

## CORPORATE GOVERNANCE

The company is committed to fulfilling its responsibilities to shareholders by ensuring that the proper processes for oversight and management of its businesses are in place, in operation and are regularly reviewed. The Board acknowledges its responsibility to ensure that good corporate governance practices and procedures are established.

Throughout the year, the company has complied with all the code provisions and a majority of the recommended best practices as set out in the Code on Corporate Governance Practices (CG Code) in Appendix 14 of the Listing Rules. In March 2005, the company adopted its own code on corporate governance practices, which was updated in October 2005 and encompassed all code provisions and most of the recommended best practices in the CG Code.

### BOARD COMPOSITION

The company is controlled through the Board of Directors, which now comprises three executive directors – Mr Clement K M Kwok, Mr C Mark Broadley and Mr Peter C Borer; seven non-executive directors comprising chairman The Hon. Sir Michael Kadoorie, deputy chairman Mr Ian D Boyce, Mr James S Dickson Leach, Sir Sidney Gordon, Mr Ronald J McAulay, Mr William E Mocatta and Mr Pierre R Boppe; and four independent non-executive directors comprising Dr The Hon. Sir David K P Li, Mr Robert C S Ng, Mr Robert W Miller and Mr Patrick B Paul. The directors' biographical details are set out on pages 42 and 43 and are also posted on the company's website at [www.hshgroup.com](http://www.hshgroup.com). All non-executive directors have letters of appointment valid for a period of three years. All directors are subject to retirement by rotation and may offer themselves for re-election. A new director appointed by the Board is subject to election by shareholders at the next annual general meeting.

*Retirement by rotation* During 2005, one third of the non-executive directors, comprising Messrs William E Mocatta, James S Dickson Leach, Pierre R Boppe and Robert W Miller, retired by rotation and were re-elected. In addition, executive director Mr Clement K M Kwok retired voluntarily at the annual general meeting and, being eligible, was re-elected. Details of the directors who will offer themselves for re-election in 2006 are set out in the directors' report.

*Confirmation of independence* The company has received from Mr Robert C S Ng, Dr The Hon. Sir David K P Li, Mr Robert W Miller and Mr Patrick B Paul, independent non-executive directors, written confirmation of independence pursuant to rule 3.13, independence guidelines, of the Listing Rules. The company considers all the independent non-executive directors to be independent.

*Directors' interests in competing business* None of the directors and their respective associates has any competing interests which need to be disclosed pursuant to rule 8.10 of the Listing Rules.

*Directors' responsibilities for the financial statements* The directors are responsible for the preparation of the financial statements for each financial period which gives a true and fair view of the state of affairs of the group and of the results and cash flows for that period. In preparing these financial statements for the year ended 31 December 2005, the directors have selected suitable accounting policies and applied them consistently, made judgements and estimates that are prudent, fair and reasonable and prepared the financial statements on a going concern basis. The directors are responsible for ensuring that the group keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the group.

*Dealing in company's securities by directors* In February 2004, the company adopted its Code for Dealing in the Company's Securities by Directors on terms no less exacting than the required standard set out in the Stock Exchange's Model Code for Securities Transactions by Directors of Listed Issuers in Appendix 10 of the Listing Rules. The company has also extended this code to specified employees.

The company has made specific enquiry of all directors regarding any non-compliance with the Model Code and the company's own dealing code during the year, and they have confirmed that they have fully complied with the required standard set out in both codes.

#### THE ROLE OF THE BOARD AND BOARD COMMITTEES

As part of good corporate governance practice, a number of Board committees have been established. These committees include representation from non-executive and independent non-executive directors whose objective views are important to the execution of the controls expected in a publicly listed company. Each committee operates within defined terms of reference; these terms of reference are posted on the company's website at [www.hshgroup.com](http://www.hshgroup.com).

The Board delegated certain authorities to the Executive, Audit, Finance and Remuneration Committees. The day-to-day management of the company's business has been delegated to the chief executive officer who exercises his authority in consultation with the Group Management Committee.

*The Board* The Board meets regularly, and has convened five times during 2005, to review business development and overall strategic policies. Its members have full access to relevant information both at the meetings and at regular intervals as material information becomes necessary to the exercise of their powers. Within the Board's purview are matters such as financial statements, dividend policy, major financings, material investments in new projects and existing assets, risk management strategy, acquisitions, treasury policy and changes in accounting policy.

