

CORPORATE GOVERNANCE REPORT

The Board of Directors (the "Board") is pleased to present this Corporate Governance Report in the Company's annual report for the year ended 31st December 2005.

The Company recognises the importance of good corporate governance to the Company's healthy growth and has devoted considerable efforts to identifying and formulating corporate governance practices appropriate to the needs of its business.

The Company's corporate governance practices are based on the principles (the "Principles"), code provisions (the "Code Provisions") and certain recommended best practices (the "Recommended Best Practices") as set out in the Code on Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules").

The Company has applied the Principles and the Code Provisions as set out in the CG Code and complied with all the Code Provisions save for the Code Provisions on internal controls which are to be implemented for accounting periods commencing on or after 1st July 2005 pursuant to the CG Code and certain deviations from the Code Provisions A.2.1, A.4.1, A.4.2, A.5.4 and D.1.2, details of which are explained below.

The Company has also put in place certain Recommended Best Practices as set out in the CG Code.

The Company periodically reviews its corporate governance practices to ensure that these continue to meet the requirements of the CG Code, and acknowledges the important role of its Board of Directors in providing effective leadership and direction to Company's business, and in ensuring transparency and accountability of Company's operations.

The key corporate governance principles and practices of the Company are summarised as follows:

THE BOARD

Responsibilities

The overall management of the Company's business is vested in the Board, which assumes the responsibility for leadership and control of the Company and is collectively responsible for promoting the success of the Company by directing and supervising its affairs. All directors should take decisions objectively in the interests of the Company.

The Board takes responsibility for all major matters of the Company, including the approval and monitoring of all policy matters, overall strategies and budgets, internal control and risk management systems, material transactions (in particular those may involve conflict of interests), financial information, appointment of directors and other significant financial and operational matters.

All directors have full and timely access to all relevant information as well as the advice and services of the Company Secretary, with a view to ensuring that Board procedures and all applicable rules and regulations are followed.

Each director is normally able to seek independent professional advice in appropriate circumstances at the Company's expense, upon making request to the Board.

CORPORATE GOVERNANCE REPORT

The day-to-day management, administration and operation of the Company are delegated to the Chief Executive Officer and the senior management. The delegated functions and work tasks are periodically reviewed. Approval has to be obtained from the Board prior to any significant transactions entered into by the abovementioned officers.

The Board has the full support of the Chief Executive Officer and the senior management to discharge its responsibilities.

Code Provision D.1.2 stipulates that the Company should formalise the functions reserved to the Board and those delegated to management.

The Company has not formalised the division of functions reserved to the Board and delegated to the management. Arrangements are being taken place for the adoption of written terms on division of functions and delegation of authority between the Board and the management.

The Company has arranged for appropriate insurance cover for directors' and officers' liabilities in respect of legal actions against its directors and senior management arising out of corporate activities.

Composition

The composition of the Board reflects the necessary balance of skills and experience appropriate to the requirements of the business of the Company and to the exercising of independent judgement.

The Board comprises the following seven directors:

Executive Directors:

Mr Wang Mingcai (*Chairman*)

Mr Li Hualin (*Chief Executive Officer*)

Mr Cheng Cheng

Non-Executive Director:

Mr Lin Jingao

Independent Non-Executive Directors:

Dr Lau Wah Sum (*Chairman of the Audit Committee and Member of the Remuneration Committee*)

Mr Aubrey Li Kwok Sing (*Chairman of the Remuneration Committee and Member of the Audit Committee*)

Dr Liu Xiao Feng (*Member of the Remuneration Committee and Audit Committee*)

The list of directors (by category) is also disclosed in all corporate communications issued by the Company pursuant to the Listing Rules from time to time.

None of the members of the Board is related to one another.

CORPORATE GOVERNANCE REPORT

During the year ended 31st December 2005, the Board at all times met the requirements of the Listing Rules relating to the appointment of at least three independent non-executive directors with at least one independent non-executive director possessing appropriate professional qualifications, or accounting or related financial management expertise.

The Company has received written annual confirmation from each independent non-executive director of his independence pursuant to the requirements of the Listing Rules. The Company considers all independent non-executive directors to be independent in accordance with the independence guidelines set out in the Listing Rules.

