

Corporate Governance Report

Corporate Governance Practices

(a) *Application of Corporate Governance Principles*

The Group is committed to promoting and maintaining the highest standard corporate governance, with the objectives of (i) the maintenance of responsible decision making, (ii) the improvement in transparency and disclosure of information to shareholders, (iii) the continuance of respect for the rights of shareholders and the recognition of the legitimate interests of shareholders, and (iv) the improvement in management of risks and the enhancement of performance by the Group. The Group has applied the principles set out in the Code on Corporate Governance Practices (“HKSE Code”) contained in Appendix 14 of the Rules Governing the Listing of Securities on the Main Board of The Stock Exchange of Hong Kong Limited (“Listing Rules”) with these objectives in mind.

(b) *Promulgation of Company’s Corporate Governance Code*

To this end, the Group has promulgated a set of Code on Corporate Governance (“Company Code”) which sets out the corporate standards and practices used by the Group to direct and manage its business affairs. It is prepared by referencing to the principles, Code Provisions and Recommended Best Practices set out in the HKSE Code. In addition to formalizing existing corporate governance principles and practices, the Company Code also serves the purpose of assimilating existing practices with benchmarks prescribed by the HKSE Code and ultimately ensuring high transparency and accountability to the Group’s shareholders. The Company Code has been posted on the Company’s website.

(c) *Establishment of Board Committees*

On 3 August 2005, the Company set up the following board committees (the Audit Committee was established and had been in existence before that date):

- (i) Executive Committee;
- (ii) Audit Committee (terms of reference of the audit committee adopted on 24 March 1999 were superseded by the new terms of reference adopted on 3 August 2005);
- (iii) Remuneration Committee;
- (iv) Nomination Committee;
- (v) Finance Committee; and
- (vi) Regulatory Compliance Committee.

Apart from the audit committee and remuneration committee required by the HKSE Code, the Company has established four additional board committees to ensure maintenance of a high corporate governance standard. Terms of reference of all board committees set up by the Company have been posted on the Company’s website, as have (1) division of responsibilities between the Company’s Chairman and Managing Director and (2) duties and powers delegated to the Company’s Managing Director and matters reserved for decision of the Board of Directors (“Board”) of the Company.

(d) *Compliance of Company and HKSE’s Code’s Provisions*

The Group has complied with all provisions in the Company Code and the HKSE Code throughout the financial year ended 31 December 2006 with two deviations mentioned below.

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(e) *Deviations from HKSE Code*

HKSE Code provision A.4.1 provides that non-executive directors should be appointed for specific term, subject to re-election. The Company has deviated from this provision in that all non-executive directors of the Company are not appointed for specific term. They are, however, subject to retirement and re-election every three years. The reason for the deviation is that the Company does not believe that arbitrary term limits on directors' service are appropriate given that directors ought to be committed to representing the long term interests of the Company's shareholders and the retirement and re-election requirements of non-executive directors have given the Company's shareholders the right to approve continuation of non-executive directors' offices.

Pursuant to HKSE Code Provision A.2.1, the roles of Chairman and Chief Executive Officer of a listed company should be separate and should not be performed by the same individual. However, in view of the present composition of the Board, the in depth knowledge of Mr. Ho, Lawrence Yau Lung of the operations of the Group and of the gaming and entertainment sector in Macau in general, his extensive business network and connections in that sector and the scope of operations of the Group, the Board believes it is in the best interests of the Company for Mr. Ho, Lawrence Yau Lung to assume the roles of Chairman and Chief Executive Officer at this time and that such arrangement be subject to review by the Board from time to time.

Securities Transactions by Directors

The Company has adopted a code of conduct regarding directors' securities transactions on terms as set out in Appendix 10 of the Listing Rules. Having made specific enquiry of the Directors of the Company, all Directors have complied with the required standard of dealings and code of conduct regarding securities transactions by directors as set out in the Model Code for the year 2006.

