

## INTERNAL CONTROLS AND RISK MANAGEMENT

### COMMITMENT AND OBJECTIVES

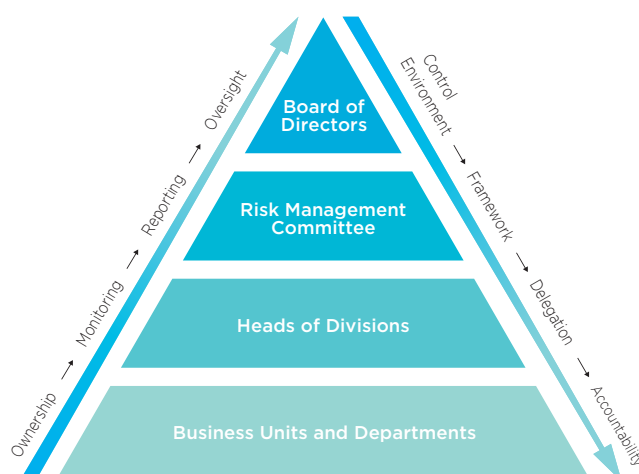
The Group is committed to establishing and maintaining sound and effective internal controls. Adopting the definition used by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in the U.S. in 1992, "internal control" is a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives. It is important to recognise that the intention is to manage rather than eliminate risks; and to provide a reasonable but not absolute assurance.

The Group has in place an internal control system, designed in light of the nature of our business, as well as our organisation structure and management philosophy. Key components of our internal control systems are analysed below adopting the COSO framework, namely, control environment; risk assessment; control activities; information and communications; and monitoring.

### ROLES AND RESPONSIBILITIES

The Board has the overall responsibility to ensure that sound and effective internal controls are maintained. A continuous process has been put in place for identifying, evaluating and managing all significant risks the Group faces:

1. Establishment and communication of a commitment to maintaining high standards of corporate governance, emphasising accountability, professionalism and ethical practices. These set the control environment in which internal control activities are built.
2. Management is charged with the responsibility to design and implement an internal controls system within an established framework. A Risk Management Committee ("RMC") has been formed. Chaired by Managing Director, RMC comprises Chief Financial Officer and other division heads of the Group. RMC is accountable for:
  - reinforcing the control environment; assessing risks; implementing the required control activities; and ensuring information and communication flows;
  - exercising proper monitoring; and generally ensuring the overall effectiveness and efficiency of controls at both inter and intra divisional levels.
3. Managing Director and Chief Financial Officer report to the Audit Committee and the Board at least annually on corporate objectives; assessment of all material controls encompassing financial, operational and compliance controls; risk assessment on principal risks facing the Group, scope of external reviews and findings (where applicable); all failure incidents, evaluated with root cause analysis and recommended remedial actions, distinguishing isolated incidents from systemic weaknesses that require procedural changes or enhancements to prevent recurrence.
4. Report on audit findings and related controls issues to the Audit Committee.



## **OUR BUSINESS MODEL AND INTERNAL CONTROLS SYSTEM**

The Board has reviewed and is satisfied as to the effectiveness of the Group's internal controls system regarding its core property leasing and management activities.

As a property investor, our core leasing and property management operations and business processes are relatively simple and well-established. A stable core property portfolio is held for generating steady rental income, as opposed to active property trading or development. Our investment property business is capital intensive rather than people intensive, with controls vested in the hands of a small management team. In this light, key control activities have traditionally been built on top-level reviews; segregation of duties and physical controls.

However, management recognises that enhancement of these control activities are necessary to support future growth of the Group. During the year, the forms and contents of management reporting are enhanced. An enterprise-wide process to review, update and document corporate policies in phases is well underway. The aim is to move towards more systematic controls allowing appropriate delegation of routine transactions and at the same time, minimising policy exceptions and overrides only where comprehensive risk evaluation and justification are documented. A more systematic use of performance indicators is introduced, so as to assist management in analysing business performance and implementing corrective actions.

## **CONTROL ENVIRONMENT**

The Group is committed to maintaining high standards of corporate governance. We have implemented a Code of Ethics applicable to all staff, emphasising the principles of respect for people, ethics and business integrity and generally meeting our responsibilities towards our stakeholders.

## **RISK ASSESSMENT AND CONTROL ACTIVITIES**

The Group has established limits of authorities. Starting from the top, there is a list of matters reserved for full Board approval. In carrying out key functions, management staff are assigned levels of authority and accountability commensurate with their positions and duties. Segregation of duties is enforced in critical functions, including involvement of the Finance Division in appropriate cases, to ensure sufficient levels of checks and balances.

The Group's risk assessment process is a five-step process:

1. Corporate goals and objectives (financial as well as non-financial) set the context for our risk management process.
2. Key business processes of our core property leasing and management activities are analysed in turn, to identify potential risks that may impede the achievements of these objectives.
3. Impact of the identified risk events are then assessed, in terms of their potential impact on achieving our corporate goals; and these risk events are then prioritised based on such impact analysis.
4. Control activities are assessed on their effectiveness, applying professional knowledge and judgment, taking into account a number of factors such as size, complexity and nature of the functions; past control weaknesses or failures; changes in the operating environment and organisation structure; and level of overrides and exceptions.
5. The risks are re-assessed after control activities are taken into consideration to ensure residual risks are acceptable.

Selected key risks that are considered by management to have significant potential impact on the Group's core business activities are set out below.

