

RISK AND RISK MANAGEMENT

De La Rue's reputation is based on security, integrity and trust. This section summarises the types of risks which are either specific to De La Rue or which could have a material adverse effect on the Group, together with the controls which have been put in place to manage those risks. The risks outlined in this section represent the principal major uncertainties and trends which may have an impact on De La Rue's ability to implement effectively its future strategy. It is not an exhaustive list as some risks may be as yet unknown and other risks, currently regarded as immaterial, could turn out to be material.

RISK MANAGEMENT AND GOVERNANCE STRUCTURE



The Combined Code on Corporate Governance requires the Board to maintain a sound system of internal control to safeguard shareholders' investment and the Group's assets and at least annually to conduct a review of the effectiveness of the Group's system of internal controls. During the year, the Board carried out its annual review which covered all material controls, including financial, operational and compliance controls and risk management systems. Additionally, the Board received information about the Group's operations throughout the year enabling it regularly to evaluate the nature and extent of the risks to which the Group is exposed. The Board is therefore able to confirm that an effective system of internal control has been in place throughout 2009/2010.

Internal control

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. It relies on the Audit and Risk Committees to assist in this process. Over the course of the last year, a comprehensive review of risk management and reporting structures has been undertaken and changes to the risk assessment procedures have been introduced to improve the management of risks at the business unit and functional levels and to strengthen the role of the Risk Committee. Details of the Audit and Risk Committees are set out in the Corporate Governance Statement on pages 45 and 46.

Management is responsible for implementing the controls which are designed to meet the particular needs of the Group, and the risks to which it is exposed, with procedures intended to provide effective internal control. The controls by their nature are designed to manage rather than eliminate risk and can only provide reasonable but not absolute assurance against material misstatement or loss. The processes used by the Board and, on its behalf, by the Audit and Risk Committees have been in place throughout the year, and include reviewing:

- Monthly finance, operational and development reports
- Internal and external audit plans
- Significant issues identified by internal and external audits
- Significant Group risks and risk mitigation actions reported by the Risk Committee including updates to the Group's risk register
- Annual compliance statements in the form of self-audit questionnaires
- Reports on other matters such as security, health, safety and environmental issues and fire risks

Internal financial control

The financial control framework includes the following key features:

- An annual strategic planning process
- An annual budget
- A system of monthly reporting by each business unit which involves comparison of actual results with the original budget and the updating of a full year forecast
- Monthly reporting of performance to the Board
- Audited annual Financial Statements
- Interim Financial Statements reviewed by the auditors

The main controls which address the financial implications of the major business risks are centred on strict approval procedures. These are reviewed annually, approved by the Board and apply to all subsidiaries. They include:

- Executive Directors' approval of all major non-routine revenue expenditure
- Board approval of all major capital expenditure
- Board approval of all acquisitions and disposals
- A system of authorisation limits which cascades throughout the Group
- Board consideration of any matter having a material effect on the Group

Capital management

The Board's policy is to maintain a strong capital base and modest levels of net debt in order to maintain investor, creditor and market confidence and to sustain future development of the business. Further details on capital management can be found in note 15 to the accounts on page 75.

Treasury, foreign exchange and borrowing facilities

The Group Treasury department provides a central service to Group companies and conducts its operations in accordance with clearly defined guidelines and policies, which have been reviewed and approved by the Board. Treasury transactions are only undertaken as a consequence of underlying commercial transactions or exposures and do not seek to take active risk positions. It is Group Treasury's role to ensure that the Group has sufficient available borrowing facilities to meet its needs in the foreseeable future.

Details of specific operational risks can be found in the Operational Review on pages 16 to 23. Details of financial risk management can be found in note 15 to the accounts on page 74.

RISK AND RISK MANAGEMENT

continued

Each business unit and every Group function has developed and maintains a risk register, capturing significant risks to which the relevant business unit is exposed or which have been identified as a risk to the Group by the relevant function. These risks are reviewed by the Risk Committee, which identifies those risks which could have a material adverse impact in the context of the Group as a whole, and which are then reported to the Board. The principal risks identified by the Risk Committee and reported to the Board in 2009/2010 are set out below but do not appear in any particular order of potential materiality or probability of occurrence.