Attendance at Board Meetings	No. of Meetings Attended	
	2005 (5 meetings in total)	2004 (5 meetings in total)
<b>Members of the Executive Committee</b>		
The Hon. Sir Michael Kadoorie (Chairman)	4	3
Mr Ian D Boyce (Deputy Chairman)	5	5
Mr Clement K M Kwok (Chief Executive Officer)	5	5
Mr James S Dickson Leach	5	3
<b>Non-executive directors</b>		
Sir Sidney Gordon	1	4
Mr Ronald J McAulay	5	4
Mr William E Mocatta	5	5
Mr Pierre R Boppe	3	3
<b>Independent non-executive directors</b>		
Dr The Hon. Sir David K P Li	3	5
Mr Robert C S Ng	2	4
Mr Robert W Miller	5	4
Mr Patrick B Paul (appointed 02/04)	5	3 (of 4)
<b>Executive directors</b>		
Mr C Mark Broadley	5	5
Mr Peter C Borer (appointed 04/04)	5	4 (of 4)

The positions of chairman and chief executive officer are segregated. It is the responsibility of the chairman to provide leadership for the Board and to ensure that it works effectively and discharges its responsibilities. It is the responsibility of the chief executive officer to effect the policies agreed by the Board, to advise the Board of any material issues which might impact the company, and to conduct the day-to-day running of the company.

Included in the composition of the Board are two family members of the majority shareholder: the chairman, The Hon. Sir Michael Kadoorie and his brother-in-law, Mr Ronald J McAulay. Several Board members are also directors of other businesses with which the majority shareholder is connected. They are: Mr Ian D Boyce, Mr James S Dickson Leach, Sir Sidney Gordon and Mr William E Mocatta.

*Executive committee* The Executive Committee meets at least twice per month. The committee is responsible for recommending general policy and direction for the company to the Board and as such, it interacts with the Audit, Finance and Remuneration Committees in respect of their policy submissions. The members of the Executive Committee comprise The Hon. Sir Michael Kadoorie, committee chairman, Mr Ian D Boyce, Mr Clement K M Kwok, and Mr James S Dickson Leach.

The company does not have a separate nomination committee; the nomination and appointment of new directors are functions of the Executive Committee. The Executive Committee reviews on a regular basis the need to appoint directors with specific business acumen in appropriate sectors that would further enhance the present skill set, or add expertise in a developing business sector.

The company already exceeds the minimum required number of independent non-executive directors on the Board, and welcomes the contribution that they make at Board and other committee levels in the exercise of their experience, knowledge and judgement on behalf of the company and the shareholders.

Nominations of suitable candidates are invited from all directors, and nominees are considered by the Executive Committee and then by the Board. There were no new appointments of directors to the Board during 2005.

**Audit committee** The composition of the Audit Committee includes only non-executive directors of which the majority are independent; the Audit Committee members are Mr Patrick B Paul, committee chairman, Mr Ian D Boyce, and Mr Robert C S Ng. All members of the committee have financial and/or legal backgrounds that enable them to accurately assess the fiscal well-being of the company, compliance, and risk assessment as well as to act impartially in discharging their duties and responsibilities.

During 2005, the Audit Committee met five times and its activities included the following: it reviewed the 2004 annual report and the 2005 interim report; had oversight of the financial reporting and audit processes and policies; reviewed the group's financial controls, internal control and risk management systems; reviewed revised terms of reference for the Audit Committee and revised Charter of Responsibilities of the internal audit department; agreed the scope of internal audit for 2005; discussed internal audit reports; conducted discussions with the external auditors on financial reporting, compliance, accounting treatment and impact on the company of new accounting standards particularly in respect of fixed assets and deferred tax, and their policies for maintaining independence; approved external auditors' remuneration and considered their re-appointment; progressed the audit plan for 2006; and reported all relevant matters to the Board.

The Audit Committee invited the company's external auditors to attend its meetings and in addition the chairman of the Audit Committee met with the external auditors with no executive directors present. He also met with the chief executive officer, the chief financial officer and divisional heads within the company.

