

# CORPORATE GOVERNANCE

The Company is **committed to maintaining and upholding good corporate governance** in order to protect the interests of shareholders, customers and staff. The Company abides strictly by the laws and regulations of the jurisdiction where it operates, and observes the guidelines and rules issued by regulatory authorities such as the Hong Kong Monetary Authority, the Hong Kong Securities and Futures Commission and the Stock Exchange of Hong Kong. It also keeps its corporate governance system under constant review to ensure that it is in line with international and local best practices.

The Company is **in full compliance with all the provisions of the Code on Corporate Governance Practices** (the Code) as appended to the Listing Rules of Hong Kong. It also **complies with nearly all the recommended best practices** set out in the Code. A more recent development is that starting from the third quarter of 2006, the Company **publishes quarterly financial and business reviews** so that shareholders can be better updated of the performance, financial position and prospects of the Company.

The **high standards of the Company's corporate governance practices are reflected in the public recognition it has won through the years**. In 2006, the Company was named one of the top ten companies for corporate governance among the 174 locally listed companies surveyed in the Corporate Governance Scorecard Project jointly sponsored by the City University of Hong Kong and the Hong Kong Institute of Directors. The Company also received a Special Mention in the Hang Seng Index Category of the Best Corporate Governance Disclosure Awards 2006 from the Hong Kong Institute of Certified Public Accountants.

## Corporate Governance Framework

The **Board is at the core of the Company's corporate governance framework**, and there is **clear division of responsibilities between the Board and the Management**. The Board is responsible for providing high-level guidance and effective oversight of the Management. Generally, the Board is responsible for:

- formulating the Group's long-term strategy and monitoring the implementation thereof;
- reviewing and approving the annual business plan and financial budget;
- approving the annual, interim and quarterly reports;
- reviewing and monitoring risk management and internal control;
- ensuring good corporate governance and effective compliance; and
- monitoring the performance of the Management.

The Board authorises the Management to execute strategies that have been approved. The Management reports to the Board and is responsible for the day-to-day operation of the Group. **The Board has formulated clear written guidelines, which stipulate the circumstances under which the Management should report to and obtain prior approval from the Board** before making decisions or entering into any commitments on behalf of the Group. The Board will regularly review these guidelines.

To avoid the concentration of power in any single individual, the **positions of the Chairman and the Chief Executive are held by two different**

**individuals. Their roles are distinct and are clearly established and stipulated in the Board's Mandate.**

In short, the Chairman is responsible for ensuring that the Board properly discharges its responsibilities and conforms to good corporate governance practices and procedures. As the Chairman of the Board, he is also responsible for making sure that all Directors are properly briefed on issues arising at the board meetings, and that all Directors receive accurate, timely and clear information. The Chief Executive is responsible for providing leadership for the whole Management and implementing the important policies and development strategies approved by the Board.

Taking into consideration market practices and international best practices in corporate governance, **the Board has established four standing Board Committees** to assist it in carrying out its responsibilities. They are the Audit Committee, Nomination and Remuneration Committee, Risk Committee, and Strategy and Budget Committee. Should the need arise, the Board will authorise an independent board committee comprising all the independent non-executive Directors to review, approve and monitor connected transactions (including the continuing connected transactions) that should be approved by the Board.

**Each of the Board Committees has a well-defined mandate.** They make recommendations to the Board on relevant matters within their terms of reference, or make decisions under appropriate circumstances in accordance with the power delegated by the Board. **A secretarial department is assigned to provide support services to each Board Committee so that it can discharge its responsibilities properly and effectively.** The Board

and Board Committees will participate in the annual performance appraisal of the secretarial departments to ensure the support services provided by these departments are adequate and of good quality. According to their mandates, **the Board and the Board Committees will review and evaluate their respective work process and effectiveness annually, with a view to identifying areas for improvement.**

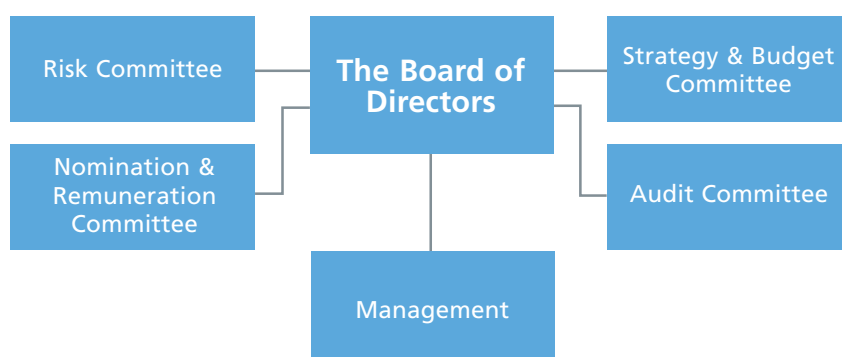
decisions are made objectively and in the best interests of the Group.

