 2007, the Group will continue its effort in fortifying the effectiveness of SAP, with a view to raising the transparency of business operation and accessibility of management information within the Group. The internal control framework of the Group will be further strengthened under the implementation of SAP.

We summarise below each of the code provisions set out in the CG Code and the recommended best practices which the Company has complied with together with corresponding details of compliance.

**Compliance of the Code on Corporate Governance Practices****A. Directors****A.1 The Board****Code Principle**

The board should assume responsibility for leadership and be collectively responsible for directing and supervising the issuer’s affairs. Directors should make decision objectively in the interest of the issuer.

**Code Provisions****Compliance****Details of Compliance**

- | Code Provisions  | Compliance | Details of Compliance   |
|--|------------|---|
| <ul style="list-style-type: none"> <li>At least four regular board meetings a year.</li> </ul> | Yes        | <ul style="list-style-type: none"> <li>The Board meets at least on a quarterly basis. In 2006, a total of 12 Board meetings (including four regular Board meetings) were held. Details of Directors’ attendance record of Board meetings and Board committees meetings in 2006 are as follows:</li> </ul> |

**Board meeting**

Director	Attendance
Mr. Wang Yusuo	5/12 (4/4)*
Mr. Yang Yu	11/12 (4/4)*
Mr. Chen Jiacheng	5/12 (4/4)*
Mr. Zhao Jinfeng	6/12 (4/4)*
Mr. Qiao Limin	7/12 (4/4)*
Mr. Yu Jianchao	10/12 (4/4)*
Mr. Cheung Yip Sang	6/12 (4/4)*
Mr. Cheng Chak Ngok	12/12 (4/4)*
Ms. Zhao Baoju	6/12 (4/4)*
Mr. Jin Yongsheng	9/12 (4/4)*
Mr. Wang Guangtian	10/12 (4/4)*
Ms. Yien Yu Yu, Catherine	11/12 (4/4)*
Mr. Kong Chung Kau	12/12 (4/4)*

\* regular Board meeting

## Compliance of the Code on Corporate Governance Practices (continued)

### A.1 The Board (continued)

Code Provisions	Compliance	Details of Compliance																										
		<p><b>Audit Committee meeting</b></p> <table border="1"> <thead> <tr> <th><i>Committee member</i></th> <th><i>Attendance</i></th> </tr> </thead> <tbody> <tr> <td>Mr. Wang Guangtian</td> <td>2/3</td> </tr> <tr> <td>Ms. Yien Yu Yu, Catherine</td> <td>3/3</td> </tr> <tr> <td>Mr. Kong Chung Kau</td> <td>3/3</td> </tr> </tbody> </table> <p><b>Remuneration Committee meeting</b></p> <table border="1"> <thead> <tr> <th><i>Committee member</i></th> <th><i>Attendance</i></th> </tr> </thead> <tbody> <tr> <td>Mr. Yang Yu</td> <td>2/2</td> </tr> <tr> <td>Mr. Wang Guangtian</td> <td>2/2</td> </tr> <tr> <td>Ms. Yien Yu Yu, Catherine</td> <td>2/2</td> </tr> <tr> <td>Mr. Kong Chung Kau</td> <td>2/2</td> </tr> </tbody> </table> <p><b>Convertible Bond Committee meeting</b></p> <table border="1"> <thead> <tr> <th><i>Committee member</i></th> <th><i>Attendance</i></th> </tr> </thead> <tbody> <tr> <td>Mr. Yang Yu</td> <td>31/31</td> </tr> <tr> <td>Mr. Yu Jianchao</td> <td>31/31</td> </tr> <tr> <td>Mr. Cheng Chak Ngok</td> <td>31/31</td> </tr> </tbody> </table>	<i>Committee member</i>	<i>Attendance</i>	Mr. Wang Guangtian	2/3	Ms. Yien Yu Yu, Catherine	3/3	Mr. Kong Chung Kau	3/3	<i>Committee member</i>	<i>Attendance</i>	Mr. Yang Yu	2/2	Mr. Wang Guangtian	2/2	Ms. Yien Yu Yu, Catherine	2/2	Mr. Kong Chung Kau	2/2	<i>Committee member</i>	<i>Attendance</i>	Mr. Yang Yu	31/31	Mr. Yu Jianchao	31/31	Mr. Cheng Chak Ngok	31/31
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<ul style="list-style-type: none"> <li>Opportunity to all directors to include matters in the agenda for regular board meetings.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Directors are consulted as to items to be included and items which the Directors may wish to include in the agenda for regular Board meetings before the finalised version of the relevant agenda is dispatched to the Directors.</li> </ul>																										
<ul style="list-style-type: none"> <li>At least 14 days notice given to all directors prior to a regular board meeting.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Notice of a regular Board meeting is given to all Directors not less than 14 days prior to such meeting. The relevant papers and documents are given to all Directors not less than 3 days prior to such meeting.</li> </ul>																										
<ul style="list-style-type: none"> <li>Access to advice and services of the company secretary.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The company secretary of the Company (the "Company Secretary") is responsible for company secretarial matters of the Group, including Board procedures and corporate governance practices compliance.</li> <li>In addition, the Company retains legal advisers and company secretarial services provider to provide legal advice and secretarial services to the Company.</li> <li>All Directors have access to the services and advice of the Company Secretary.</li> </ul>																										