The Board of Directors – Function and Composition

The Board is entrusted with the overall responsibility for promoting the success of the Company by the direction and supervision of the Company's business and affairs and the ultimate responsibility for the day to day management of the Company, which is delegated to the Chief Executive Officer/Managing Director and the management. Lists of (1) duties and powers delegated to the Company's Chairman and Managing Director and matters reserved for decision of the Board and (2) division of responsibilities between the Company's Chairman and Managing Director are given at the Company's website under the section "Corporate Governance".

The Board comprises a total of seven Directors, with three Executive Directors, namely, Mr. Ho, Lawrence Yau Lung¹ (Chairman and Chief Executive Officer), Mr. Tsui Che Yin, Frank and Mr. Chung Yuk Man, Clarence²; one Non-executive Director, namely, Mr. Ng Ching Wo; and three Independent Non-executive Directors, namely, Sir Roger Lobo, Dr. Lo Ka Shui and Mr. Sham Sui Leung, Daniel⁴. An Independent Non-executive Director has appropriate professional qualifications, accounting and financial management expertise.

Dr. Ho Hung Sun, Stanley, the former Chairman of the Company is the father of Mr. Ho, Lawrence Yau Lung, the Chairman and Chief Executive Officer of the Company.

Each of the Independent Non-executive Directors has made an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules. The Company is of the view that all Independent Non-executive Directors meet the independence guidelines set out in Rule 3.13 of the Listing Rules and are independent in accordance with the terms of the guidelines.

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The Directors acknowledge their responsibility for preparing the financial statements set out in this Annual Report which give a true and fair view and are prepared in accordance with the relevant statutory requirements and applicable accounting standards in force.

Board Operation

The Board meets regularly over the Company's affairs and operations. In 2006, the Board held seven meetings. The attendance record of each member of the Board is set out below:

Executive Directors	Attendance
Ho, Lawrence Yau Lung (<i>Chairman and Chief Executive Officer</i>)	7/7 ¹
Tsui Che Yin, Frank	7/7
Chung Yuk Man, Clarence (<i>Chief Operating Officer</i>)	3/3 ²
Ho Hung Sun, Stanley	2/2 ³
Non-executive Director	
Ng Ching Wo	4/7
Independent Non-executive Directors	
Sir Roger Lobo	6/7
Lo Ka Shui	6/7
Sham Sui Leung, Daniel	3/3 ⁴
Kwan Chiu Yin, Robert	0/2 ⁵

Remuneration Committee

As mentioned above, a Remuneration Committee was formed on 3 August 2005 for, inter alia, the following purposes:—

- (a) to make recommendations to the Board on policies and structure for remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration; and
- (b) to determine the remuneration packages for executive directors and senior management and to make recommendations to the board on the remuneration of Non-executive Directors.

Other details of the role and function of the Remuneration Committee are given at the Company's website under the section "Corporate Governance".

The Remuneration Committee is made up of the Company's Non-executive Director and Independent Non-executive Directors, namely Dr. Lo Ka Shui (Chairman), Sir Roger Lobo and Mr. Ng Ching Wo.

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In 2006, the Remuneration Committee held four meetings. The attendance record of each member of the Committee is set out below:

	Attendance
Lo Ka Shui (<i>Chairman</i>)	4/4
Sir Roger Lobo	4/4
Ng Ching Wo	4/4

The formulation of the Group's remuneration strategy and policy is based on the principles of equity and market competitiveness so as to drive staff to work towards the mission of the Group and to retain talents. The Company has also adopted a share option scheme as an incentive to Directors and employees. Details of the scheme are set out in Note 51 to the consolidated financial statements.

The emoluments of the Directors are determined with regard to the performance of individuals, the Company's operating results and market standards. During the year, the Remuneration Committee has considered and approved (a) bonus payments to employees of the Group, (b) salary increases of senior management of the Group, (c) range of salary increases for employees of the Group and (d) the Directors' fees. The Committee has also made recommendations to the Board in relation to the remuneration packages of the Directors appointed during the year in line with the Group's remuneration strategy and policy.