The Board currently has 13 members, comprising six independent non-executive Directors, six non-executive Directors and one executive Director. Mr. Koh Beng Seng was appointed independent non-executive Director with effect from 23 March 2006 and was duly elected by the shareholders at the annual general meeting held on 26 May 2006 in accordance with the

Biographical details of the Directors are set out in the “Board of Directors and Senior Management” section of this Annual Report and the Company’s website at [www.bochk.com](http://www.bochk.com).

All the existing **non-executive Directors and independent non-executive Directors** of the Company have been **appointed for a fixed term, with formal letters of appointment** setting out the key terms and conditions of their appointment. Pursuant to the Articles of Association, all Directors, including the Chairman, Vice Chairmen and Chief Executive, shall retire by rotation at least once every three years at annual general meetings and be eligible for re-election. All Directors appointed by the Board are subject to election by shareholders at the first general meeting following their appointment. The Nomination and Remuneration Committee has established a **written and formal process for the appointment of independent non-executive Directors to ensure that the appointment procedures are standardised, thorough and transparent.**

The following chart sets out the Company’s corporate governance framework.



The Company’s corporate website ([www.bochk.com](http://www.bochk.com)) contains detailed information on the Company’s corporate governance principles and framework, the compositions of the Board and Board Committees and a summary of their respective terms of reference, shareholders’ rights and the Company’s Fair Disclosure Policy.

requirement of the Company’s Articles of Association. Save as disclosed above, there were no other changes to the composition of the Board in 2006 and up to the date of this report.

### Board of Directors

**Non-executive Directors and independent non-executive Directors form the majority of the Board.** This structure ensures the independence and objectivity of the Board’s decision-making process as well as the thoroughness and impartiality of the Board’s oversight of the Management. The Board acts honestly and in good faith in order to maximise long-term shareholder value and fulfill its corporate responsibility to other stakeholders of the Group. Its

**All Directors possess extensive experience in banking and management, and nearly half of them are independent non-executive Directors, of whom several are experts in financial management.** The Board has adopted the “Policy on Independence of Directors”, some provisions of which are even more stringent than Rule 3.13 of the Listing Rules. The Company has received from each of the independent non-executive Directors an annual confirmation of his/her independence by reference to the Policy. On the basis of these confirmations and information available to it, the Company considers all of them to be independent.

There is **no relationship (including financial, business, family or other material/relevant relationship(s)) among the Board members.** Messrs. Xiao Gang, Hua Qingshan and Li Zaohang are directors of BOC. Mr. Zhou Zaiqun and Mdm. Zhang Yanling are members of the senior management of BOC. It is expressly provided in the Board’s Mandate that, unless permissible under applicable laws or regulations, if a substantial shareholder or Director has a conflict of interest in the matter to be considered by the Board, a Board meeting attended by independent non-executive Directors who have no material interest in the matter shall be held to deliberate on the same.

The Company has arranged for **appropriate Directors' Liability Insurance Policy to indemnify the Directors for liabilities arising out of corporate activities.** The coverage and the sum insured under the policy are reviewed annually.

To ensure that newly appointed Directors have adequate understanding of the Company's business and operation, and to enable current Directors to constantly update their skills and knowledge so that they can continue to offer informed advice and contribute to the Board, the Board enforces a **formal system for the initial induction and ongoing professional development of the Directors.** In 2006, the Board invited a distinguished speaker with extensive experience in capital management to share with the Board members the latest development in capital management for banks under Basel II.