### Compliance of the Code on Corporate Governance Practices (continued)

#### A.1 The Board (continued)

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Minutes of meetings kept by company secretary and available for inspection.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>All Board and Board committees minutes and records are kept by the Company Secretary and will be available for inspection in Hong Kong by any Directors.</li> </ul>
<ul style="list-style-type: none"> <li>Draft and final minutes of board meetings sent to all directors for comments and records, in both cases, within a reasonable time.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Draft minutes of a Board meeting will be prepared by the Company Secretary and circulated to all the Directors for review and comment, and final version of the Board minutes will be sent to all Directors for record as soon as practicable after the relevant Board meeting.</li> </ul>
<ul style="list-style-type: none"> <li>Agreed procedure for directors to seek independent professional advice at the company's expense.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has adopted a written procedure for the Directors to seek independent professional advice at the Company's expense.</li> </ul>
<ul style="list-style-type: none"> <li>If a substantial shareholder/director (or any of his/her associates) has a conflict of interest in a matter which the Board has determined to be material, a board meeting should be held. The director having interest in the matter must abstain from voting and not be counted in quorum. Independent non-executive directors who, and whose associates, have no material interest in the transaction should be present at such board meeting.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Articles of Association of the Company stipulate that subject to certain exceptions contained therein, a Director shall not be entitled to vote on (nor shall be counted in the quorum in relation thereto) any resolution of the Board in respect of any contract or arrangement or any other proposal whatsoever in which he/she has any material interest, and if he/she shall do so his/her vote shall not be counted (nor will he/she be counted in the quorum for the resolution).</li> <li>It is the practice of the Board to hold a meeting to decide on any matter in which a substantial shareholder or a Director (or any of its/his/her associates) has a material interest and to request for presence of independent non-executive Directors.</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

### A.1 The Board (continued)

Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Insurance cover in respect of legal action against directors.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>There is in place a directors &amp; officers liabilities insurance covering the Directors and officers of the Group.</li> </ul>
<ul style="list-style-type: none"> <li>Board committees should adopt broadly the same principles and procedures.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Currently, there are three Board committees, being the Audit Committee, the Remuneration Committee and the Convertible Bond Committee. All Board committees adopt broadly the same principles and procedures applicable to the Board as stated in this Section A.1 hereinabove.</li> </ul>

### A.2 Chairman and chief executive officer

#### Code Principle

The management of the board and the day-to-day management of the issuer's business should be clearly divided and separately undertaken by different officers to ensure a balance of power and authority.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Roles and responsibilities of chairman and chief executive officer should be separate and clearly established and set out in writing.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The roles and responsibilities of the chairman (the "Chairman") and the chief executive officer (the "CEO") of the Company are separate and clearly set out in writing.</li> <li>Mr. Wang Yusuo, the Chairman, is responsible for overseeing the Group's overall direction and strategic planning. In addition, the Chairman also plays a key role in driving all Directors to actively contribute to the Board affairs and establishing good corporate governance practices and procedures.</li> <li>Mr. Yang Yu, the CEO, is responsible for managing the business of the Group, executing the strategies and decisions of the Board, and managing the day-to-day operations of the Group.</li> <li>Apart from acting as a director or chief executive officer in a number of companies owned and controlled by Mr. Wang Yusuo and/or his family, Mr. Yang Yu has no other relationship with Mr. Wang Yusuo.</li> </ul>
<ul style="list-style-type: none"> <li>The chairman should ensure all directors be briefed on issues arising at board meetings.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Currently, the Chairman is responsible for provision of the necessary information, either through himself or other members of the management, to all Directors on issues arising at the Board meeting.</li> </ul>
<ul style="list-style-type: none"> <li>The chairman should ensure that directors receive adequate information.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has established procedure regarding supply and access of information (see Section A.6 below). Further, the Chairman will upon request provide the necessary information, either through himself or other members of the management, to all Directors for discharging their duties.</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

## A.2 Chairman and chief executive officer (continued)

Recommended Best Practice	Compliance	Details of compliance
<p>Various recommended roles for chairman including:</p> <ul style="list-style-type: none"> <li>Ensuring establishment of good corporate governance practices and procedures.</li> <li>Encourage directors to make a full and active contribution to board affairs.</li> <li>Facilitate the effective contribution of non-executive directors and ensure constructive relations between executive and non-executive directors.</li> <li>Ensure effective communication with shareholders and views of shareholders are communicated to the board as a whole.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Chairman plays a key role in ensuring good corporate governance practices and encouraging active participation and constructive contribution and relations of the Directors.</li> <li>The Board has taken the following measures in relation to corporate governance practices: <ol style="list-style-type: none"> <li>the Board has adopted guidelines regarding: <ol style="list-style-type: none"> <li>the roles and responsibilities of the Board and the senior management;</li> <li>the procedure for the Directors to seek independent professional advice at the Company's expenses;</li> <li>the division of responsibilities between the Chairman and the CEO; and</li> <li>dealing in the securities of the Company by employees of the Group; and</li> </ol> </li> <li>the Company arranged training programmes and seminars on various topics covering, inter alia, matters relating to strategy and management of companies, corporate governance and leadership for the Directors and the management members.</li> </ol> </li> </ul>



