Internal Control and Risk Management

REVIEW OF GROUP INTERNAL CONTROL SYSTEM IN 2006

The Committee of Sponsoring Organizations of the U.S. Treadway Commission ("COSO") set down the generally recognised global framework of internal control systems. Internal control is defined as a process effected by an entity's board, management and other personnel to provide reasonable assurance regarding the achievement of its objectives. It has five components, namely, Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring. It is important to recognise that an internal control system aims to manage rather than eliminate risks; and to provide reasonable but not absolute assurance.

Hysan's Board of Directors has the overall responsibility to ensure that sound and effective internal control are maintained, while management is charged with the responsibility to design and implement an internal control system.

The Group's core operation is property leasing and management, which involves relatively simple and well-established business processes. The Group has a well-established Control Environment, emphasising high standards of corporate governance and business ethics. Its Control Activities have traditionally been built on senior management reviews (with controls being vested in the hands of a small management team); segregation of duties and physical controls.

Management recognises that enhancement of our internal control system is necessary to support the continual growth of the Group. In terms of management style, we also aim to move towards a culture based on systematic and structured control principles.

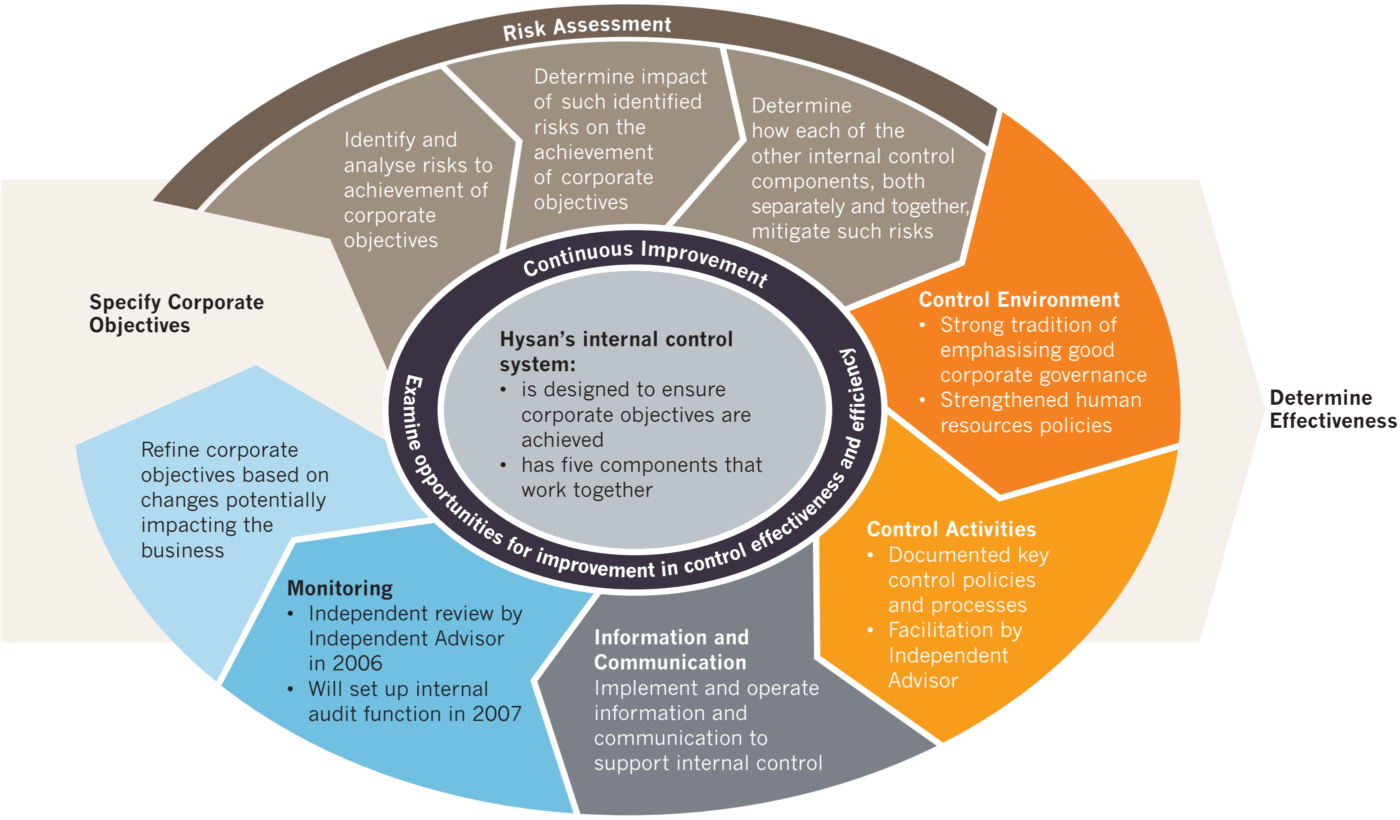
In this light, management has undertaken a phased review project on Group internal control system during 2006 and has enhanced its internal control system in the following ways:

- Strengthening the Control Environment: management takes the view that this forms the foundation of internal control by setting the tone across the organization.
- Formalising and documenting policies and procedures for all key operational, financial reporting and compliance functions.
- Requiring department managers to undergo a detailed self-risk assessment process using a common risk management framework, with facilitation and assistance from a reputable international accounting firm ("Independent Advisor").
- Engaging the Independent Advisor to assess and report on the adequacy and effectiveness of the established internal control arrangements by performing independent reviews and testings.