**Seven Board meetings were held during the year with an average attendance rate of 99%.** The meeting schedule had been prepared and approved by the Board in the preceding year. In general, Board agenda and meeting materials are despatched to all Board members for review at least seven days before the meetings. Board agenda is approved by the Chairman following consultation with other Board members and the Management. As a general practice, the Chairman will meet all non-executive Directors (including independent non-executive Directors) in the absence of executive Directors and the Management at least once in a year. This practice has been incorporated in the Working Rules of the Board. Individual attendance records of the Directors in 2006 are set out as follows:

Director	Number of Board meetings attended	Attendance rate
<i>Non-executive Directors</i>		
Mr. XIAO Gang ( <i>Chairman</i> )	7 out of 7	100%
Mr. SUN Changji ( <i>Vice Chairman</i> )	7 out of 7	100%
Mr. HUA Qingshan	7 out of 7	100%
Mr. LI Zaohang	7 out of 7	100%
Mr. ZHOU Zaiqun	7 out of 7	100%
Mdm. ZHANG Yanling	7 out of 7	100%
<i>Independent Non-executive Directors</i>		
Dr. FUNG Victor Kwok King	7 out of 7	100%
Mr. KOH Beng Seng <sup>(Note)</sup>	6 out of 6	100%
Mr. SHAN Weijian	6 out of 7	86%
Mr. TUNG Chee Chen	7 out of 7	100%
Mr. TUNG Savio Wai-Hok	7 out of 7	100%
Mdm. YANG Linda Tsao	7 out of 7	100%
<i>Executive Director</i>		
Mr. HE Guangbei ( <i>Vice Chairman and Chief Executive</i> )	7 out of 7	100%

Note: Mr. Koh Beng Seng was appointed independent non-executive Director on 23 March 2006.

Apart from formal Board meetings and general meetings, there will also be opportunities for the Board and the Management to interact and communicate on relatively less formal occasions. For example, **each year a Board member will be invited to give a talk to the Company's middle to senior management.** In 2006, Mr. Shan Weijian, Chairman of the Audit Committee and an experienced investment banker, was invited to share with the Company's executives his knowledge and insights on mergers and acquisitions in the banking industry.

**An off-site event will be held annually to enhance communication among Board members, and between the Board and the Management.** In

2006, the Board went on a trip to Pingyao in Shanxi, the birthplace of China's banking industry. (Note: In the 19th Century, Pingyao was a prominent financial centre of China, tantamount to Asia's Wall Street. The founding and success of Pingyao's money exchange shops was based on effective management and corporate governance which closely resembled certain international best practices nowadays. Most strikingly, ownership was separated from management while internal control was emphasised and a performance-based incentive scheme was practised.)

## Audit Committee

The Audit Committee currently has seven members comprising one non-executive Director and all the six independent non-executive Directors. Independent non-executive Directors make up 86% of the Committee members. The Committee is chaired by Mr. Shan Weijian, an independent non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- integrity of financial statements and financial reporting process;
- internal control systems;
- effectiveness of internal audit function and performance appraisal of the Head of Internal Audit;
- appointment of external auditors and assessment of their qualifications, independence and performance and, with authorisation of the Board, determination of their remuneration;
- periodic review and annual audit of the Company's and the Group's financial statements, and financial and business review;
- compliance with applicable accounting standards as well as legal and regulatory requirements on financial disclosures; and
- corporate governance framework of the Group and implementation thereof.

The work performed by the Audit Committee in 2006 included the

review and, where applicable, approval of:

- the Company's Directors' Report and financial statements for the year ended 31 December 2005 and the annual results announcement that were recommended to the Board for approval;
- the Company's interim financial statements for the six months ended 30 June 2006 and the interim results announcement that were recommended to the Board for approval;
- the Company's announcement on quarterly financial and business review for the period ended 30 September 2006 that was recommended to the Board for approval;
- the audit report and report on internal control recommendations submitted by the external auditors, and the on-site examination report issued by regulators;
- the re-appointment of external auditors, the audit fees payable to external auditors for the annual audit, interim review and other non-audit services;
- the Group's internal audit plan for 2006 and key areas identified;
- the deployment of human resources and pay level of the Internal Audit, and the Department's budget for 2006; and
- the 2006 key performance indicators for and 2005 performance appraisal of the Head of Internal Audit.

The "Policy on Staff Reporting of Irregularities" adopted by the Board in 2005 has **proved to be effective**.

Last year, reports on a number of cases were received and handled satisfactorily through the channels and procedures set out in the said Policy.