## Compliance of the Code on Corporate Governance Practices *(continued)*

### A.3 Board composition

#### **Code Principle**

The board should have a balance of skills and experience appropriate for the requirements of the business of the issuer. The board should also include a balanced composition of executive and non-executive directors (including independent non-executive directors) to ensure that independent judgment can be made effectively.

#### **The Company's Board**

The Board currently comprises eight executive Directors, two non-executive Directors and three independent non-executive Directors. As at 31 December 2006, the Board members were as follows:

Mr. Wang Yusuo	(Chairman and executive Director)
Mr. Yang Yu	(CEO and executive Director)
Mr. Chen Jiacheng	(Executive Director)
Mr. Zhao Jinfeng	(Executive Director)
Mr. Qiao Limin	(Executive Director)
Mr. Yu Jianchao	(Executive Director)
Mr. Cheung Yip Sang	(Executive Director)
Mr. Cheng Chak Ngok	(Executive Director)
Ms. Zhao Baoju	(Non-executive Director)
Mr. Jin Yongsheng	(Non-executive Director, re-designated on 5 June 2006)
Mr. Wang Guangtian	(independent non-executive Director)
Ms. Yien Yu Yu, Catherine	(independent non-executive Director)
Mr. Kong Chung Kau	(independent non-executive Director)

During the year under review, Mr. Jin Yongsheng was re-designated from an Executive Director to a Non-executive Director with effect from 5 June 2006.

For qualifications, experience, expertise and relationships (if any) of the Board members, please refer to the biographies of the Directors on pages 32 to 35 of this Annual Report.

#### **Roles and functions**

The Board is responsible for formulating strategic business development, reviewing and monitoring the business performance of the Group, as well as preparing and approving financial statements. The Board gives clear directions as to the powers delegated to the management for the administrative and management functions of the Group. Such arrangements are reviewed by the Board on a periodic basis and appropriate adjustments may, from time to time, be made to ensure the decisions of the Board can be carried out effectively.

For the year ended 31 December 2006, the Board:

1. reviewed the performance of the Group and formulated business strategy of the Group;
2. reviewed and approved the annual results of the Group for the year ended 31 December 2005 and the interim results of the Group for the 6 months period ended 30 June 2006;
3. reviewed the effectiveness of the system of internal control and risk management of the Group;
4. reviewed the amendments to the Articles of Association and general mandates to issue and repurchase shares of the Company; and
5. reviewed connected transactions of the Group.

**Compliance of the Code on Corporate Governance Practices (continued)****A.3 Board composition (continued)****Board committees**

Currently, the Board has established the following committees with defined terms of reference:

1. Convertible Bond Committee;
2. Audit Committee; and
3. Remuneration Committee.

The Convertible Bond Committee was established on 2 August 2005 and consists of the following members:

Mr. Yang Yu	(Executive Director and chairman of the Convertible Bond Committee)
Mr. Yu Jianchao	(Executive Director)
Mr. Cheng Chak Ngok	(Executive Director and Company Secretary)

The Convertible Bond Committee is primarily responsible for reviewing the validity of conversion notices given by holders of the convertible bonds issued by the Company and to determine either issuing new shares of the Company or making cash payment in lieu of new shares to such holders in accordance with the terms of the convertible bonds.

In 2006, the Convertible Bond Committee met 31 times. Attendance record of the convertible bonds members is set out Section A.1 above.

Further details of the Remuneration Committee and the Audit Committee are set out in Sections B.1 and C.3 below respectively.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>• Identify the independent non-executive directors in all corporate communications that disclose the names of directors of the issuer.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>• The names of all Directors and their titles (including Chairman, Chief Executive Officer, executive Directors, non-executive Directors and independent non-executive Directors) are disclosed in all corporate communications that disclose the names of the Directors, including annual reports, announcements, circulars to shareholders, notices of general meetings and in the Company's website at <a href="http://www.xinaogas.com">www.xinaogas.com</a>.</li> </ul>

Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>• Maintain on the website an updated list of directors identifying their roles, functions and (where applicable) whether they are independent non-executive directors.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>• Biographies of the Directors, including their titles, roles and responsibilities, are maintained on the Company's website at <a href="http://www.xinaogas.com">www.xinaogas.com</a> and updated from time to time.</li> </ul>





## Compliance of the Code on Corporate Governance Practices *(continued)*

### A.4 Appointment, re-election and removal

#### Code Principle

There should be a formal, considered and transparent procedure for the appointment of new directors to the board. All directors should be subject to re-election at regular intervals.