The non-executive directors bring a wide range of business and financial expertise, experiences and independent judgement to the Board. Through active participation in Board meetings, taking the lead in managing issues involving potential conflict of interests and serving on Board committees, all non-executive directors make various contributions to the effective direction of the Company.

Appointment and Re-election of Directors

Code Provision A.4.1 stipulates that non-executive directors should be appointed for a specific term, subject to re-election.

Code Provision A.4.2 stipulates that all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.

Each of the independent non-executive directors of the Company was appointed for a two-year term. Mr. Lin Jingao, the only non-executive director of the Company, does not have a specific term of appointment. However, he is subject to retirement by rotation at the annual general meetings in accordance with the Bye-laws of the Company. Mr. Lin will retire by rotation at the forthcoming annual general meeting and he does not offer himself for re-election.

The Company's Bye-laws deviates from Code Provision A.4.2 as it provides that one-third of the directors for the time being (save for the Chairman and Managing Director), or if their number is not three nor a multiple of three, then the number nearest to one-third, shall retire from office at each annual general meeting, when they shall be eligible for re-election and that any new director appointed by the Board to fill a causal vacancy or as an addition to the Board during the year shall hold office until the next following annual general meeting after appointment, when he/she shall be eligible for re-election.

To conform with Code Provision A.4.2, a special resolution will be proposed at the forthcoming annual general meeting of the Company to amend the Company's Bye-laws so that all directors will be subject to retirement by rotation once every three years and any new director appointed to fill a causal vacancy shall be subject to re-election by shareholders at the first general meeting after appointment.

Though the Company has not set up a nomination committee, the Board as a whole is responsible for reviewing the Board composition, developing and formulating the relevant procedures for nomination and appointment of directors, monitoring the appointment and succession planning of directors and assessing the independence of independent non-executive directors.

CORPORATE GOVERNANCE REPORT

The Board reviewed its own structure, size and composition regularly to ensure that it has a balance of expertise, skills and experience appropriate to the requirements of the business of the Company.

Where vacancies on the Board exist, the Board will carry out the selection process by making reference to the skills, experience, professional knowledge, personal integrity and time commitments of the proposed candidates, the Company's needs and other relevant statutory requirements and regulations. An external recruitment agency may be engaged to carry out the recruitment and selection process when necessary.

In accordance with the Company's Bye-laws, Mr. Li Hualin and Mr. Lin Jingao shall retire by rotation and only Mr. Li Hualin, being eligible, offers himself for re-election at the forthcoming annual general meeting.

The Board recommended the re-appointment of the above director standing for re-election at the forthcoming annual general meeting of the Company.

A circular containing detailed information of the director standing for re-election at the forthcoming annual general meeting would be sent to the shareholders.

Training for Directors

Each newly appointed director receives comprehensive, formal and tailored induction on the first occasion of his/her appointment, so as to ensure that he/she has appropriate understanding of the business and operations of the Company and that he/she is fully aware of his/her responsibilities and obligations under the Listing Rules and relevant regulatory requirements.

There are also arrangements in place for providing continuing briefing and professional development to directors whenever necessary.

Board Meetings

Number of Meetings and Directors' Attendance

Regular Board meetings should be held at least four times a year at approximately quarterly intervals for reviewing and approving the financial and operating performance, and considering and approving the overall strategies and policies of the Company.

During the year ended 31st December 2005, five regular Board meetings, two Audit Committee meetings and one Remuneration Committee meeting were held.

CORPORATE GOVERNANCE REPORT

The individual attendance record of each director at the meetings of the said meetings of the Board, the Audit Committee and the Remuneration Committee during the year ended 31st December 2005 is set out below:

Directors	Attendance/Number of Meetings		
	Board	Audit Committee	Remuneration Committee
<i>Executive Director</i>			
Mr Wang Mingcai (<i>Chairman</i>)	5/5	–	–
Mr Li Hualin (<i>Chief Executive Officer</i>)	4/5	–	–
Mr Cheng Cheng	4/5	–	–
<i>Non-Executive Director</i>			
Mr Lin Jingao	2/5	–	–
<i>Independent Non-Executive Director</i>			
Dr Lau Wah Sum	4/5	2/2	1/1
Mr Aubrey Li Kwok Sing	4/5	2/2	1/1
Dr Liu Xiao Feng	4/5	1/2	1/1

Note: One of the Board meetings (with the presence of Mr Wang Mingcai, Mr Li Hualin, Mr Cheng Cheng, Mr Lin Jingao, Dr Lau Wah Sum, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, being all directors) has discussed the directors' nomination matters.