Pursuant to paragraph C.2 of the Code, the Audit Committee conducted an annual review of the effectiveness of the internal control systems of the Group in 2006. This review covered all material controls, including financial, operational and compliance controls as well as risk management. Upon completion of the review, the **Audit Committee considered that the key areas of the Group's internal control systems had been reasonably implemented** to prevent material misstatement or loss, safeguard the Group's assets, maintain appropriate accounting records, ensure compliance with applicable laws and regulations, and fulfill the requirements of the Code regarding internal control systems in general. For detailed information on this topic, please refer to the "Internal Control" section below.

In addition, in accordance with international best practices, the Audit Committee **engaged an independent third party to conduct a quality assurance review on the Group's internal audit function** during the year. The review found that many **practices adopted by the Internal Audit Department were in line with the industry**. It also came up with some recommendations for further improvement. The Audit Committee agreed to those recommendations and the Internal Audit Department was tasked to implement necessary measures in that regard to further enhance the effectiveness of the Group's internal audit function.

**Six Audit Committee meetings were held during the year with an average attendance rate of 95%.** Individual attendance records of the relevant Directors are set out as follows:

Director	Number of Committee meetings attended	Attendance rate
Mr. SHAN Weijian ( <i>Chairman</i> )	6 out of 6	100%
Mr. ZHOU Zaiqun	6 out of 6	100%
Dr. FUNG Victor Kwok King	5 out of 6	83%
Mr. KOH Beng Seng <sup>(Note)</sup>	4 out of 4	100%
Mr. TUNG Chee Chen	5 out of 6	83%
Mr. TUNG Savio Wai-Hok	6 out of 6	100%
Mdm. YANG Linda Tsao	6 out of 6	100%

Note: Mr. Koh Beng Seng was appointed a member of the Audit Committee on 23 March 2006.

### Nomination and Remuneration Committee

The Nomination and Remuneration Committee currently has six members comprising two non-executive Directors and four independent non-executive Directors. The independent non-executive Directors represent two-thirds of the Committee members. The Committee is chaired by Mr. Sun Changji, Vice-chairman of the Board.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- overall human resources and remuneration strategies of the Group;
- selection and nomination of Directors, Board Committee members and certain senior executives as designated by the Board from time to time;
- structure, size and composition (including skills, experience and knowledge) of Directors and Board Committee members;
- remuneration of Directors, Board Committee members and senior management; and

- effectiveness of the Board and Board Committees.

The work performed by the Committee in 2006 included the review and, where applicable, approval of:

- performance appraisal of the executive Director and designated senior executives for year 2005;
- proposal on staff bonus for year 2005 and salary adjustment for year 2006 for the Group, including the designated senior executives;
- key performance indicators of the Group and the designated senior executives for year 2006;
- medium-term human resources strategies of the Group and the action plan for implementing these strategies;
- important human resources policies such as the "Succession Policy for the Senior Positions of BOCHK", the "Performance Evaluation Method for the Executives Directly Supervised by the Board", "Staff Code of Conduct", the "Reform of Compensation Structure" and so on;

- reports on self-evaluation of the Board and Board Committees, which were organised and analysed by the Committee. The Committee also made recommendations to the Board regarding the results of the self-evaluation, with a view to further enhancing the role and effectiveness of the Board and Board Committees; and

- matters relating to the appointment of independent non-executive Directors to the boards of certain major subsidiaries of the Group.

Pursuant to the "**Policy on Directors' Remuneration**" adopted by the Company in 2005, in recommending the remuneration of Directors, the Committee makes reference to companies of comparable business type or scale, and the nature and quantity of work at both Board and Board Committee levels (including frequency of meetings and nature of agenda items) in order to compensate Directors reasonably for their time and efforts spent. The Committee will regularly review, deliberate and recommend the remuneration of Directors to the Board. Following the review by the Board, the proposed remuneration will be put to shareholders for final approval at general meetings. **No individual Director is allowed to participate in the procedures for deciding his/her individual remuneration package.** Information relating to the remuneration of each Director for 2006 is set out in Note 22 of the 2006 Annual Report. The present scale of Director's fees, including additional fees for membership of Board Committees, is given below:

Board of Directors:	
All Directors	HK\$200,000 p.a.
Board Committees:	
Chairman	HK\$100,000 p.a.
Other Committee members	HK\$50,000 p.a.