Currently, the Company does not have a nomination committee for appointment of new Directors to the Board. The responsibilities of identifying and selecting suitably qualified individuals to become members of the Board are undertaken by the Board collectively. Where the Board considers necessary or desirable to appoint a new member to the Board (whether to fill a casual vacancy or otherwise), each member of the Board may nominate suitable individual(s) as candidate(s) of member(s) of the Board for the decision of the Board.

In selecting a suitable candidate to become a member of the Board, the Board will consider various criteria such as education, qualification, experience, skills and possible contribution of such candidate.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Non-executive directors should be appointed for a specific term, subject to re-election.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Currently, the term of appointment of all non-executive Directors (including independent non-executive Directors) are three years subject to retirement by rotation in accordance with the Articles of Association of the Company.</li> </ul>
<ul style="list-style-type: none"> <li>Every director should be subject to retirement by rotation at least once every three years.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company's Articles of Association stipulate that every Director will be subject to retirement by rotation at least once every three years.</li> </ul>
<ul style="list-style-type: none"> <li>All directors appointed to fill a casual vacancy should be subject to election at the first general meeting after appointment.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company's Articles of Association stipulate that a Director appointed to fill a casual vacancy will be subject to election at the next general meeting after appointment.</li> </ul>
Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Further appointment of an independent non-executive director serving more than nine years requires (i) separate shareholders approval and (ii) explanatory statement to shareholders to provide information on his continual independence.</li> <li>Information to shareholders regarding the independence of the independent non-executive director proposed to be appointed.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Currently, none of the independent non-executive Directors has served the Company for more than nine years. The Company will comply with this recommended best practice as and when the situation occurs.</li> <li>It is the current practice of the Company that a separate resolution will be proposed at the general meeting for shareholders' approval in respect of each Director nominated for election or re-election.</li> <li>Where Directors are subject to election or re-election at a general meeting, a circular will be issued in which detailed biographies, interests and (where appropriate) independence of such Directors will be disclosed.</li> </ul>

**Compliance of the Code on Corporate Governance Practices (continued)****A.5 Responsibilities of directors****Code Principle**

All directors (including non-executive directors) shall keep abreast of their responsibilities as a director of an issuer, and of the conduct, business activities and development of such issuer.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Every newly appointed director should receive a comprehensive, formal induction to ensure that he/she has proper understanding of the business and his/her responsibilities under regulatory requirements, business and governance policies of the issuer.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board will provide information memorandum on director's duties and obligations under the Cayman Islands laws, the Hong Kong laws and the Listing Rules to a newly appointed Director to assist such Director to understand his/her responsibilities.</li> <li>The Board will also arrange for a meeting between the Company's legal advisers and a newly appointed Director in which the Company's legal advisers will explain to such Director his/her responsibilities under the relevant legal and regulatory requirements.</li> <li>In addition, the Company will provide relevant information and organize various activities to ensure the newly appointed Director properly understands the business and governance policies of the Company. The newly appointed Director will be given opportunities to raise questions and give comments.</li> </ul>
<ul style="list-style-type: none"> <li>Functions of non-executive directors include:               <ul style="list-style-type: none"> <li>bringing an independent judgment at board meetings.</li> <li>taking the lead where potential conflicts of interests arise.</li> <li>serving on committees if invited.</li> <li>scrutinising the issuer's performance.</li> </ul> </li> </ul>	Yes	<ul style="list-style-type: none"> <li>Non-executive Directors are consulted as to the matters to be included for discussion at the Board meetings and are provided with opportunities to raise questions or comments at Board meetings.</li> <li>In relation to each connected transaction or continuing connected transaction of the Company that requires independent shareholders' approval, the independent non-executive Directors will give independent opinion on the transaction.</li> <li>All the independent non-executive Directors are members of the Audit Committee and the Remuneration Committee; both committees serve the function of scrutinising the Company.</li> </ul>
<ul style="list-style-type: none"> <li>Directors should ensure that they can give sufficient time and attention to the affairs of the issuer.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>There have been satisfactory attendances in general for Board meetings and Board committees meetings. Please refer to Directors' attendance record of Board meetings and Board committees meetings (see Section A.1.)</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