Nomination Committee

As mentioned above, a Nomination Committee was formed on 3 August 2005 for, inter alia, the following purposes:–

- (a) to review the structure, size and composition (including the skills, knowledge and experience) of the Board;
- (b) to identify individuals suitably qualified to become Board members and make recommendations to the Board on the selection of individuals nominated for directorship; and
- (c) to make recommendations to the Board on relevant matters relating to the appointment or re-appointment of directors and succession planning for directors.

The Nomination Committee is made up of the Company's Executive Director, Non-executive Director and Independent Non-executive Director, namely Mr. Ng Ching Wo (Chairman), Sir Roger Lobo and Mr. Ho, Lawrence Yau Lung.

In 2006, the Nomination Committee held one meeting. The attendance record of each member of the Committee is set out below:

	Attendance
Ng Ching Wo (<i>Chairman</i>)	1/1 ⁶
Sir Roger Lobo	1/1
Ho, Lawrence Yau Lung	Not applicable ⁷
Kwan Chiu Yin, Robert	0/1 ⁵

During the year, the Nomination Committee has reviewed the structure, size and composition of the Board. The Committee has also recommended the appointment of Mr. Chung Yuk Man, Clarence and Mr. Sham Sui Leung, Daniel as an Executive Director and an Independent Non-executive Director respectively to the Board.

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Executive Committee

As mentioned above, an executive committee was formed on 3 August 2005 for, inter alia, the following purposes:–

- (a) to oversee the implementation of the Company's strategic objectives and risk management policies; and
- (b) to oversee the business and operations of all of the business units of the Group.

The Executive Committee is made up of the Company's Executive Directors, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank, Mr. Chung Yuk Man, Clarence⁸ and members of the Company's senior management. The Executive Committee held meetings from time to time to discuss operational matters of the Company's business and new projects.

Finance Committee

As mentioned above, a finance committee was formed on 3 August 2005 for, inter alia, the following purposes:–

- (a) to conduct review on matters such as Group wide financial, accounting, treasury and risk management policies, major financing transactions, corporate plans and budgets; and
- (b) to review major acquisitions and investments and their funding requirements.

The Finance Committee is made up of the Company's Executive Directors, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank and Mr. Chung Yuk Man, Clarence. The Finance Committee held meetings from time to time to discuss financial matters of the Company's new and existing business.

Regulatory Compliance Committee

As mentioned above, a regulatory compliance committee was formed on 3 August 2005 for, inter alia, the following purposes:–

- (a) to review and advise upon matters in respect of the present or future regulation of the Company's gaming and financial services businesses; and
- (b) to comply with applicable laws and regulations, including the Listing Rules.

The Regulatory Compliance Committee is made up of the Company's Executive Directors and Independent Non-executive Director, namely, Mr. Ho, Lawrence Yau Lung (Chairman), Mr. Tsui Che Yin, Frank, Dr. Lo Ka Shui and the Group Legal Counsel (non-voting capacity). The Regulatory Compliance Committee held meetings from time to time to discuss the ongoing compliance matters of the Group.

Audit Committee

The Company's Audit Committee was formed on 24 March 1999 and is composed of a Non-executive Director and two Independent Non-executive Directors of the Company as at 31 December 2006, namely, Sir Roger Lobo (Chairman), Mr. Sham Sui Leung, Daniel and Mr. Ng Ching Wo. The primary duties of the Audit Committee are (a) to review the Group's annual reports, financial statements and interim reports, (b) to provide advice and comments thereon to the Board and (c) to review and supervise the financial reporting process and internal control procedures of the Group. Other details of the role and function of the Audit Committee are available on the Company's website under the section "Corporate Governance".

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In 2006, the Audit Committee held two meetings. The attendance record of each member of the Committee is set out below:

	Attendance
Sir Roger Lobo (<i>Chairman</i>)	2/2 ⁹
Ng Ching Wo	2/2
Sham Sui Leung, Daniel	1/1 ¹⁰
Kwan Chiu Yin, Robert	0/1 ⁵

The Audit Committee has carefully reviewed the Company's half-yearly and annual results and its system of internal control and has made suggestions to improve them. The Committee also carried out and discharged its duties set out in HKSE Code. In the course of doing so, the Committee has met the Company's management, qualified accountant and external auditors several times during 2006.