The **Nomination and Remuneration Committee** also has the delegated responsibility to **determine the specific remuneration packages of the executive Director and designated senior executives**, including share options, benefits in kind, pension rights, etc. Currently the principal components of the Company's remuneration packages for the executive Director and designated senior executives include basic salary, discretionary bonus and other benefits in kind. A significant portion of the executive Director's or designated senior executives' discretionary bonus is based on the Group's and the individual's performance during the year. The Committee reviews and recommends to the Board the annual performance targets for the executive Director and designated senior executives by reference to the corporate goals and objectives approved by the Board from time to time. The Committee also reviews the performance of the executive Director and designated senior executives against the targets set on an ongoing basis, and reviews and approves

their specific performance-based remuneration.

Based on the "Procedures for the Nomination and Appointment of Independent Non-executive Directors of the Company" adopted by the Committee in 2005, the Committee reviewed and approved the "**Procedures for the Nomination and Appointment of Independent Non-executive Directors for major subsidiaries in the Group**", thus further formalising the procedures for the nomination and appointment of independent non-executive directors of the major subsidiaries and enhancing the transparency of the same. Pursuant to such procedures, appropriate candidates were identified and appointed as independent non-executive directors to the boards of Nanyang and Chiyu respectively in 2006.

**Five Nomination and Remuneration Committee meetings were held during the year with an average attendance rate of 93%**. Individual attendance records of the relevant Directors are set out as follows:

Director	Number of Committee meetings attended	Attendance rate
Mr. SUN Changji ( <i>Chairman</i> )	5 out of 5	100%
Mr. LI Zaohang	5 out of 5	100%
Dr. FUNG Victor Kwok King	3 out of 5	60%
Mr. SHAN Weijian	5 out of 5	100%
Mr. TUNG Chee Chen	5 out of 5	100%
Mdm. YANG Linda Tsao	5 out of 5	100%

## Risk Committee

The Risk Committee currently has four members, of whom two are non-executive Directors and two are independent non-executive Directors. To be in line with the best corporate governance practices, in March 2006, the Board appointed Mr. Koh Beng Seng, the then newly appointed independent non-executive Director, as the Chairman of the Risk Committee.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- formulation of the risk appetite and risk management strategy of the Group, and determination of the Group's risk profile;
- identification, assessment and management of material risks faced by the various business units of the Group;
- review and assessment of the adequacy and effectiveness of the Group's risk management process, system and internal control;
- review and monitoring of the Group's compliance with the risk management policies, process, system and internal control, including the Group's compliance with requirements of prudence and laws and regulations in business development;
- review and approval of high-level risk-related policies of the Group; and
- review of significant or high risk exposures and transactions.

The work performed by the Committee in 2006 included the following:

- review of risk management limits;
- review of Risk Management Policy Statement, and a range of risk management policies covering credit risk, market risk, operational risk and stress testing;
- review and recommendation to the Board of the proposed approach to calculate minimum capital charge for credit and operational risks under Basel II, and the approval of the policies relating thereto;
- recommendations to the Board for further enhancing the Group's risk management framework and structure;
- review of significant or high risk exposures and transactions; and
- review of periodic risk management reports.

**Six Risk Committee meetings were held during the year with an average attendance rate of 90%.** Individual attendance records of the relevant Directors are set out as follows:

Director	Number of Committee meetings attended	Attendance rate
Mr. XIAO Gang ( <i>former Chairman</i> ) <sup>(Note)</sup>	2 out of 2	100%
Mr. KOH Beng Seng ( <i>Chairman</i> ) <sup>(Note)</sup>	4 out of 4	100%
Mr. HUA Qingshan	4 out of 6	67%
Mdm. ZHANG Yanling	5 out of 6	83%
Mr. TUNG Savio Wai-Hok	6 out of 6	100%

Note: Mr. Koh Beng Seng was appointed as the Chairman of the Risk Committee in the place of Mr. Xiao Gang with effect from 23 March 2006.

### Strategy and Budget Committee

The Strategy and Budget Committee currently comprises five members, of whom two are non-executive Directors, two are independent non-executive Directors, and one is the Chief Executive and executive Director. The Committee is chaired by Mdm. Yang Linda Tsao, an independent non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- review and monitoring of the Group's long term strategy;
- review of the process for formulating the Group's long term strategy to ensure that it is sufficiently robust to take into account the appropriate range of alternatives;
- monitoring of the implementation of the Group's long term strategy through agreed metrics and offering of strategic guidance to the Management;
- making of recommendations to the Board on the major investments, capital expenditure and strategic commitments of the Group and monitoring of the implementation of the same; and
- review and monitoring of the Group's regular/periodic (including annual) business plan and financial budget.

