

Our Approach to Risk Management

We maintain a solid, 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 to build a sustainable business.

Risk Management and Internal Control

Li & Fung acknowledges that risk is inherent in our business and the markets in which we operate, and we undertake and monitor risk in pursuit of our strategic and business objectives. The challenge is to identify, understand and manage risks so they can be minimized, transferred or avoided. This demands a proactive approach to risk management and an effective group-wide risk management framework which helps anticipate risk and the Company's exposure, put controls in place to counter threats and effectively pursue the set approach.

The Board is responsible for maintaining a solid, effective system of risk management and internal control and for reviewing its effectiveness, and the adequacy of necessary policies and procedures. We recognize that risk management is the responsibility of all our people as an integral part of our day-to-day business process. Our 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 delegates to management the design, implementation and ongoing assessment of our systems of risk management and internal control, and through its Audit Committee oversees and reviews the adequacy and effectiveness of relevant financial, operational and compliance controls and risk management procedures that are in place. The Audit Committee, in conjunction with the Risk Management and Sustainability Committee, reviews the emerging risks of the Group annually and the risk management and internal controls in place to address those risks. Qualified professionals within the business maintain and monitor these systems of control on an ongoing basis.

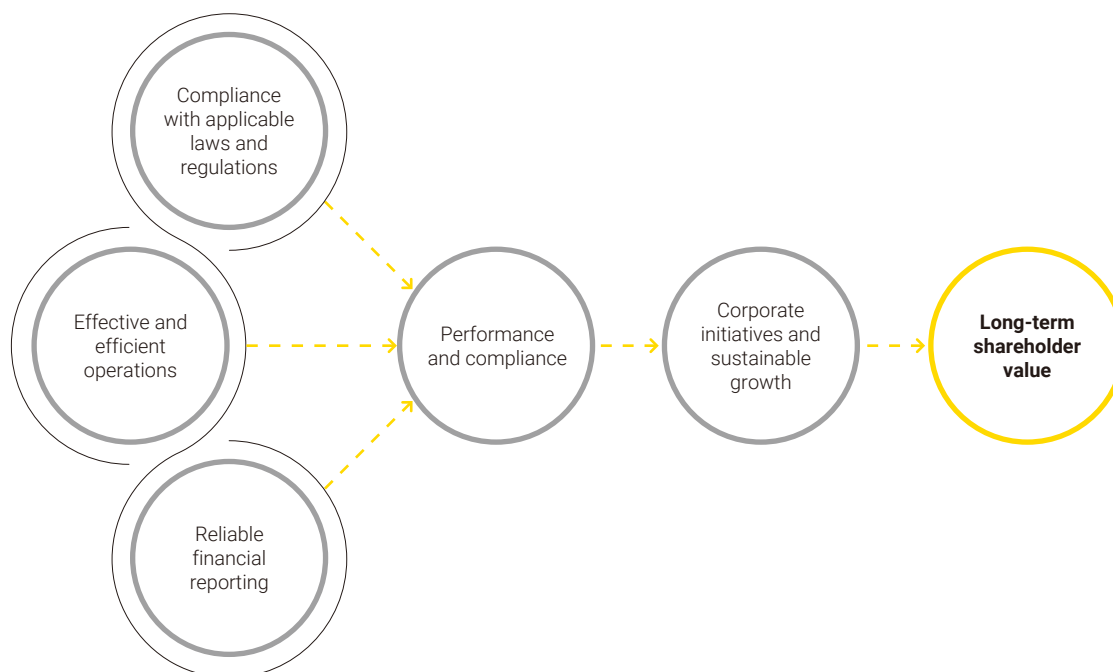
Described below are the main characteristics of our risk management and internal control framework.

Control Environment

The control environment is the foundation on which an effective system of internal control is built and operated. 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.

The Group operates within an established control environment, consistent with the principles outlined in Internal Control and Risk Management – A Basic Framework issued by the Hong Kong Institute of Certified Public Accountants.

Our Internal Control Framework is Designed to Achieve



Our Governance Structure

Our governance structure enables risk identification and escalation whilst providing assurance to the Board. We assign clear roles and responsibilities for managing risk and

maintain systems to facilitate the implementation of policies and guidelines. This structure comprises three layers of roles and responsibilities to manage risk and internal control as follows:

Role	Accountability	Responsibilities
Oversight	Audit Committee of the Board, Risk Management and Sustainability Committee of the Board	Oversight of corporate governance, financial reporting, risk management and internal control systems
Risk and control owner	Li & Fung Management and Operations Support Group	<ul style="list-style-type: none"> Day-to-day execution and monitoring of internal control Strategic policies and operating guidelines formulation and execution Balance between business operational efficiency and exercising internal control Ensuring that critical risks are reported to the Board, along with the status of actions taken to manage these risks
Risk monitoring and communication	Corporate Compliance team	<ul style="list-style-type: none"> Supporting the Board in the evaluation of risk management and internal control systems to identify areas for improvement Monitoring of corporate governance disclosure, statutory and listing rules compliance Undertaking of independent investigations

Management of Key Risks

Li & Fung's risk management process is embedded in our strategy formulation, business planning, capital allocation, investment decisions, internal controls and day-to-day operations. This includes risk identification, exposure evaluation, control development and execution. There is also a continual process with periodic monitoring, review and reporting to the Risk Management and Sustainability Committee. Emerging risks that may have an impact on the Group are also discussed in the Audit Committee meetings.

