





Our approach to risk management

We maintain a sound and effective system of risk management and internal controls to support us in achieving high standards of corporate governance.

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We identify and manage both risks and opportunities, and our internal controls review the effectiveness and efficiency of our operations, the reliability of financial reporting, and compliance with applicable laws and regulations – all aimed at building a sustainable business.

Risk Management and Internal Control

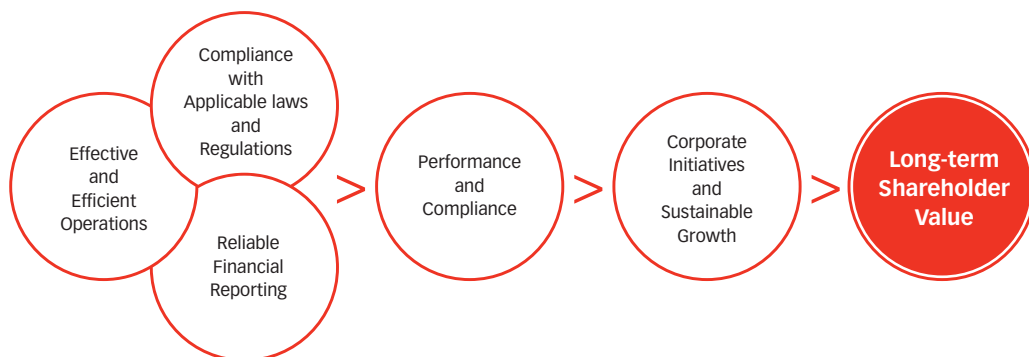
The Board is responsible for maintaining a sound and effective system of risk management and internal controls at Li & Fung and for reviewing its effectiveness. Such a system is designed to manage the risk of failure to achieve corporate objectives and aims to provide reasonable, but not absolute, assurance against material misstatement, loss or fraud.

The Board has delegated to management the design, implementation and ongoing assessment of our system of internal controls, while the Board through its Audit Committee oversees and reviews the adequacy and effectiveness of relevant financial, operational and compliance controls and risk management procedures that have been in place. The Audit Committee annually reviews the emerging risks of the Group, and the risk management and internal controls in place to address those risks. Qualified personnel within the business maintain and monitor these systems of controls on an ongoing basis. Described below are the main characteristics of our risk management and internal control framework:

Control Environment

The Group operates within an established control environment, which is consistent with the principles outlined in *Internal Control and Risk Management – A Basic Framework* issued by the Hong Kong Institute of Certified Public Accountants. The scope of internal control relates to three major areas: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations.

Our Internal Control Framework is Designed to Achieve:



Management of Key Risks

1. OPERATIONS RISK MANAGEMENT

We have adopted a tailored governance structure with defined lines of responsibility and appropriate delegation of authority. This is characterized by the establishment of an Operation Support Group to centralize the function and exercise control over global treasury activities, financial and management reporting, human resources and information technology systems. All these controls of major operations are supplemented with written policies and Key Operating Guidelines (KOGs) tailored to the needs of respective operating groups in the markets in which we operate.

These policies and KOGs cover key risk management and control standards for our operations worldwide including the businesses of our different operating groups, commitments, credit control and advance payments, capital expenditure, authorizations and approvals for payment processes, and product liability insurance. They also cover administrative activities including information technology user policy, business travel policy, HR processes, training sponsorship and procedures for handling grievances.

Contingency and business continuity plans including fire drills, preparedness for pandemics and failover tests of key operating systems are also examined periodically to evaluate effectiveness. Corrective actions are taken whenever necessary.

2. FINANCIAL AND CAPITAL RISK MANAGEMENT

The Board approves the Company's Three-Year Plan financial budgets and reviews its operating and financial performance and key performance indicators against the budget on a semi-annual basis. Management closely monitors actual financial performance at both the Group and operating group levels on a quarterly and monthly basis.

The Group has adopted a principle of minimizing financial and capital risks. Details of our financial and capital risk management covering market risk (including foreign exchange risk, price risk, cash flow and fair value interest rate risk), credit risk and liquidity risk are set out in *Notes 39 and 40* to the accounts on pages 196 to 200.

3. INVESTMENT RISK MANAGEMENT

The Investment Committee (comprising the Honorary Chairman, Group Chairman, Executive Directors and senior management) develops investment control procedures, and monitors and approves major investments and acquisitions. Significant investments and acquisitions (with consideration above a threshold as pre-set by the Board) also require Board approval.

Management also monitors the integration process of newly acquired businesses through a structured post-acquisition integration program focusing on the alignment of operational and financial controls with the Group's standards and practices. Any significant integration issues must be reported to the Risk Management and Sustainability Committee.

4. REPUTATION RISK MANAGEMENT

The reputation capital of Li & Fung is built on its long-established standards of ethics in conducting business. Our core ethical practices as endorsed by the Board are set out in our Code of Conduct and Business Ethics (available at our corporate website under the Sustainability section) for all Directors and employees. A number of accompanying policies, guidelines and procedures covering anti-bribery, gifts, entertainment and hospitality, declaration of interest, and whistle-blowing were created to set a framework to help our people make decisions and comply with both the ethical and behavioral standards of Li & Fung. For ease of reference and as a constant reminder, the Code and the accompanying policies and guidelines are available on One Family, our internal communications platform.