### A.5 Responsibilities of directors (continued)

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Directors must comply with their obligations under the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 of the Listing Rules regarding their securities transactions.</li> <li>The board should establish written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealing in securities of the issuer.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company has adopted the Model Code as the code of conduct regarding securities transaction by the Directors of the Company. Each Director is specifically required to confirm with the Company that he/she has complied with the required standard set out in the Model Code at least twice each year and there has not been any non-compliance by any Director in this respect.</li> <li>The Company has adopted written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealing in securities of the Company.</li> </ul>
Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Directors should participate in a programme of continuous professional development.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>In 2006, the Company organized 16 internal training programmes and seminars for the Directors and the senior management on various matters relating to corporate governance, leadership, strategy, management, corporate culture and SAP implementation. There have been satisfactory attendances in general.</li> </ul>
<ul style="list-style-type: none"> <li>Directors should disclose to the issuer at the time of his appointment (and on periodic basis) offices held in other organisations and other significant commitments.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Details of a Director, including the offices held by such Director in other organisations and other significant commitments are kept by the Company Secretary, and updated at least once a year. Biography of each Director is updated from time to time and confirmed by such Director before being published in the Company's annual report and circulars.</li> <li>Executive Directors who intend to accept any directorship or appointment in other companies or entities would need to consult and obtain prior approval from the Board before acceptance.</li> </ul>
<ul style="list-style-type: none"> <li>Non-executive directors should ensure regular attendance of and active participation in board committees, board meetings and general meetings.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>During the year under review, the non-executive Directors have actively participated in Board meetings, Board committees meetings (if invited) (see Section A.1) and general meetings in general.</li> </ul>
<ul style="list-style-type: none"> <li>Non-executive directors should make a positive contribution to the development of the issuer's strategy and policies through independent, constructive and informed comments.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>During the year under review, the non-executive Directors have satisfactorily discharged their duties.</li> </ul>

**Compliance of the Code on Corporate Governance Practices (continued)****A.6 Supply of and access to information****Code Principle**

Directors should be provided in a timely manner with appropriate information in such form and of such quality as will enable them to make an informed decision and to discharge their duties and responsibilities as director of an issuer.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Agenda and papers for regular board meetings should be sent in full to all directors at least three days before the date of such board meetings.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Agenda and Board papers are currently sent in full to all Directors at least three days before the date of a regular Board meeting.</li> </ul>
<ul style="list-style-type: none"> <li>Each director should have separate and independent access to senior management.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Senior management will meet, formally and informally, with the Directors from time to time and as requested by the Directors.</li> </ul>
<ul style="list-style-type: none"> <li>Directors are entitled to have access to board papers and related materials and steps must be taken to respond promptly and fully to director queries.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Papers relating to Board meetings will be circulated to the Directors who may request for further information. Draft minutes of a Board meeting will be circulated to all the Directors for review and comment prior to the same being finalised. Board minutes will be sent to the Directors for record after the meeting.</li> <li>Board and committees minutes and papers are available for inspection by Directors and Board committees members.</li> <li>Each Director will be given the opportunity to raise questions or provide comments at Board meetings, and his/her questions will be answered at the meeting or promptly thereafter. Comments will be noted and relevant action will be taken (if appropriate) after discussion.</li> </ul>

## Compliance of the Code on Corporate Governance Practices *(continued)*

### B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

#### B.1 *The level and make-up of remuneration and disclosure*

##### **Code Principle**

An issuer should establish a formal and transparent procedure for setting policy on executive directors' remuneration and for fixing the remuneration package for all directors. No director should be involved in deciding his own remuneration.

##### **Remuneration Committee**

The Remuneration Committee was established on 31 December 2004 and currently consists of the following members:

Mr. Yang Yu	(Executive Director, CEO and chairman of the Remuneration Committee)
Mr. Wang Guangtian	(Independent non-executive Director)
Ms. Yien Yu Yu, Catherine	(Independent non-executive Director)
Mr. Kong Chung Kau	(Independent non-executive Director)

The Remuneration Committee is primarily responsible for the following duties:

1. 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 the policy on such remuneration;
2. to have the delegated responsibilities to determine the specific remunerations packages of all executive Directors and senior management;
3. to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the Board from time to time;
4. 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;
5. 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;
6. to make recommendations to the Board on the remuneration for non-executive Directors;
7. to ensure that no Director or any of his associates is involved in deciding his own remuneration;
8. to consult the Chairman and/or the CEO about their proposals relating to the remuneration of executive Directors and have access to professional advice if considered necessary; and
9. to report to the Board.

The Remuneration Committee met twice during the year under review considering the remuneration of and share options granted to the Directors and senior management. Attendance record of the Remuneration Committee members is set out in Section A.1 above.

**Compliance of the Code on Corporate Governance Practices (continued)***B.1 The level and make-up of remuneration and disclosure (continued)*

<b>Code Provisions</b>	<b>Compliance</b>	<b>Details of Compliance</b>
<ul style="list-style-type: none"> <li>Remuneration committee should be established with specific written terms of reference (containing the minimum prescribed details as set out in paragraph B.1.3 of Appendix 14 to the Listing Rules) and should be available on request.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company has established a Remuneration Committee with terms of reference which meet the requirements as set out in paragraph B.1.3 of Appendix 14 to the Listing Rules.</li> <li>The terms of reference of the Remuneration Committee are posted on the Company's website and will be available on request.</li> </ul>
<ul style="list-style-type: none"> <li>The remuneration committee should consult the chairman and/or chief executive officer regarding proposed remuneration of other executive directors and have access to professional advice if necessary.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The terms of reference of the Remuneration Committee provide that the committee should consult the Chairman and/or the CEO about proposed remuneration of other executive Directors.</li> <li>The Remuneration Committee will consult the Chairman and/or the CEO before making recommendation on remuneration to the Board and will seek independent professional advice as and when necessary.</li> </ul>
<ul style="list-style-type: none"> <li>The remuneration committee should be provided with sufficient resources to discharge its duties.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The terms of reference of the Remuneration Committee provide that members of the Remuneration Committee may seek outside legal and independent professional advice as and when necessary at the costs of the Company.</li> <li>In addition, the Board and the senior management will give full support to the Remuneration Committee.</li> </ul>
<b>Recommended Best Practice</b>	<b>Compliance</b>	<b>Details of compliance</b>
<ul style="list-style-type: none"> <li>Where the board resolves to approve any remuneration which the remuneration committee has previously resolved not to approve, the board must disclose the reasons for its resolution in its next annual report.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has not resolved to approve any remuneration which the Remuneration Committee has previously resolved not to approve. The Board will disclose the reasons in the next annual report if such circumstances occur in the future.</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

