

# Corporate Governance Report

The Company is committed to high standards of corporate governance so as to ensure better transparency and protection of shareholders' interests. None of the Directors is aware of information that would reasonably indicate that the Company is not, or was not for any part of the year ended 31 December 2005, in compliance with the code provisions set out in the Code on Corporate Governance Practices contained in Appendix 14 of the Rule Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules").

## The Board of Directors

As at 31 December 2005, the Board consisted of seven Directors. The Board has the collective responsibility for leadership and control of, and for promoting the success of, the Company by directing and supervising the Company's affairs. The Board is committed to the Company's objectives of enhancing shareholder's value and provision of superior products and services. The Board sets the Group's overall objectives and strategies, monitors and evaluates its operating and financial performance and reviews the corporate governance standard of the Company. It also decides on matters such as annual and interim results, major transactions, director appointments or re-appointments, and dividend and accounting policies. The Board has delegated the authority and responsibility for implementing its business strategies and managing the daily operations of the Group's businesses to the management.

## Co-Chairmen and Chief Executive Officer

The roles of the co-Chairmen of the Board and the Chief Executive Officer of the Company are separated, with a clear division of responsibilities. The co-Chairmen of the Board are responsible for formulating corporate strategies and overall business development planning. The Chief Executive Officer's duty is to oversee the execution of daily business activities. The division of responsibilities at the board level is to ensure a balance of power and authority.

## Board Composition

The Company benefits from the professional management expertise of its Directors. Brief biographies of the Directors are set out in the "Directors' Biographical Information" section in the Company's 2005 Annual Report. The professional management expertise of the Directors ensures that the Board has the capabilities of sustaining the Company's continued success.

As at 31 December 2005, the Board comprised four Executive Directors and three Independent Non-executive Directors. All the Independent Non-executive Directors meet the guidelines for assessment of independence, as set out in Rule 3.13 of the Listing Rules.

The Board held five meetings in 2005. The attendance records of individual Directors are set out below:

Name	Position	Number of board meetings held during the Director's term of office in 2005	Number of meetings attended
Dr. Chang Chu Cheng	Chairman	5	5
Mr. Ko Chun Shun, Johnson	Chairman	3	3
Mr. Tsoi Tong Hoo, Tony	Executive Director and Chief Executive Officer	5	5
Mr. Ho Te Hwai, Cecil	Executive Director and Company Secretary	5	5
Dr. Lo Wing Yan, William	Independent Non-executive Director	5	4
Mr. Yuen Kin	Independent Non-executive Director	5	5
Mr. Hou Ziqiang	Independent Non-executive Director	5	4
Dr. Yan Sze Kwan <sup>#</sup>	Executive Director	2	2
Mr. Chung Shun Ming <sup>#</sup>	Executive Director	2	2
Mr. Kwok Siu Kwan <sup>#</sup>	Executive Director	2	1
Prof. Kao Kuen, Charles <sup>#</sup>	Independent Non-executive Director	1	1
Mr. Lui Chi Shing, Anthony <sup>#</sup>	Independent Non-executive Director	1	1

<sup>#</sup> Retired from the Board in 2005

The Directors have no financial, business, family or other material/relevant relationships with each other save for the following:

- (1) Messrs. Ko Chun Shun, Johnson, Tsoi Tong Hoo, Tony, and Yuen Kin have common directorship in Universal Holdings Limited ("Universal", a listed company in Hong Kong), the controlling shareholder of which is Mr. Ko Chun Shun, Johnson;
- (2) Mr. Ho Te Hwai, Cecil, is the financial controller of Universal; and
- (3) Messrs. Ko Chun Shun, Johnson, and Ho Te Hwai, Cecil, are the Chairman of the board of directors and the Company Secretary of DVN (Holdings) Limited respectively.

In the Board's opinion, these relationships do not affect the Directors' independent judgment and integrity in executing their roles and responsibilities. All Directors bring a variety of experience and expertise to the Company.

### Appointment, Re-election and Removal

Since the full Board is involved in the appointment of new Directors, the Company has not established a nomination committee. New Directors are sought mainly through referrals. In evaluating whether an appointee is suitable to act as a Director of the Company, the Board will review the independence, experience and skills of the appointee as well as personal ethics, integrity and time commitment of the appointee. During the year, Messrs. Ko Chun Shun, Johnson, Tsoi Tong Hoo, Tony, and Ho Te Hwai, Cecil, were appointed as Executive Directors of the Company while Messrs. Yuen Kin and Hou Ziqiang were appointed as Independent Non-executive Directors of the Company.

The Independent Non-executive Directors have been appointed for a fixed term expiring on 31 December 2006. All Directors are subject to retirement by rotation at least once every three years.

The Board has established two committees in which the Independent Non-executive Directors play an active role. Directors have full access to all board committee documents.