The following are considered material risks faced by the Group and are managed as such:

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 Operations Support Group (OSG) to centralize business support functions and exercise control over global treasury activities, financial and management reporting, human resources (HR), corporate services, and legal and information technology systems. This ensures adequate segregation of duties and a series of checks and balances between OSG and management so that all material transactions, activities, processes, wrongdoings or irregularities can be identified.

All controls of major operations are supplemented by written policies and Key Operating Guidelines (KOGs) tailored to the needs of the 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 use, staff expense claims, business travel, HR processes, training sponsorship and procedures for handling grievances. Our policies and KOGs are periodically reviewed and amended when considered necessary, in line with the dynamic changes in our business environment and operations.

The compliance with these KOGs is also subject to periodic assessment by the internal audit team during the compliance audits, which are conducted on an ongoing basis across the Group throughout the year. Any significant non-compliance incidents as identified need to be followed up for proper rectification and reported to the Audit Committee periodically.

Contingency and business continuity plans, crisis management including fire drills, preparedness for pandemics and natural disasters and failover tests of key operating systems are also examined periodically to evaluate effectiveness. In 2017, no significant corrective action needed to be taken.

With the strategic divestment of three of our product verticals, Furniture, Sweaters and Beauty, and a renewed focus on our core business, we anticipate further streamlining and simplification of our operations and processes from 2018 onward.

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. Monthly updates are also provided to the Board to give timely and comprehensive assessments of the Group's performance, position, prospects and economic performance. Management closely monitors actual financial performance at both the Group and operating group levels, on a monthly and quarterly 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 36 and 37 to the "Financial Statements" on pages 248 to 252.

3. INVESTMENT RISK MANAGEMENT

The Investment Committee (comprising the Honorary Chairman, Group Chairman, Executive Directors and senior management) reviews strategic investments and acquisitions under a rigorous investment process. Significant investments and acquisitions (with consideration above a threshold pre-set by the Board) also require Board approval. Procedures are in place to monitor the ongoing post-acquisition performance of the investments.

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 reputational 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 (Code), available on our internal and external websites, for all Directors, employees and other stakeholders. A number of accompanying policies, guidelines and procedures covering anti-bribery, gifts, entertainment and hospitality, declaration of interest and whistleblowing were created to set a framework for our people to make decisions and comply with 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 employees are required to abide by the Code and they must apply business principles and ethics which are consistent with those expected by the Board and the Company's Shareholders and other stakeholders. Employees are also required to declare any conflicts of interest when they arise, and any reported conflicts are followed up on by our HR, Legal and/or Corporate Governance divisions. Training sessions are regularly held throughout our global operations to foster an ethical culture and reiterate the Company's zero-tolerance approach to bribery and the importance of proper business ethics.

In 2017, we formed a Business Ethics Education Working Group (Working Group), led by our Learning & Organizational Development (L&OD) team. The Working

Group comprises members from L&OD, Legal, Corporate Governance, Digital Learning, HR and business units to allow cross-functional collaboration and enable the following contributions:

- Legal and Corporate Governance members provide their technical expertise, real-life case studies and verification of training materials
- Business unit members share their concerns, frequently encountered situations and risks to the business
- L&OD team delivers workshops, provides train-the-trainer training for overseas offices to ensure local HR and line managers are well-equipped to deliver workshops and handle business ethics situations locally
- Digital Learning team designs the electronic learning platforms so that all employees can access business ethics training anytime and anywhere. An electronic learning platform for all employees will be launched in 2018 to further strengthen employee awareness of the Company's ethical values

The aim of the Working Group is to make a positive impact on the Group's corporate compliance culture and work ethics by providing educational workshops and e-learning materials to employees. We consider education an important way to remind our employees of our core value of upholding rigorous business ethics and integrity, to create a stronger Li & Fung and maintain a sustainable business and our reputation.

Any ethical cases or concerns raised through our guidelines on whistleblowing and reporting of concerns are investigated independently. Disciplinary actions, including summary dismissal or police involvement, are taken in any serious cases.

Additionally, our suppliers are required to acknowledge their understanding of our Li & Fung Supplier Code of Conduct, which stipulates our ethical standards and requirements for doing business and emphasizes our zero tolerance of any kind of bribery, use of child or forced labor or serious health and safety issue. As outlined in "Our Supply Chain" section, suppliers are periodically subject to compliance auditing to ensure their compliance with our Supplier Code of Conduct.