During the year, the Strategy and Budget Committee guided and monitored the Management's implementation of the Group's 2006-2011 Strategic Plan as approved by the Board in 2005. The Committee also played a prominent role in driving the formulation of the Group's key business strategies, including those for the development of China business, SME business, wealth management business, global market business and treasury business. The Committee monitored the implementation of the Group's budget and business plan for 2006. In planning for 2007, the Committee reviewed and endorsed the Group's 2007 financial budget and business plan, and recommended the same to the Board for approval.

**Five Strategy and Budget Committee meetings were held during the year with an average attendance rate of 92%.** Individual attendance records of the relevant Directors are set out as follows:

Director	Number of Committee meetings attended	Attendance rate
Mdm. YANG Linda Tsao ( <i>Chairlady</i> )	5 out of 5	100%
Mr. HE Guangbei	5 out of 5	100%
Mr. HUA Qingshan	4 out of 5	80%
Mr. ZHOU Zaiqun	4 out of 5	80%
Mr. TUNG Savio Wai-Hok	5 out of 5	100%

### Ad Hoc Committee

The Board established an ad hoc Independent Board Committee and an ad hoc IT Committee during the year.

The Independent Board Committee was established to advise the independent shareholders in relation to the acquisition of a 51% equity interest in BOC Life from BOC Insurance and the proposed revised caps and new annual cap for certain continuing connected transactions. The Independent Board Committee was comprised of Mr. Tung Chee Chen (Chairman), Dr. Fung Victor Kwok King, Mr. Shan Weijian, Mr. Tung Savio Wai-Hok and Mdm. Yang Linda Tsao, all being independent non-executive Directors. Based on the advice of NM Rothschild & Sons (Hong Kong) Limited, independent financial advisors to the Committee, the Independent Board Committee considered the terms of the relevant transactions to be fair, reasonable and in the interests of the Company and the shareholders as a whole, and therefore recommended the independent shareholders to vote in favour of the relevant transactions at the extraordinary general meeting on 26 May 2006. The Chairman of the Independent Board Committee and representatives of the independent

financial advisors were present at that meeting to respond to questions and comments raised by shareholders. The resolutions proposed at the meeting were duly passed by the independent shareholders by way of poll voting. The acquisition of 51% equity interest in BOC Life was completed in June 2006.

The IT Committee was established to conduct a high level review of specified aspects of the Group's IT strategies to ensure that the Group's business and the implementation of its business strategy is/will be supported by appropriate IT. The Committee is chaired by Mr. Tung Chee Chen and members of the Committee comprise of Mr. Li Zaohang, Mr. Koh Beng Seng and Mr. Tung Savio Wai-Hok. A reputable international consultant has been engaged to assist the Committee in its review. The Committee expects to conclude its review and submit a final report to the Board in the first half of 2007.

### Directors' Securities Transactions

The Company has adopted the "Code for Securities Transactions by Directors" to govern securities transactions by Directors. The terms

of the said Code are more stringent than the mandatory standards set out in the "Model Code for Securities Transactions by Directors of Listed Issuers" contained in Appendix 10 of the Listing Rules. Further, following the listing of the Company's parent company, Bank of China Limited, in June 2006, the Code has been revised so that the requirements set out therein apply equally to the Director's dealings in the securities of BOC. In this connection, the Company had made specific enquiry of all Directors, who confirmed that they had complied with the standards set out in both the Company's Code and the said Model Code throughout year 2006.

### External Auditors

Pursuant to the "Policy on External Auditors" approved by the Board in 2005, the **Audit Committee** reviewed and monitored and **was satisfied with the independence and objectivity of PricewaterhouseCoopers, the Group's external auditors, and the effectiveness of their audit procedures**, based on the principles and standards set out in the policy that were in line with international best practices. Upon the recommendation of the Audit



Committee, the Board will propose that PricewaterhouseCoopers be re-appointed as auditors of the Group at the Company's 2007 annual general meeting. Subject to authorisation by the shareholders, the Board will authorise the Audit Committee to determine the remuneration of PricewaterhouseCoopers.