### C. ACCOUNTABILITY AND AUDIT

#### C.1 Financial reporting

##### Code Principle

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

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Management should provide explanation on financial and other information to enable the board to make informed assessment.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Directors are provided with general financial information with explanation thereof (if appropriate) of the Group on a regular basis. Moreover, the management also regularly meets with the Directors to present results and discuss any variance between the budget and the actual results (if any).</li> </ul>
<ul style="list-style-type: none"> <li>Acknowledgement of directors' responsibility for preparing the accounts and a statement by the auditors regarding reporting responsibilities in auditors' report.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>A statement of Directors' responsibilities for financial statements is set out in the interim and annual reports.</li> <li>Auditors' reporting responsibilities statement is set out in the auditors' report.</li> </ul>
<ul style="list-style-type: none"> <li>Board's responsibility to present a balanced, clear and understandable assessment in annual/interim reports, price-sensitive announcements and other financial disclosures/reports under regulatory requirements.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board is collectively responsible for ensuring clear and understandable assessment in annual/interim reports, price-sensitive announcement and other financial disclosures/reports under regulatory requirements. In addition, the Audit Committee has been established to monitor the integrity of financial statements of the Company.</li> </ul>

#### C.2 Internal controls

##### Code Principle

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

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>The directors should at least annually conduct a review of the effectiveness of the system of internal control.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has conducted a review of the effectiveness of the system of internal control and risk management of the Group covering all material controls including financial, operational and compliance controls, and risk management functions for the year 2006.</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

## C.2 Internal controls (continued)

Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Issuers should disclose as part of the Corporate Governance Report a narrative statement how they have complied with the code provisions on internal control during the reporting period.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board is responsible for the Group's system of internal control and risk management and for reviewing its effectiveness.</li> <li>Starting from 2006, the Group has engaged IBM to implement ERP and install SAP. During the course of SAP development, all control points in our current operational and financial system have been recognized, reviewed and improved. SAP also enhances the financial reporting system by providing more accurate and timely information.</li> <li>The Group has established written procedures and an assessment system on assessing the effectiveness of the system of internal control and risk management of the Group.</li> <li>A designated inspection team has been established to perform the internal control and risk management work of the Group with reference to established procedures and an assessment system.</li> <li>Reports on each subsidiary of the Group will be produced for consideration.</li> <li>The designated team will monitor the performance of those subsidiaries with low assessment results and will give advice on measures to be taken by such subsidiaries.</li> <li>During the year under review, some internal control weaknesses have been found and corrected. There have not been any significant problems relating to the internal control aspects of the Group.</li> </ul>



## Compliance of the Code on Corporate Governance Practices *(continued)*

### C.3 Audit committee

#### **Code Principle**

The board should establish formal and transparent arrangements for considering how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors. The audit committee should be established with a clear terms of reference.

#### **Audit Committee**

The Audit Committee was established on 28 March 2001 and currently consists of the following members:

Mr. Wang Guangtian	(Independent non-executive Director and chairman of the Audit Committee)
Ms. Yien Yu Yu, Catherine, CFA	(Independent non-executive Director)
Mr. Kong Chung Kau, CPA	(Independent non-executive Director)

The Audit Committee is primarily responsible for the following duties:

1. to make 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;
2. to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard;
3. to develop and implement policy on the engagement of an external auditor to supply non-audit services; and
4. to monitor integrity of financial statements of the Company and the Company's annual report and accounts, interim report and to review significant financial reporting judgments contained in them.

The Audit Committee met 3 times during the year under review considering the interim and annual results of the Group and discussing with the auditors on the impact on any change of accounting policies, the scope of work regarding the annual audit, interim review and the remuneration of the auditors. Attendance record of the Audit Committee members is set out in Section A.1 above.

#### **Auditors' remuneration**

For the year ended 31 December 2006, audit and non-audit services provided to the Group by Deloitte Touche Tohmatsu, the auditors of the Company, and the amounts of remuneration paid and payable in connection therewith are as follows:

<b>Services</b>	<b>Approximate Amount</b>
Audit services for the year 2006	
• Audit fee paid – Interim review	HK\$700,000
• Audit fee payable – Final results (subject to final agreement with the auditors)	HK\$3,900,000
Non-audit services for the year 2006	
• Fee paid for agree-upon procedures in respect of connected transactions of the Group and other miscellaneous services	HK\$60,300

The Audit Committee is of the view that the auditors' independence was not affected by the provision of the abovementioned non-audit services to the Group.