Our internal audit program integrates the assessment of compliance with the Code and the accompanying policies, guidelines and procedures. The Internal Audit team assesses the significance and risk profiles (e.g. country specific, labor intensity, compliance culture, corruption vulnerability, complexity of regulations, transaction complexity) of the Group's business, operations and processes when determining the audit scope. The scope of internal audits covers the following in respect of the Code:

- Reviewing compliance with the Code and relevant policies and guidelines during the onsite audit of global offices and operations, including business transactions and related documentation
- Reviewing the Code self-assessment program completed by global offices with relevant supporting documentation
- Conducting interactive forums, training and/or individual meetings with management and our people to ensure a culture of good corporate governance, risk identification and compliance is embedded in operations

We are committed to upholding the ten principles of the United Nations' Global Compact regarding human rights, labor, environment and anti-corruption. As included in our Code, 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. In 2017, we shared our Disclosure Statement on Modern Slavery and the Company's policies and actions relating to modern slavery and human trafficking in business and the supply chain. We also acknowledge our responsibility to maintain a respectful workplace that is free of all forms of discrimination or harassment.

5. REGULATORY COMPLIANCE RISK MANAGEMENT

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

With the launch of Organisation for Economic Co-operation and Development/G20 Base Erosion and Profit Shifting (BEPS) projects, there come stricter and more demanding taxation reporting requirements in different jurisdictions. Compliance with these rules becomes more challenging as some non-G20 countries also reacted by legislating new taxation laws in line with the BEPS requirements. Our in-house taxation experts and external advisors are working on aligning our processes and practices to ensure compliance with the new requirements.

6. INFORMATION TECHNOLOGY RISK MANAGEMENT

Mitigating cyber security risk continues to be one of our strategic focuses in our digital transformation journey.

Being awarded the ISO 27001 Information Security Management certification in 2017 reaffirms the Company's commitment to protect users and clients from cyber security threats. We constantly strengthen our three-tiered approach of providing user awareness training, updating our technology and improving our processes in order to prevent, detect and mitigate security related incidents that might cause financial loss and reputational damage.

We strive to discover any looming threats, eliminate them and restore order immediately. Together with managed security services subscribed from top security experts, we have implemented our Security Operation Center (SOC) with state-of-the-art technology for 24/7 monitoring on any suspicious activities. To mitigate potential damage, we have well-developed comprehensive security incident handling procedures to respond to different types of attacks effectively. At regular intervals, we provide tailor-made security awareness training, such as phishing exercises through various channels, to help our people become more cautious about cyber security.

As information security is becoming increasingly important, we will continue to use a systematic and risk-based approach to manage the security of our information assets, including financial information, intellectual property, employee details or information entrusted to the Company by third parties. We will continue to enhance our security posture and ensure system availability through our resilient infrastructure setup.

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, HR, contingency and disaster recovery, IT governance, corporate responsibility and sustainability, and specific risks such as operational and adaptation risk arising from climate change.

Internal and External Audit

Internal Audit

The internal audit function is carried out by the Corporate Governance team and its mission, authority, roles and responsibilities were formalized under internal audit charter adopted by the Audit Committee. Under the supervision of the Group Chief Compliance and Risk Management Officer, it independently reviews compliance with Group policies and guidelines, legal and regulatory requirements, risk management and internal controls and evaluates their adequacy and effectiveness. The internal audit team has unrestricted access to any information required for review of any operations, controls and compliance with corporate policies, guidelines, rules and regulations. The Group Chief Compliance and Risk Management Officer has the right to consult the Audit Committee without reference to management and 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 Group's Three-Year Plan and is reviewed and endorsed by the Audit Committee.

The principal tasks of the Corporate Governance team include:

- Preparation of an internal audit plan using a risk-based assessment methodology that covers the Group's significant operations over a three-year cycle
- Review of all operations, controls and compliance with KOGs and corporate policies, rules and regulations. The audit scope covers significant controls including financial, operational and compliance controls, and risk management policies and procedures
- Review of special areas of concern or risk as raised by the Audit Committee, the Risk Management and Sustainability Committee or senior management
- Conduct independent investigation of cases related to the potential/actual violation of the Company's Code

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 its meetings.

As part of the annual review of the effectiveness of the Group's risk management and internal control systems for 2017, 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 of the responses noted in the self-assessment programs and considered sound internal control practices to be in place for 2017.

External Audit

Our external auditor, PricewaterhouseCoopers (PwC), performs independent statutory audits of the Group's financial statements. 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 come to its notice during the course of the audit. PwC noted no significant internal control weaknesses in its audit for 2017.

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 2017:

- 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 the Group's policies and KOGs under management's authorization and the financial statements 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 and internal audit functions were adequate