For 2006, the fee charged by PricewaterhouseCoopers was HK\$37 million, of which HK\$29 million was for audit services and HK\$8 million related to other services. For 2005, the fee charged by PricewaterhouseCoopers was HK\$35 million, of which HK\$27 million was for audit services and HK\$8 million related to other services.

The Audit Committee was satisfied that the non-audit services did not affect the independence of PricewaterhouseCoopers. The non-audit service fees paid to PricewaterhouseCoopers in 2006 comprised mainly the tax-related services fee of HK\$2.4 million and the due diligence fee of HK\$4.9 million.

### Internal Control

The Board has the responsibility to ensure that the Group maintains sound and effective internal controls to safeguard the Group's assets.

The internal control system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss; to manage rather than completely eliminate the risk of system failure; and to assist in the achievement of the Group's objectives. In addition to safeguarding

the Group's assets, it also ensures the maintenance of proper accounting records and compliance with relevant laws and regulations.

Starting from 2005, the Group conducts an annual review of the effectiveness of its internal control systems covering all material controls, including financial, operational and compliance controls as well as risk management. The review is conducted by making reference to the guidelines and definitions given by the regulatory and professional bodies for the purpose of assessing five different internal control elements, namely, the control environment, risk assessment, control activities, information and communication, and monitoring. The assessment covers all the major internal controls and measures, including financial, operational and compliance controls as well as risk management functions. The annual review is coordinated by the Group's Internal Audit, which, after the Management and various business departments have performed their self-assessment, will carry out an independent examination and other post-assessment work on the review process and results. The results of the 2006 review have been reported to the Audit Committee and the Board.

**The Audit Committee and the Board considered that the key areas of the Group's internal control systems were reasonably implemented** to prevent material misstatement or loss, safeguard the Group's assets, maintain appropriate accounting records, ensure compliance with applicable laws and regulations,

as well as fulfill the requirements of the Code regarding internal control systems in general.

The key procedures that the Group has essentially established and implemented to provide internal controls are summarised as follows:

- With a management that functions under a rational organisational structure and whose authority and responsibility are clearly delineated, the Group has formulated policies and procedures to ensure reasonable checks and balances for all the operating units, reasonable safeguard for the Group's assets, the implementation of internal controls and adherence to relevant laws and regulations and risk management in its operations.
- The Management draws up and continuously monitors the implementation of the Group's strategies, business plans and financial budgets. The accounting and management systems that are in place provide the basis for evaluating financial and operational performance.
- The Group has various risk management and human resources policies. There are specific units and personnel that are responsible for identifying, assessing and managing all the major risks. These include reputation, strategic, legal, compliance, credit, market, operational, liquidity and interest rate risks. (The Group's risk management governance structure is given on page 41 to 46 in this Annual Report.)

- The Group has established an information technology governance structure that produces a range of reports on information systems and management, including information on the monitoring of various business units, financial information and operating performance. Such information facilitates the Management, business units and the regulatory bodies in assessing and monitoring the Group's operation and performance. Proper communication channels and reporting mechanisms are in place at various business units and levels to facilitate exchange of information.

- Pursuant to a risk-based approach and in accordance with the internal audit plan approved by the Audit Committee, the Group's Internal Audit conducts independent reviews on such aspects as financial activities, various business units, various kinds of risks, operations and activities. Audit reports are submitted directly to the Audit Committee. Internal Audit will closely follow up on the items that require attention and put forward recommendations for improvement.

- The Audit Committee reviews the reports submitted by external auditors to the Group's Management in connection with the annual audit as well as the recommendations made by regulatory bodies on internal control. Internal Audit will follow up on the same to ensure

timely implementation of the recommendations, and will also periodically report the status of the implementation to the Management and the Audit Committee.

### Communication with Shareholders and Shareholders' Rights

**The Board attaches a high degree of importance to continuous communication with shareholders, especially direct dialogue with them at the Company's annual general meetings. Shareholders are therefore encouraged to actively participate at such meetings.**

The Chairmen of the Board and all Board Committees, and representatives of PricewaterhouseCoopers were present at the Company's 2006 annual general meeting held on 26 May 2006 at the Hong Kong Convention and Exhibition Centre to respond to questions and comments raised by shareholders. Resolutions passed at the Company's 2006 annual general meeting included: adoption of the Company's and the Group's 2005 financial statements, declaration of 2005 final dividend, re-election of Directors, re-appointment of auditors and grant of a general mandate to the Board to issue and repurchase shares of the Company.