Auditors' Remuneration

For the year ended 31 December 2006, the Company paid to its auditors, Deloitte Touche Tohmatsu, around HK\$4.8 million for audit and non-audit services provided to the Company. Out of this amount, HK\$3.0 million was for audit services and the balance of HK\$1.8 million was for non-audit services (such as interim review of the Group's financial statements, audit of the Group's ORSO schemes for certain subsidiaries, audit work related to the spin-off, agreed-upon procedures for agreeing the Company's final results announcement and tax services).

Internal Control

The Board recognises its overall responsibility for the establishment and maintenance of a sound system of internal control and the review of its effectiveness in order to safeguard the shareholders' investment and the Group's assets.

(a) Internal Control System

The Group's system of internal control consists of various policies, procedures and control activities designed to provide reasonable assurance against material misstatement or loss. The sound system of internal control is developed to safeguard the Group's assets and resources against unauthorized use or disposition, ensure the transactions are executed in accordance with management's authorization and ensure the accounting records are reliable for preparing financial information internally and publicly.

(b) Internal Audit Function

The Group has its Internal Audit Department to assist the Board to independently review the Group's internal controls throughout the year ended 31 December 2006. The Internal Audit Department reports directly to the Audit Committee and brings appropriate matters identified during the course of audits to the Audit Committee's attention. The Internal Audit Department also has the rights to consult the Audit Committee without reference to the management. This reporting structure allows the Internal Audit Department to maintain its independence.

(c) Internal Audit Charter

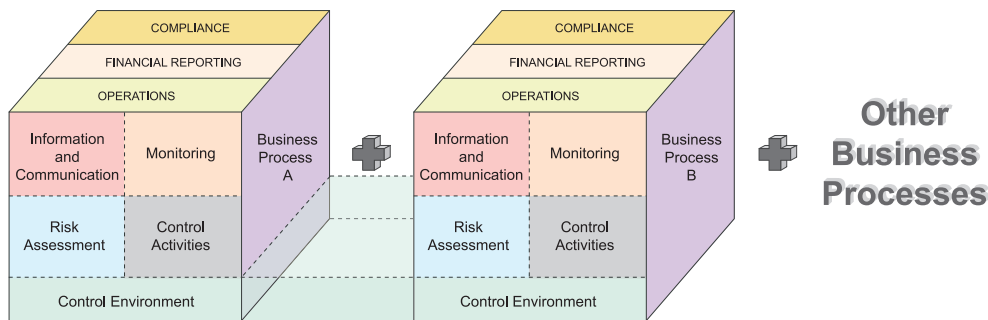
The mission, scope of work, accountability, independence, authority and responsibility of the Internal Audit Department are clearly stated in a written Internal Audit Charter, which is approved and periodically reviewed by the Audit Committee.

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(d) *Risk Assessment and Internal Control Review*

The Internal Audit Department adopts a risk and control based audit approach and has established an integrated framework of internal controls in assessing the adequacy and effectiveness of the Group’s system of internal control on an on-going basis. The integrated framework is developed by referring to the COSO (“The Committee of Sponsoring Organizations of the Treadway Commission”) framework, as recommended by the Hong Kong Institute of Certified Public Accountants.

The five components of the integrated framework serve as the assessment criteria for the review, as illustrated below:



Integrated framework of internal controls

(1) *Control Environment*

Control environment is the foundation for other components of the internal control system. Factors of control environment include ethical values and competence of personnel, direction provided by the Board and effectiveness of management.

(2) *Risk Assessment*

Risk assessment involves the identification and analysis of risks underlying the achievement of process objectives, including risks relating to the changing regulatory and operating environment, which serves as a basis for determining how such risks should be mitigated and managed.

(3) *Control Activities*

Control activities entail a diverse range of policies and procedures that help to ensure management directives are carried out and any actions that may be needed to address risks in order to achieve process objectives.

(4) *Information and Communication*

Information and communication comprises effective processes and systems to identify, capture and report operational, financial and compliance-related information in a form and timeframe that enable staff to carry out their responsibilities.