Attendance at Audit Committee	No. of Meetings Attended	
	2005 (5 meetings in total)	2004 (4 meetings in total)
Mr Patrick B Paul (committee chairman)	5	3 (of 3)
Mr Ian D Boyce	5	4
Mr Robert C S Ng	2	3
Mr William E Mocatta	-	1 (of 1)
Mr Clement K M Kwok	-	1 (of 1)
Mr James S Dickson Leach	-	1 (of 1)

**Finance committee** The Finance Committee meets at least twice per month to review all aspects of the company's finances, including such items as debt levels, gearing and foreign exchange risks. It exercises the delegated authority granted to it by the Board and reports to the Executive Committee and to the Board as necessary. Members of the Finance Committee are: Mr Ian D Boyce, committee chairman, Mr Clement K M Kwok, Mr James S Dickson Leach and Mr C Mark Broadley.

**Remuneration committee** The Remuneration Committee is composed solely of non-executive directors of which the majority is independent. Committee members are Mr Ian D Boyce (chairman), Mr Robert W Miller, and Mr Patrick B Paul.

The Remuneration Committee meets at appropriate intervals to review human resource issues, including group-wide remuneration policies, and to review the competitive terms and conditions of employment of the chief executive officer and the executive directors. During 2005, the committee met twice.

The committee obtains benchmark reports from internal and external sources for evaluation of market trends and the competitive levels of remuneration being offered to executive directors and staff. The committee weighs compensation, performance-related bonuses and retirement provisions against industry norms and sets parameters on what is fair for the company to support, and competitive within the appropriate markets in which it operates.

During 2005, the Remuneration Committee reviewed the letters of appointment for non-executive directors. Fees and benefits for non-executive directors are evaluated given the pool of qualified candidates, the demand for their services, their potential contribution to the development and oversight of the company, and market practice. An independent review of such fees was last conducted by KPMG in 2004 and the new level of fees approved at the annual general meeting in the same year continues to be adopted.

No director plays a part in any discussions about his own remuneration.

Attendance at Remuneration Committee	No. of Meetings Attended	
	2005 (2 meetings in total)	2004 (3 meetings in total)
Mr Ian D Boyce (committee chairman)	2	3
Mr Robert W Miller	1	3
Mr Patrick B Paul	2	2

The group does not have any long-term incentive schemes other than the retirement scheme described under the employee developments and benefits section (page 47) and in note 32 to the financial statements. Additional information on the basis of determining the emoluments payable to the directors and senior management is set out in note 9 to the financial statements.

The company has not adopted any share option scheme during the year.

## INTERNAL CONTROLS, AUDIT AND RISK MANAGEMENT

The Board has overall responsibility for the company's system of internal control and for reviewing its effectiveness. The Board has conducted a review to ensure that the highest levels of financial management and asset protection are in place and shareholders' interests are protected. It is satisfied that the systems are effective and adequate to their purpose.

**Internal controls** In May 2003, the company introduced a comprehensive Company Management Authority Manual that designates the approvals process by which funds and/or expenses are approved; the executives to whom application should be made for approval and sign-off; and the limits of funding which individuals are authorised to approve before countersignature of a supervisor or committee must be sought. This check-and-balance process provides effective expenditure controls. It enables officers of the company to manage risk responsibly and in a manner appropriate to the levels of exposure attached to business activities. The manual is subject to regular review and updating.

The company introduced new comprehensive purchasing and tendering procedures in July 2005 to replace the previous procedures, to ensure that there is an open and fair process for awarding contracts. The new procedures adopt a more structured approach to dealing with the approvals process of purchases with different engagement values. The procedures also detail the different selection procedures, assessment and marking guidelines, as well as the award of contracts and their administration. A review independent of the selection team is introduced at all levels of purchases, including the setting up of an independent tender committee to evaluate the tender process for high value contracts.

On an annual basis, general managers and financial controllers of each business unit are required to submit a General Representation Letter to the chief executive officer and the chief financial officer giving personal certification of compliance by themselves and their subordinates of successful implementation of all internal systems of control and procedures in their respective units, and to provide supplementary information should there be any departure arising therefrom. These General Representation Letters reinforce personal responsibility for good governance and controls at all levels within the group.

The Board closely monitors the systems of controls and periodically recommends amendments as the changing nature of the company's business demands.