The Board is aware of investors' concern regarding the potential dilution of the shareholders' value arising from the exercise of power pursuant to the grant of a general mandate to issue shares to the Board. Given its commitment to high

standards of corporate governance, the Board announced at the 2006 annual general meeting certain **internal policies for the exercise of the powers granted to the Board under the general mandates to issue and repurchase shares** as follows:

- The Board will not exercise the mandate to issue shares for cash and unrelated to any asset acquisition in excess of 10% of the Company's issued share capital or at a discount that will result in significant dilution of shareholder value. In the exercise of such power to issue shares for cash, the Board will have regard to factors such as the Group's capital adequacy ratio, and in particular, its Tier 1 capital, cost and benefit of raising Tier 2 capital, need for cash for the Group's business development, the principle that shareholders should be treated equally and the alternative of conducting a rights issue.



The Company was granted a *Special Mention Award* by the judges of *Best Corporate Governance Disclosure Awards 2006* organised by the Hong Kong Institute of Certified Public Accountants, in recognition of our commitment to improving corporate governance and disclosure

- The Board has set the triggering events for the exercise of the power to repurchase shares, which include: market price of the Company's shares is lower than the fair value of the shares; the Group has surplus funds which is in excess of its short to mid term development requirements; and the Board considers it proper and appropriate to exercise the general mandate for enhancing the return on equity or net assets or earnings per share of the Company. In general, such purchases will be made on the Stock Exchange. However, if it is expected that the size of the purchases may lead to a disorderly market for the Company's shares, then the Board will consider making the purchases through a general offer, i.e. offer to all existing shareholders in proportion to their respective shareholdings. The price at which shares are repurchased will not be higher than the fair value of the shares of the Company.

The Board has resolved to adopt the above policies if it is granted by the shareholders the general mandates to issue and repurchase shares at the 2007 annual general meeting.

Apart from the annual general meeting, the Company also held an extraordinary general meeting on 26 May 2006 for the purpose of seeking the approval of the independent shareholders for the acquisition of a 51% equity interest in BOC Life from BOC Insurance and the proposed revised caps and new annual cap for certain continuing connected transactions. The Chairman of the Independent Board Committee and representatives of the Committee's independent financial advisors were present at the extraordinary general meeting to respond to questions and

comments raised by shareholders. The resolutions proposed at the general meeting were duly passed by the independent shareholders by way of poll voting.

In order to enhance the transparency of shareholders' voting, **all the resolutions proposed at the Company's 2007 annual general meeting will be voted on by poll** as in previous years. The Company has engaged Computershare Hong Kong Investor Services Limited, the Company's Share Registrar, to act as the scrutineer for such purpose. The results of the poll voting will be published in the press and on the Company's website at [www.bochk.com](http://www.bochk.com) and the Stock Exchange's website at [www.hkex.com.hk](http://www.hkex.com.hk) on the following business day.

In order that shareholders can have a better understanding of the agenda items to be discussed at the 2007 annual general meeting and to encourage their active participation so that exchange of views and communication can be further enhanced, **the Company has provided detailed information on the 2007 annual general meeting in a circular** which is despatched together with this Annual Report to the shareholders. This includes background information to the proposed resolutions, information on the retiring Directors and information on voting and other issues relating to the 2007 annual general meeting in the form of "Frequently Asked Questions" (including how to convene an extraordinary general meeting and how to put forward a proposal for consideration by shareholders at a general meeting).

Further shareholder information is set out in the "Investor Relations" section of this Annual Report. Shareholders who

wish to raise any queries with the Board may write to the Company Secretary at 52nd Floor, Bank of China Tower, 1 Garden Road, Hong Kong.

### **Directors' Responsibility Statement in relation to Financial Statements**

The following statement should be read in conjunction with the auditors' statement of their responsibilities as set out in the auditors' report contained in this Annual Report. The statement is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

The Directors are required by the Hong Kong Companies Ordinance to prepare financial statements, which give a true and fair view of the state of affairs of the Company. The financial statements should be prepared on a going concern basis unless it is not appropriate to do so. The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the requirements of the Hong Kong Companies Ordinance. The Directors also have general responsibilities for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors consider that in preparing the financial statements contained in this Annual Report, the Company has adopted appropriate accounting policies which have been consistently applied with the support of reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.