Practices and Conduct of Meetings

Notices of regular Board meetings are served to all directors at least 14 days before the meetings and reasonable notice is generally given for other Board meetings. For committee meeting, notices are served in accordance with the required notice period stated in the relevant terms of reference.

Agenda and Board papers together with all appropriate, complete and reliable information are sent to all directors/committee members at least 3 days before each Board meeting or committee meeting to keep the directors apprised of the latest developments and financial position of the Company and to enable them to make informed decisions. The Board and each director also have separate and independent access to the senior management whenever necessary.

The Chief Financial Officer, Qualified Accountant, Chief Executive Officer and Company Secretary will attend Board and committee meetings, when necessary, to advise on business developments, financial and accounting matters, statutory compliance, corporate governance and other major aspects of the Company.

Minutes of all Board meetings and committee meetings are kept by the Company Secretary. Draft minutes are normally circulated to directors for comment within a reasonable time after each meeting and the final version is signed by the Chairman and kept for future reference and directors' inspection.

CORPORATE GOVERNANCE REPORT

According to current Board practice, any material transaction, which involves a conflict of interests for a substantial shareholder or a director, will be considered and dealt with by the Board at a duly convened Board meeting. The Company's Bye-laws also contain provisions requiring directors to abstain from voting and not to be counted in the quorum at meetings for approving transactions in which such directors or any of their associates have a material interest.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Code Provision A.2.1 stipulates that the roles of Chairman and Chief Executive Officer should be separate and should not be performed by the same individual. The division of responsibilities between the Chairman and Chief Executive Officer should be clearly established and set out in writing.

The Company fully supports the division of responsibility between the Chairman of the Board and the Chief Executive Officer to ensure a balance of power and authority.

The positions of the Chairman and Chief Executive Officer of the Company are currently held by Mr Wang Mingcai and Mr Li Hualin respectively.

There are no written terms on the general division of responsibilities between the Chairman and the Chief Executive Officer. The Board considers that the responsibilities of the Chairman and the Chief Executive Officer are clear and distinctive and hence written terms thereof are not necessary. The Chairman provides leadership and is responsible for the effective functioning of the Board in accordance with good corporate governance practice. With the support of the senior management, the Chairman is also responsible for ensuring that the directors receive adequate, complete and reliable information in a timely manner and appropriate briefing on issues arising at Board meetings. The Chief Executive Officer focuses on implementing objectives, policies and strategies approved and delegated by the Board. He is in charge of the Company's day-to-day management and operations. The Chief Executive Officer is also responsible for developing strategic plans and formulating the organisational structure, control systems and internal procedures and processes for the Board's approval.

BOARD COMMITTEES

The Board has established two committees, namely, the Audit Committee and the Remuneration Committee, for overseeing particular aspects of the Company's affairs. All Board committees of the Company are established with defined written terms of reference. The terms of reference of the Board committees are posted on the Company's website and are available to shareholders upon request.

The three independent non-executive directors of the Company are the members of each of the Audit Committee and Remuneration Committee of the Company.

The Board committees are provided with sufficient resources to discharge their duties and, upon reasonable request, are able to seek independent professional advice in appropriate circumstances, at the Company's expenses.

CORPORATE GOVERNANCE REPORT

REMUNERATION COMMITTEE

The primary objectives of the Remuneration Committee include making recommendations on and approving the remuneration policy and structure and remuneration packages of the executive directors and the senior management. The Remuneration Committee is also responsible for establishing transparent procedures for developing such remuneration policy and structure to ensure that no director or any of his associates will participate in deciding his own remuneration, which remuneration will be determined by reference to the performance of the individual and the Company as well as market practice and conditions.