The policies and procedures, including in the Company Management Authority Manual, and their effective implementation are subject to independent evaluation by the internal audit and risk management department which reports its findings and recommendations to the Audit Committee for review. It is within the Audit Committee's purview to review such reports, and discuss with management the effectiveness of the system of internal control and its assessment of risks and related issues identified during the process.

***Internal audit and risk management*** The role of the company's internal audit and risk management department is to identify the major risk areas to the company, whether of a financial, legal, reputational, environmental, safety or security nature, and to benchmark these against the internal control systems in place and the adherence to these in practice by the business units. These are typically conducted over a three-year cycle.

During 2005, the department conducted high-level risk identification and evaluation exercises for the group and reported results to the Audit Committee.

The head of department attended four of the five Audit Committee meetings held during the period to seek approval for amendments to the audit plan and to report on progress made against the following: the agreed audit plan; the outcome and main recommendations of all audits and reviews; the state of implementation of internal audit recommendations; the internal control rating scores assigned to all audited entities; and the updated company risk register.

The head of department also met with the chairman of the Audit Committee and with the external auditors with no directors present.

Audits and reviews of 13 business units, five head office functions and three overseas corporate-owned entities were conducted and finalised during the year. In the opinion of the Audit Committee, nothing arose in the department's reports of a material nature requiring that it be brought to the attention of shareholders.

#### EXTERNAL AUDITORS

It is important to the group that the independence of its external auditors is not compromised. Contracts for substantial non-audit work to be awarded to the external auditors must, therefore, be pre-approved by the Audit Committee and the scope of work determined to provide only efficiencies of scale and added value, with no adverse effect on actual or perceived independence of the audit work itself. During the year, the company's auditors, KPMG, provided audit services to the value of HK\$7 million. KPMG also provided taxation services to the value of HK\$1 million.

#### CODE OF CONDUCT

The company has a detailed code of conduct, to which employees are signatories, governing the standards of behaviour expected in dealing with colleagues, customers, suppliers, contractors, consultants and professional firms.

A broad summary of the code of conduct is published on the group's website at [www.hshgroup.com](http://www.hshgroup.com), covering the group's policies on the following areas: bribery, illegal gifts and commissions, accepting/offering advantages, entertainment and hospitality industry practice, use of proprietary information, handling conflict of interest situations, insider trading, misuse of the company's assets and resources, loans, personal conduct outside hours of work including outside employment, monitoring of compliance and the means of enforcement, understanding and compliance of the code of conduct, violation of the code of conduct, and complaints.

In addition to the values to which the company expects its staff to adhere in their daily business practices, the code sets out the process for resolution of internal ethical problems that may arise within the workplace. The code is reviewed regularly and benchmarked against emerging mores and standards as the work environment becomes more sophisticated, and as technological advances create new behavioural dynamics.

## INVESTOR RELATIONS

The company is keen to promote two-way communications both with its institutional and its private investors. The annual report and the interim report are distributed to individual and institutional investors and are also available for download from the company's website at [www.hshgroup.com](http://www.hshgroup.com).

The annual general meeting is the principal occasion at which the chairman and directors may interface directly with the shareholders. All shareholders have at least 21 days' formal notice of the annual general meeting and the key dates in the corporate results and meetings calendar are also posted on the company's website in advance. All directors are usually present at the annual general meeting to which all shareholders are invited and during which they have the opportunity to raise questions with the Board. During the year, continuous dialogue between investors and the company on the company's business is encouraged and enquiries from shareholders are handled by the executive directors.

At the 2005 Annual General Meeting, held at noon on Thursday, May 5, at The Peninsula Hong Kong, separate resolutions were proposed on the following issues: to receive the audited financial statements and the reports of the directors and auditors, for the year ended 31 December 2004; to declare a final dividend; to re-elect five directors; to re-appoint KPMG as auditors of the company at a fee to be agreed by the directors; to grant a general mandate to issue new shares; to grant a general mandate for share repurchase; and to add shares repurchased to the general mandate given to issue new shares. Each resolution was voted on by poll and passed and the results of the poll voting were posted on the company website as well as published in the media the following day.

In addition to the shareholders, media are also invited to attend and report on the annual general meeting.

The important dates for 2006 are:

- Annual General Meeting: Thursday, 18 May 2006
- Interim Results 2006 Announcement: Thursday, 14 September 2006.

Details of the public float are set out in the Directors' Report on page 84.