## Compliance of the Code on Corporate Governance Practices (continued)

## C.3 Audit committee (continued)

Code Provisions	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Minutes should be kept by a duly appointed secretary and should be sent to all committee members within a reasonable time.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Audit Committee minutes and papers are kept by the Company Secretary. Draft Audit Committee minutes is circulated to all the committee members for review and comment and final version of the minutes will be sent to all the committee members for record, as soon as practicable after the relevant Audit Committee meeting.</li> </ul>
<ul style="list-style-type: none"> <li>A former partner of the existing auditors should not sit on the Audit Committee.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>None of the Audit Committee members is a former partner of the external auditors of the Group.</li> </ul>
<ul style="list-style-type: none"> <li>The terms of reference of audit committee should contain the minimum prescribed details in paragraph C.3.3 of Appendix 14 to the Listing Rules and should be made available on request.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company has established an Audit Committee with terms of reference which meet the requirements as set out in paragraph C.3.3 of Appendix 14 to the Listing Rules.</li> <li>The terms of reference of the Audit Committee are posted on the Company's website and will be available on request. The primary responsibilities of the Audit Committee are set out therein.</li> </ul>
<ul style="list-style-type: none"> <li>Where the board disagrees with the audit committee's view on the selection, appointment, resignation or dismissal of the external auditors, the issuer should include in the Corporate Governance Report the audit committee's recommendation and the board's view.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has not had any disagreement with the Audit Committee on the selection, appointment, resignation or dismissal of external auditors. Should there be such a disagreement, the Board will include the relevant details in its Corporate Governance Report.</li> </ul>
<ul style="list-style-type: none"> <li>The audit committee should be provided with sufficient resources to discharge its duties.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The terms of reference of the Audit Committee provide that the members of the Audit Committee may seek outside legal or other independent professional advice as and when necessary at the costs of the Company.</li> <li>In addition, the Board and the senior management will give full support to the Committee.</li> </ul>

## Compliance of the Code on Corporate Governance Practices (continued)

### D. DELEGATION BY THE BOARD

#### D.1 Management functions

##### Code Principle

An issuer should have a formal schedule of matters specifically reserved to the board for its decision. The board should give clear directions to management as to the matters that must be approved by the board before decisions are made on behalf of the issuer.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>The board must give clear directions as to the powers of management, including circumstances where management should obtain prior approval from the board.</li> <li>Formalise the functions reserved to the board and those delegated to management.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Board has set out in writing clear division of the responsibilities of the Board and the senior management. In general, the Board is responsible for establishing the strategies and direction of the Group, setting objectives and business development plans, monitoring the performance of the senior management, and ensuring good corporate governance. The senior management, which is led by the CEO, is responsible for executing the strategies and plans set by the Board, and reporting to the Board periodically to ensure proper execution.</li> </ul>
Recommended Best Practice	Compliance	Details of compliance
<ul style="list-style-type: none"> <li>Disclosure of division of responsibility between the board and management to assist those affected by corporate decisions to better understand their respective accountabilities.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company has written internal guidelines setting out the division of responsibilities between the Board and management of the Company. In addition, the Board has made such disclosure to the Directors, the management and other staff by various means including internal circulars and meetings with management and staff.</li> </ul>
<ul style="list-style-type: none"> <li>Formal letters of appointment for directors setting out the key terms and conditions relative to their appointment so that directors understand the delegation arrangements.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>It is the practice of the Company to enter into a (i) written service contract with each executive Director setting out the rights, obligation, duties, responsibilities and other terms and conditions of his/her appointment, and (ii) a letter of appointment with each non-executive Director confirming the terms of his/her appointment.</li> </ul>

**Compliance of the Code on Corporate Governance Practices (continued)***D.2 Board committees***Code Principle**

Board committees should be formed with specific written terms of reference which deal clearly with the committees' authority and duties.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Clear terms of reference to enable proper discharge of committee functions.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The Company currently has three Board committees, being the Audit Committee, the Remuneration Committee and the Convertible Bond Committee, each of which has clear written terms of reference setting out details of the authorities and duties of such committee.</li> <li>The terms of reference of the abovementioned Board committees will be available on request.</li> </ul>
<ul style="list-style-type: none"> <li>The terms of reference should require committees to report back to the board their decisions.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The terms of reference of each of the Board committees contain provisions which require such Board committee to report back to the Board any decision made by it.</li> </ul>