Key Risks	Description and Areas of Impact	Key Control Activities
Market Risk	<ul style="list-style-type: none"> <li>Failing to achieve market rental rate and occupancy</li> </ul>	<ul style="list-style-type: none"> <li>Internal research to monitor market trends</li> <li>Benchmarking Group rentals and occupancy achieved against market index and peer group performance based on published information</li> <li>Management review process includes monthly profitability review meeting between business units and Finance Division; monitoring of budget variances; general use of performance indicators to monitor group performance</li> </ul>
Operational Risk	<ul style="list-style-type: none"> <li>Inadequate controls on costs and expenditures</li> <li>Procurement not achieving value for money</li> <li>Failing to attract and retain quality staff</li> <li>Business interruption due to disaster or incidents with long-term devastating impacts</li> </ul>	<ul style="list-style-type: none"> <li>Budgetary controls on costs and investigation of material variances</li> <li>Policies and procedures on major cost items to control unnecessary or inappropriate spending</li> <li>Segregation of duties in areas of payment, approval and transaction recording</li> <li>Established procedures in the Procurement Manual</li> <li>Tenders or competitive quotes for major items</li> <li>Established performance management system; regular compensation review and participating in peer group salary surveys to ensure market competitiveness</li> <li>In-house training for general management skills; external training for functional expertise</li> <li>Survey on employee satisfaction with follow-up actions</li> <li>External professional insurance advisor to advise the Group on major insurance issues</li> <li>Appropriate insurance cover in place to mitigate property damage and business interruption</li> <li>Contingency plans and/or disaster recovery plans for reasonably foreseeable events; subject to regular review and update</li> </ul>
Financial Risk	<ul style="list-style-type: none"> <li>Failing to produce accurate financial accounts on a timely basis</li> <li>Liquidity and interest rate mismanaged</li> <li>Insufficient return on capital and assets</li> <li>Payment not properly controlled</li> </ul>	<ul style="list-style-type: none"> <li>Qualified accountants in key positions of the Finance Division to ensure high level of competence and quality</li> <li>Annual audit by external auditors</li> <li>Management of liquidity and interest rate centralised in Treasury Department</li> <li>Financial Risk Management Policy and annual funding plan reviewed and approved by the Board</li> <li>In-house research to benchmark against industry and peer group based on published information</li> <li>Acquisition of assets or new projects requires detailed appraisal based on business and financial justifications and is subject to established approval limits and authorities, including the requirement for board approval where appropriate</li> <li>All payments are centrally handled by the Finance Division and the cheques are safekept in secure places</li> <li>Daily bank reconciliation is prepared and reviewed</li> <li>Year-end bank confirmation by external auditors</li> </ul>
Compliance Risk	<ul style="list-style-type: none"> <li>Violating or breaching listing rules, related laws and regulations</li> </ul>	<ul style="list-style-type: none"> <li>Legal and Secretarial Department responsible for Group compliance with Listing Rules; procedures in place to liaise with Finance Division and lines to monitor ongoing compliance particularly regarding potential transactions with persons related to the Company's Directors, management and substantial shareholders</li> <li>External legal advice is sought if necessary, coordinated by Legal and Secretarial Department</li> </ul>
Reputational Risk	<ul style="list-style-type: none"> <li>Damage to the reputation of the Group</li> </ul>	<ul style="list-style-type: none"> <li>Group commitment to media and investor friendly behaviour; active engagement with stakeholders</li> <li>Active monitoring of media and analysts' reports</li> <li>Group Communication Policy with clear designation of spokespersons, authorities and responsibilities</li> </ul>

## INFORMATION AND COMMUNICATIONS

The importance of internal controls and risk management is communicated to staff members in order to foster a control environment and awareness within the Group. Staff policy is set out to ensure that competent personnel in key managerial and supervisory positions possess appropriate knowledge and experience to effectively administer management policies and procedures.

The enterprise resource planning system is the backbone of the Group's management of inter-departmental information and communications. With the financial and operational data running off a single database, information can be shared more easily and in a more timely manner within the Group.

## MONITORING

The Group recognises that the operating environment changes over time, hence potentially affecting the effectiveness of control measures. Risk assessment is, therefore, an ongoing rather than one-off exercise. RMC is charged with the responsibility of assessing the effectiveness of the system and reporting to the Board on a regular basis. Should any significant control failings or weaknesses be found, the Committee will bring them to the Board's notice and propose appropriate corrective actions.

Management is currently of the view that there is no immediate need to set up an internal audit function within the Group in light of the size, nature, and complexity of the Group's business. The situation will be reviewed from time to time.

External consultants have been engaged in the past to review selected areas of the control systems. Management will consider doing so in the future where appropriate, so as to obtain an independent opinion on the effectiveness of the internal controls.

## WAY FORWARD

We shall continue to enhance our control activities in qualitative as well as quantitative terms. Specific initiatives will include:

- (i) Progress further the phased enterprise-wide process to review and update corporate policies;
- (ii) Re-define, and streamline where appropriate, our management reporting system in order to facilitate the wider use of "management by exceptions" approach. Key performance indicators will also be reviewed and used more extensively in reporting;
- (iii) Engage external consultants to review the internal controls, policies and procedures and the risk assessment process;
- (iv) Enhance further transparency and internal communications of policies and procedures by a range of tools including on-line accessibility.