All colleagues are required to abide by the Code of Conduct and training sessions are regularly held to reiterate the Company's zero-tolerance approach to bribery and the importance of proper business ethics. Any ethical cases or concerns raised through our guidelines on whistle-blowing and reporting of concerns are investigated independently.

Li & Fung is committed to upholding the 10 principles of the United Nations' Global Compact regarding human rights, labor, environment and anti-corruption. As included in our Code of Conduct, we uphold the International Labour Organization's core conventions for the elimination of forced, compulsory or underage labor, elimination of discrimination in respect of employment and occupation, and respect for freedom of association and collective bargaining. We also acknowledge our responsibility to maintain a respectful workplace that is free of all forms of discrimination or harassment.

In 2014, no incident of non-compliance with the Company's Code of Conduct that has significant impact to our operations was reported.

5. REGULATORY COMPLIANCE RISK MANAGEMENT

The Corporate Compliance group is comprised of the Corporate Governance and Corporate Secretarial teams. Under the supervision of the Group Chief Compliance Officer and in conjunction with designated internal and external legal advisors, the team regularly reviews adherence to relevant laws and regulations, Listing Rules compliance, public disclosure requirements and our standards of compliance practices.

6. INFORMATION TECHNOLOGY RISK MANAGEMENT

We continued to invest in information technology systems to support transactional volume growth with improved information availability and controls, and to enhance the security of our systems to manage cyber security risks.

Our Total Sourcing system, which is a controlled platform for engaging with our vendor community, continued to be enhanced to simplify operations and improve productivity in transactions and information sharing. LF Portal, our dedicated portal for customers to access business information, now provides dashboard alternatives to traditional reports in a secured environment.

Enhancement of the company's overall system security continues to receive high attention. Actions taken include further investments in people and enhanced security processes, engaging external companies to review and provide additional managed services including vulnerability scan and security awareness trainings, as well as separating the governance and reporting structures of the IT security team from the Company's infrastructure group. Moreover, the Network Operation Centre (NOC) was newly set up to closely monitor network devices and servers on a 7x24 basis. The NOC also improves visibility and responsiveness in case of any system failure.

In 2014, disaster recovery for all critical systems and applications were tested successfully.

Risk Management Monitoring

In conjunction with the Audit Committee, the Risk Management and Sustainability Committee regularly monitors and updates the Group's risk profile and exposure and reviews the effectiveness of the system of internal control in mitigating risks. Key risk areas covered by the Committees include reputation, business credit, financial and operational risks of our supply chain operations, investment and acquisitions, taxation, inventory and receivable management, group-wide insurance, human resources, contingency and disaster recovery, IT governance, corporate responsibility and sustainability.

Internal and External Audit

Internal Audit

The Internal Audit team sits within the Corporate Governance team. Under the supervision of the Group Chief Compliance Officer, it independently reviews compliance with Group policies and guidelines as well as legal and regulatory requirements, risk management and internal controls and evaluates their adequacy and effectiveness. The Group Chief Compliance Officer reports all major findings and recommendations to the Audit Committee on a regular basis.

The Corporate Governance team's Internal Audit Plan is linked to the current Three-Year Plan and was reviewed and endorsed by the Audit Committee.

The principal features of the tasks of the Corporate Governance team include:

- Internal Audit plan as prepared under a risk-based assessment methodology that covers the Group's significant operations over a three-year cycle period;
- An audit scope which covers significant controls including financial, operational and compliance controls, and risk management policies and procedures;
- Unrestricted access to all the information needed for review of all operations, controls and compliance with KOG and corporate policies, rules and regulations; and
- Review of special areas of concerns or risks as raised by the Audit Committee, the Risk Management and Sustainability Committee or senior management.

Major audit findings and recommendations from the Corporate Governance team, and management's response to these findings and recommendations, are presented at Audit Committee meetings. The implementation of all recommendations is followed up on a three-month basis and the status is reported to the Audit Committee at each of its meetings.

As part of the annual review of the effectiveness of the Group's risk management and internal control systems for 2014, management conducted an Internal Control Self-Assessment of business operations and relevant accounting functions. The Corporate Governance team has independently performed a post-assessment review on the findings noted in the self-assessment programs and considered that sound internal control practices were in place for 2014.

External Audit

Our external auditor, PricewaterhouseCoopers (PwC), performs independent statutory audits of the Group's accounts. To facilitate the audit, the external auditor attended all meetings of both the Audit Committee and the Risk Management and Sustainability Committee. The external auditor also reports to the Audit Committee any significant weaknesses in our internal control procedures which might come to its notice during the course of audit. PwC noted no significant internal control weaknesses in its audit for 2014.

Overall Assessment

Based on the respective assessments made by management and the Corporate Governance team and also taking into account the results of the work conducted by the external auditor for the purpose of its audit, the Audit Committee considered that for 2014:

- The risk management and internal controls and accounting systems of the Group were in place and functioning effectively, and were designed to provide reasonable but not absolute assurance that material assets were protected, business risks attributable to the Group were identified and monitored, material transactions were executed in accordance with management's authorization and the accounts were reliable for publication.
- There was an ongoing process in place for identifying, evaluating and managing the significant risks faced by the Group.
- The resources, qualifications, experience, training programs and budget of the employees of the Group's accounting and financial reporting teams were adequate.