**E. COMMUNICATION WITH SHAREHOLDERS***E.1 Effective communication***Code Principle**

The board should endeavour to maintain an on-going dialogue with shareholders and, in particular, use annual meetings or other general meetings to communicate with shareholders and encourage their participation.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>A separate resolution should be proposed by the chairman for each substantially separate issue.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>Separate resolutions are proposed at general meeting on each substantially separate issue. For example, a separate resolution will be proposed for each director nominated for election or re-election.</li> </ul>
<ul style="list-style-type: none"> <li>The chairman of the board should attend the annual general meeting and arrange for the chairmen of the audit, remuneration and nomination committees (as appropriate) or in the absence of the chairman of such committees, another member of the committee to be available to answer questions at the annual general meeting.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>In the year under review, the Company held one annual general meeting.</li> <li>The Chairman and two members of the Audit Committee and the Remuneration Committee attended the said annual general meeting in 2006.</li> </ul>
<ul style="list-style-type: none"> <li>The chairman of the independent board committee (if any) should also be available to answer questions at any general meeting to approve a connected transaction or any other transaction that is subject to independent shareholders' approval.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>During 2006, there was no general meeting for approving a connected transaction or any other transaction that is subject to independent shareholders' approval.</li> </ul>

## Compliance of the Code on Corporate Governance Practices *(continued)*

### E.2 Voting by poll

#### Code Principle

The issuer should regularly inform shareholders of the procedure for voting by poll and ensure compliance with the requirements about voting by poll contained in the Listing Rules and the constitutional documents of the issuer.

Code Provisions	Compliance	Details of Compliance
<ul style="list-style-type: none"> <li>Disclosure in general meeting circulars of procedures and rights of shareholders to demand a poll.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>The rights and the procedure for demanding a poll stipulated in the Articles of Association of the Company are in compliance with the requirements of the Listing Rules. Such rights and procedures are set out in the circular accompanying the notice of general meeting dispatched to shareholders. The poll procedures are also explained to shareholders at general meetings.</li> </ul>
<ul style="list-style-type: none"> <li>Ensure that votes cast are properly counted and recorded.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>It is the practice of the Company to appoint representatives of the share registrar of the Company as scrutineer for the voting procedure.</li> </ul>
<ul style="list-style-type: none"> <li>Chairman of meeting should adequately explain the procedures for demanding a poll by shareholders and the poll procedures at the commencement of meeting.</li> </ul>	Yes	<ul style="list-style-type: none"> <li>At the annual general meeting held in the year under review, the chairman explained the procedures for demanding a poll by shareholders and the poll procedures at the commencement of the meeting.</li> </ul>

## Additional Corporate Governance Information

### I. Shareholders' rights

The Company is committed to ensure shareholders' interest. To this end, the Company communicates with its shareholders through various channels, including annual general meetings, extraordinary general meetings (if any), annual reports, notices of general meetings, circulars sent to shareholders, announcements, press releases and other corporate communications available on the Company's website.

Registered shareholders are notified by post for the shareholders' meetings. Any registered shareholder is entitled to attend annual and extraordinary general meetings of the Company provided that their shares have been fully paid up and recorded in the register of members of the Company. In respect the financial year ended 31 December 2006, an annual general meeting of the Company will be held on 29 May 2007 and it is currently expected that interim results for the six months ended 30 June 2007 will be announced in September 2007.

Pursuant to article 72 of the Articles of Association of the Company, any two or more members of the Company or any one member of the Company which is a recognised clearing house (or its nominee(s)) may convene a general meeting by depositing at the principal office of the Company in Hong Kong the written requisition specifying the objects of the meeting and signed by the requisitioner(s), provided that such requisitioner(s) hold(s) as at the date of deposit of the requisition not less than one-tenth of the paid up capital of the Company which carries the right of voting at general meetings of the Company.

If the Board does not within 21 days from the date of deposit of the requisition proceed duly to convene the meeting, the requisitioner(s) themselves or any of them representing more than one-half of the total voting rights of all of them, may convene the general meeting in the same manner, as nearly as possible, as that in which meetings may be convened by the Board provided that any meeting so convened shall not be held after the expiration of three months from the date of deposit of the requisition, and all reasonable expenses incurred by the requisitioner(s) as a result of the failure of the Board shall be reimbursed to the requisitionists by the Company.

Shareholders can make enquiries or proposals to the Company by putting their enquiries or proposals to the Company using the contact details listed under the Section headed "Investor relations" below.

### II. Investor relations

The Company regards communication with institutional and other investors as an important means to enhance the transparency of the Group and collecting views and feedbacks from such investors. The Group has an Investor Relations Department to handle matter relating to investor relations. In the year under review, the executive Directors and senior management of the Company participated in 6 international investors' conferences, as well as 2 international road shows covering Germany, Holland, Hong Kong, Italy, Japan, China, Singapore, the UK, the US and Switzerland, to communicate with existing shareholders and the investment community in respect of the Group's latest results, prospects and development strategies. In addition, the Company also maintains communication with the media through press conferences, news releases to the media and on the Company's website, and answering enquiries from the media.

Shareholders, investors and the media can make enquiries to the Company through the following means:

Hotline telephone number:	(852) 2528 5666
By fax:	(852) 2865 7204
By post:	Rooms 3101-03, 31/F., Tower 1 Lippo Centre, 89 Queensway, Hong Kong Attention: Mr. Wilson Cheng
By email:	xinao@xinaogas.com