## Audit Committee

The Audit Committee comprises three independent non-executive directors: Dr. Lo Wing Yan, William (Chairman of the Audit Committee), Mr. Yuen Kin and Mr. Hou Ziqiang. It is responsible for appointment of external auditors, review of the Group's financial information and oversight of the Group's financial reporting system and internal control procedures. It is also responsible for reviewing the interim and final results of the Group prior to recommending them to the Board for approval. It meets regularly to review financial reporting and internal control matters and to this end has unrestricted access to both the Company's external and internal auditors.

The Audit Committee held two meetings in 2005, in which the Committee reviewed with management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters so as to ensure that an effective control environment is maintained.

The Audit Committee also made its recommendation to the board that the external auditor should be reappointed and approved the remuneration and the terms of engagements of the external auditor.

The internal and external auditors have unrestricted access to the Audit Committees, which ensures that their independence remains unimpaired.

The attendance records of individual Directors are set out below:

Name	Number of meetings held by Audit Committee during the Director's term of office in 2005	Number of meetings attended
Dr. Lo Wing Yan, William	2	2
Mr. Yuen Kin	2	2
Mr. Hou Ziqiang	2	2
Prof. Kao Kuen, Charles <sup>#</sup>	1	1
Mr. Lui Chi Shing, Anthony <sup>#</sup>	1	1

<sup>#</sup> Retired from the Board in 2005

## Remuneration Committee

The Remuneration Committee is responsible for setting and monitoring the remuneration policy for the Executive Directors. It is also responsible for fixing the remuneration packages for all Directors. The Remuneration Committee comprises Dr. Lo Wing Yan, William (the Committee Chairman), Mr. Hou Ziqiang and Mr. Ko Chun Shun, Johnson.

The Company's remuneration policy is to link remuneration packages for Executive Directors with the achievement of annual and long-term performance goals. By providing competitive and performance-linked compensation, the Company seeks to attract, motivate and retain key executives, which is essential to its long-term success.

The terms of service contracts of the Executive Directors appointed in 2005 were approved by the Board of Directors before the existence of Remuneration Committee. The Remuneration Committee held two meetings in 2005, in which the Committee reviewed the Company's remuneration policy and fixed the remuneration packages for key executives.

The attendance records of individual Directors are set out below:

Name	Number of meetings held by Remuneration Committee during the Director's term of office in 2005	Number of meetings attended
Dr. Lo Wing Yan, William	2	2
Mr. Hou Ziqiang	2	2
Mr. Ko Chun Shun, Johnson	2	2
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### Directors' Responsibility for the Financial Statements

The Directors are responsible for overseeing the preparation of financial statements for each financial period with a view to ensuring such financial statements give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. The Company's financial statements are prepared in accordance with all relevant statutory requirements and applicable accounting standards. The Directors are responsible for ensuring that appropriate accounting policies are selected and applied consistently; and that judgments and estimates made are prudent and reasonable.

The reporting responsibilities of KPMG, the Company's auditors, are set out in the Auditors' Report on page 27 of this Annual Report.

### Auditors' Remuneration

Total auditors' remuneration in relation to statutory audit work of the Group amounted to HK\$1,779,000 (2004: HK\$1,345,000), of which a sum of HK\$1,521,000 was paid to the Group's principal auditor, KPMG.

The remuneration paid to the Group's principal auditor, KPMG, and its affiliated firms, for services rendered is broken down below:

	2005 HK\$	2004 HK\$
Statutory audit	1,521,000	1,189,000
Non-audit services	628,000	128,000
Total	<hr/> 2,149,000	<hr/> 1,317,000

### Internal Control

To maintain sound and effective internal controls to safeguard shareholders' investment and the Company's assets, the Directors conducted a review of the effectiveness of the Company's system of internal control in 2005. The review covered financial, operational and compliance controls and risk management functions. To further strengthen its control system, the Company has established an Internal Audit Department, before the issue date of the 2005 Annual Report to perform independent evaluations and reporting of the adequacy and effectiveness of the Company's controls, information system and operations.

### **Business Improvement Team Meeting**

Business Improvement Team (BIT) Meeting is held once a month for the discussion about how to improve the Company's business and how to manage operational and business risks. The meetings are chaired by the Chief Executive Officer. In the meetings, department heads review the performance of their corresponding departments, alert the management about operational issues, receive comments on how to improve the performance and report the progress or results of improvement measures initiated in previous BIT meetings. Directors attend these meetings from time to time.

### **Communication with Shareholders**

The Company attaches great importance to communicate with shareholders and a number of means, including regular group meetings and plant tours, are used to promote greater understanding and dialogue with the investment community. The Company holds press conferences to announce its annual and interim results. Key executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Company's development.

The Group's website [www.varitronix.com](http://www.varitronix.com) contains an "investor and media relations" section which offers timely access to the Company's press releases, financial reports and major announcements.

The Annual General Meeting is an important opportunity for communicating with shareholders. The Company's co-Chairmen, Executive Directors, Chairman of Audit Committee and Independent Non-executive Directors are available at the Annual General Meeting to answer questions from shareholders.

### **Model Code for Securities Transactions by Directors**

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 of the Listing Rules. Following specific enquiry by the Company, all Directors confirmed that they have complied with the required standards as set out in the Model Code throughout the year under review.