The Remuneration Committee normally meets annually for reviewing the remuneration policy and structure and determination of the annual remuneration packages of the executive directors and the senior management and other related matters. The Company Secretary is responsible for collection and administration of the human resources data and making recommendations to the remuneration committee for consideration. The Remuneration Committee shall consult the Chairman and/or the Chief Executive Officer of the Company about these recommendations on remuneration policy and structure and remuneration packages.

The Remuneration Committee met once during the year ended 31st December 2005 and reviewed the remuneration policy and structure of the Company and remuneration packages of the executive directors and the senior management for the year under review.

AUDIT COMMITTEE

The Audit Committee comprises three independent non-executive directors (including one independent non-executive director who possesses the appropriate professional qualifications or accounting or related financial management expertise). None of the members of the Audit Committee is a former partner of the Company's existing external auditors.

The main duties of the Audit Committee include the following:

- (a) To review the financial statements and reports and consider any significant or unusual items raised by the qualified accountant or external auditors before submission to the Board.
- (b) To review the relationship with the external auditors by reference to the work performed by the auditors, their fees and terms of engagement, and make recommendation to the Board on the appointment, re-appointment and removal of external auditors.
- (c) To review the adequacy and effectiveness of the Company's financial reporting system, internal control system and risk management system and associated procedures.

During the year ended 31st December 2005, the Audit Committee held two meetings and once passed circular resolutions, to review the financial results and reports, financial reporting and compliance procedures, the report on the Company's internal control and risk management review and processes and the re-appointment of the external auditors.

The Company's annual results for the year ended 31st December 2005 has been reviewed by the Audit Committee.

CORPORATE GOVERNANCE REPORT

There are no material uncertainties relating to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

There is no different view taken by the Audit Committee from the Board regarding the selection, appointment, resignation or dismissal of external auditors.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 to the Listing Rules.

Specific enquiry has been made of all the directors and the directors have confirmed that they have complied with the Model Code throughout the year ended 31st December 2005.

The Company has not established written guidelines (the "Employees Written Guidelines") in respect of the dealings in the Company's securities by employees who are likely to be in possession of unpublished price-sensitive information of the Company. Arrangements are being taken for adoption of the Employees Written Guidelines on no less exacting terms than the Model Code.

RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS AND AUDITORS' REMUNERATION

The Board is responsible for presenting a balanced, clear and understandable assessment of annual and interim reports, price-sensitive announcements and other disclosures required under the Listing Rules and other regulatory requirements.

The directors acknowledge their responsibility for preparing the financial statements of the Company for the year ended 31st December 2005.

The statement of the external auditors of the Company about their reporting responsibilities on the financial statements is set out in the "Report of the Auditors" on page 28.

The remuneration paid to the external auditors of the Company in respect of audit services and non-audit services for the year ended 31st December 2005 amounted to HK\$2,700,000 and HK\$96,500 respectively. The said non-audit services related to the preparation and filing of the profits tax returns of the Company and its subsidiaries.

SHAREHOLDER RIGHTS AND INVESTOR RELATIONS

The rights of shareholders and the procedures for demanding a poll on resolutions at shareholders' meetings are contained in the Company's Bye-laws. Details of such rights to demand a poll and the poll procedures are included in all circulars to shareholders and will be explained during the proceedings of meetings. Whenever voting by way of a poll is required, the detailed procedures for conducting a poll will be explained.

Poll results will be published in newspapers on the business day following the shareholders' meeting and posted on the website of the Stock Exchange.

CORPORATE GOVERNANCE REPORT

The general meetings of the Company provide an opportunity for communication between the shareholders and the Board. The Chairman of the Board as well as the chairmen of the Remuneration Committee and Audit Committee or, in their absence, other members of the respective committees, and, where applicable, the independent Board committee, are available to answer questions at the shareholders' meetings.

Separate resolutions are proposed at shareholders' meetings on each substantial issue, including the election of individual directors.

The Company continues to enhance communications and relationships with its investors. Designated senior management maintains regular dialogue with institutional investors and analysts to keep them abreast of the Company's developments. Enquiries from investors are dealt with in an informative and timely manner.

To promote effective communication, the Company also maintains a website at www.cnpc.com.hk, where extensive information and updates on the Company's business developments and operations, financial information, corporate governance practices and other information are posted.