(5) *Monitoring*

Monitoring is a process that assesses the adequacy and quality of the internal control system’s performance over time. Deficiencies in internal controls should be reported to the appropriate level upstream, which may be, for example, senior management, the Audit Committee, or the Board.

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During the year, the Internal Audit Department has assisted the Board to conduct an annual risk assessment and internal control review to identify significant risks faced by the Group and evaluate the existing internal controls to mitigate these risks.

(e) *Internal Audit Planning*

Annual internal audit plan for the Group is formulated based on the results of the annual assessment of risks and review of internal control. The annual plan so formulated is reviewed by the Audit Committee. In addition to the internal audit plan, Internal Audit Department also conducts other projects and investigations as may be required.

(f) *Price-sensitive Information*

In respect of procedures and internal controls for the handling and dissemination of price-sensitive information, a mechanism has been established to identify, analyze and disclose any material price-sensitive information with reference to the “Guide on disclosure of price-sensitive information” issued by the Hong Kong Exchanges and Clearing Limited. Besides, the Group’s staff handbook contains the general prohibition from buying or selling the Group’s securities while staff members are in possession of any insider information about the Group. Staff members are also prohibited from disclosing such information to persons who do not have a demonstrable need to know the information.

The Board has reviewed and is satisfied with the adequacy and effectiveness of the Group’s system of internal control including, in particular, the operational, financial and compliance controls and risk management functions and no significant internal control deficiency has been identified.

Shareholders’ Rights

Pursuant to Article 66 of the Articles of Association of the Company, the Board may, whenever it thinks fit, convene an extraordinary general meeting, and extraordinary general meetings shall also be convened on requisition, as provided by the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (“Companies Ordinance”). In accordance with Section 113 of the Companies Ordinance, members holding at the date of the deposit of the requisition not less than one-twentieth of such of the paid-up capital of the Company as at the date of the deposit carries the right of voting at general meetings of the Company can request the Company to convene an extraordinary general meeting. The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the Company.

The Company regards the annual general meeting of the Company (“AGM”) an important event as it provides an opportunity for the Board to communicate with the shareholders. Active participation by the shareholders at the AGM is highly welcomed. Notices of AGM and related papers are sent to the shareholders no less than 21 days before the meeting.

The Company Secretarial Department and the Public Relations Department respond to letters and telephone enquiries from shareholders/investors. Whenever a shareholder has any enquiries on matters in relation to the Company, he or she may put such enquires in writing and address the same to the Company Secretary at the registered office of the Company at 38th Floor, The Centrium, 60 Wyndham Street, Central, Hong Kong or through email to info@melco-group.com. The website of the Company at <http://www.melco-group.com> also provides a medium to make information of the Company and the Group available to the shareholders with a section on “Corporate Governance” included.

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Notes:

- (1) Mr. Ho, Lawrence Yau Lung was appointed as the Chairman and Chief Executive Officer with effect from 15 March 2006.
- (2) Mr. Chung Yuk Man, Clarence was appointed as an Executive Director with effect from 18 May 2006.
- (3) Dr. Stanley Ho resigned as the Chairman and an Executive Director with effect from 15 March 2006.
- (4) Mr. Sham Sui Leung, Daniel was appointed as an Independent Non-executive Director with effect from 14 June 2006.
- (5) Mr. Kwan Chiu Yin, Robert resigned as an Independent Non-executive Director and ceased to be a member of the Nomination Committee and the Audit Committee with effect from 15 March 2006.
- (6) Mr. Ng Ching Wo was appointed as the Chairman of Nomination Committee with effect from 14 June 2006.
- (7) Mr. Ho, Lawrence Yau Lung was appointed as a member of the Nomination Committee with effect from 14 June 2006.
- (8) Mr. Chung Yuk Man, Clarence was redesignated from a non-voting co-opted member to a member of the Executive Committee with effect from 18 May 2006.
- (9) Sir Roger Lobo was appointed as the Chairman of the Audit Committee with effect from 14 June 2006.
- (10) Mr. Sham Sui Leung, Daniel was appointed as a member of the Audit Committee with effect from 14 June 2006.