CONTROL ENVIRONMENT

The Group's Control Environment has the following components:

- Integrity and ethical value
- Importance of the Board of Directors
- Management's philosophy and operating style
- Levels of authority and responsibility
- Human resources policies



The Group has in place a formal Code of Ethics emphasising the key principles of "respect for people", "ethics and business integrity" and "meeting our responsibility". Guidelines on specific areas including corporate and financial reporting, conflicts of interest, personal benefits, relations with suppliers and contractors have been issued. As part of the Group's staff orientation programme, new personnel are informed of our Code of Ethics, corporate mission, and objectives. We also provide periodically updated information and seminars to serve as a constant reminder to staff. Relevant documents are also posted on our intranet, providing easy access for all. Suspected breaches of the Code of Ethics are reported directly to the Head of Human Resources (instead of business lines), who in turn reports to the Managing Director.

The Board and management are committed to maintaining high standards of corporate governance. The Board continually enhances its effectiveness in fulfilling its stewardship role including monitoring management performance. Details are set out in the separate Corporate Governance Report (page 44).

Management recognises the significance to address the possibility of management overriding established control policies and procedures. This is particularly important during this early stage of the Group's formalisation of key policies and procedures, and in the context of a family-controlled company. Formal and specific guidelines stating the need to have minimal management overrides are communicated in meetings, which are then issued across the organisation.

The Group has formalised and strengthened certain key Human Resources policies to further enhance the effectiveness of internal control. Development of people and of their competence, as well as segregation of duties in key people management activities including staff hiring and termination are emphasised. The recruitment process stresses effectiveness as well as transparency, thereby ensuring appropriate checks-and-balances between business lines and Human Resources department. Disciplinary and grievance policies are set out with transparent procedures and appropriate levels of line authority. Instances involving breaches of Code of Ethics will be handled independently of business line management. These policies have been communicated, reinforced and monitored across the organization during the review year.

CONTROL ACTIVITIES AND RISK ASSESSMENT

In pursuit of the objective to move towards a culture based on systematic and structured control principles, including allowing appropriate delegation of routine transactions while minimizing policy exceptions and overrides, management has further enhanced the Group's internal control system in 2006 by taking the following steps:

- Mapping control processes: management has conducted an entity-wide exercise to map all key control processes to appropriate control objectives, as derived from the Group's Mission Statement, strategic management objectives, financial/general operational controls.

- Establishing ownership: process owners are identified who have the responsibility of ensuring that controls exist and are in operation.

- Updating policies and procedures: the process owners are also responsible for documenting and updating the relevant policies in light of self-risk assessment. A document called "risk register" is created which sets out the main strategic and operational risks that have been identified, and how these are managed. The process owners are responsible for maintaining the relevant risk registers.

- Setting up functional groups or committees: specific focus groups or committees on certain areas of control are engaged once the objectives and principles are established. Examples are the budget review committees.

This exercise was accomplished in combination with a self-risk assessment process, which allowed line managers to make a more informed decision as to whether certain policies would need further refinement. The Independent Advisor was engaged to conduct facilitated workshops and interviews to assist department managers in performing the self-risk assessment. The process owner has to assess the likelihood of the relevant risk occurring, in accordance with the Group's risk management framework.

The Managing Director and the Chief Financial Officer report the results of their review of the risk registers to the Audit Committee and to the Board.

As a result of the Independent Advisor's review, certain potential improvement areas were identified. These include the further strengthening of segregation of duties as well as the checks-and-balances system. Management has adopted all the recommendations and established clear timelines for implementation. Progress will be reported to the Audit Committee and the Board.

MONITORING

In the absence of an internal audit function, the Independent Advisor was engaged to perform an agreed review and testings. No major deficiencies were identified.

The Group's external auditors, Deloitte Touche Tohmatsu, have audited the financial statements for the year ended 2006 and have reviewed the internal control systems to the extent that they considered necessary to support their audit report.

Management has reviewed the need for and planned to establish an internal audit function during 2007. The scope of work of internal auditors, unlike that of the external auditors, is not restricted to risks relating to financial statements. The internal auditors will perform independent reviews and provide the Audit Committee and the Board with an objective view as to the adequacy and effectiveness of the internal control systems established by management. This plan is also endorsed by the Independent Advisor.

COMMUNICATION

The significance of internal control and risk management is communicated to staff members by way of internal meetings, updates and workshops. The risk assessment workshops facilitated by the Independent Advisor also raised the risk awareness of line managers. Moving forward, communication will be a key area of focus with the aim of further strengthening general risk awareness across the organisation.

Management also plans to engage an independent service provider, with direct reporting line to the Audit Committee, to monitor the whistle-blowing system under the Code of Ethics. This should make staff feel even more comfortable and protected should they want to express concerns involving the management.

In general, the establishment of a whistle-blowing system and an internal audit function reflects management's commitment to further strengthening our Control Environment.

COMPLIANCE WITH CODE OF CORPORATE GOVERNANCE REQUIREMENTS

Directors acknowledge their responsibility for the Group's internal control systems and confirm they have reviewed and are satisfied as to its effectiveness in managing risks. In doing so, the Board has taken note of management's reports and the findings of the review performed by the Independent Advisor.

Management has adopted the Independent Advisor's recommendations aimed at further strengthening the Group's internal control, which is a continual process. Actions are in progress in accordance with established timelines.