Risk	Mitigation
Loss of key site There are a number of key manufacturing sites across the business. The total loss of any one of these key sites could have a major financial impact, particularly where the site forms a source of supply for the business.	The Group aims to achieve the highest standards of health, safety and environmental management. Risk engineering to minimise risks, particularly from fire hazards and the use of flammable solvents, is a key focus to ensure that site risks are clearly prioritised and resourced and actions taken, wherever possible, to terminate or minimise these risks. The development, updating and testing of business continuity plans is also an essential component in maintaining assurance for the continuity of supply.
Contract issues Customer contracts contain a range of obligations and conditions. If liabilities were to be triggered, significant penalties could be incurred. Quality failures could also trigger liability claims that may require re-manufacturing.	Commercial and contract risks are managed through a variety of means. Contracts are reviewed by the internal legal team and material exposures, together with identified means of mitigating them, are submitted to the Board (sometimes through its General Business Committee) for approval. Supplier performance is also kept under regular review with rigorous testing and quality control applied to products.
Product security There is the potential for reputational damage in the event of the loss of materials from a manufacturing site as a result of negligence or theft. Loss of product whilst in transit, particularly during transshipment, through the failure of freight companies or through the loss of an aircraft or vessel as a result of an accident or natural disaster is also possible.	Security is a key focus across De La Rue. Robust physical and audit security procedures at production sites reduce the risk of an inadvertent loss or theft during manufacturing. Movements of security materials between De La Rue sites and for onward delivery to customers are conducted applying stringent operational procedures using carefully selected carriers and suitably screened personnel. All movements are risk managed and monitored globally on a 24/7 basis. Procedures are kept under continuous review and any incident or non-compliance is fully investigated.
Pension funding The Group operates a defined benefit pension scheme in the UK. Presently there is a deficit between the projected liability on the scheme and the assets held by the scheme. The size of the deficit may be materially impacted by a number of factors including inflation, investment returns, changes in interest rates and life expectancy. An increase in the deficit may require the Group to increase the cash contributions to the scheme which would reduce the Group's available cash for other purposes.	The performance of the pension scheme is reviewed regularly by Group management in conjunction with the scheme's Trustee. External actuarial and investment advice is taken on a regular basis to ensure that the scheme is managed in the best interests of both the Group and the scheme's members. Following consultation with the members, Trustee and advisers, agreement has been reached to close the defined benefit plan to all members with effect from April 2013, with a replacement defined contribution scheme being brought into operation.
Environmental breach Our main banknote paper manufacturing site is at Overton mill which is located in an environmentally sensitive area. Any significant breach of operations, such as unauthorised discharges, could result in immediate suspension of operations at the site.	Environmental awareness is afforded high priority at all De La Rue manufacturing sites and particularly at Overton. To ensure continued compliance with regulations, constant monitoring of all key operating parameters is in place with regular testing of discharge water against performance criteria agreed by the Environment Agency. Controls and specialist personnel are in place on a continuous basis throughout the year with regular training and awareness programmes in place for all employees.

Risk	Mitigation
<p>Foreign exchange</p> <p>The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar and euro. Any material exposure to foreign exchange risk could have a major effect on the Group's profits.</p>	<p>The Group aims to hedge between 60 and 100 per cent of foreign exchange exposure risk arising from future commercial transactions and recognised assets and liabilities. An annual review of hedging policy is presented to the Board.</p>
<p>Health and safety failure</p> <p>All De La Rue's activities are subject to extensive internal Health, Safety and Environmental (HSE) procedures, processes and controls. Nevertheless, there is a risk that failure of process could in the worst case lead to a serious injury or fatality.</p>	<p>The Group has detailed corporate health and safety standards which are internally audited and supplemented by certification to the OHSAS18001 standard in all major facilities, requiring independent external audit verification. The Health, Safety and Environment Committee has Operating Board representatives from each business unit and reviews HSE performance regularly. Each facility has clear HSE action plans which are prioritised, monitored and subject to review by local senior management to ensure that health and safety standards are maintained. HSE performance is reported to the Board each month.</p>
<p>Breach of competition regulations</p> <p>Breach of competition regulations could result in significant financial penalties as well as reputational damage.</p>	<p>Regular training takes place for all sales and other personnel who may have contact with competitors, for example at industry forums or during formal tender processes.</p>
<p>Information security</p> <p>The confidentiality, integrity and availability of information systems could be affected by factors that include human error, ineffective design or operation of key controls or through malfunction or deliberate attack. Outages and interruptions could affect our ability to conduct day to day operations and any compromise of the confidentiality of information could impact our reputation with current and potential customers.</p>	<p>De La Rue keeps all aspects of its security arrangements under regular review. There are a number of controls in place to manage this risk including network segregation, access restrictions, system monitoring, security reviews and vulnerability assessments of infrastructure and applications. Business continuity plans are in place to help recover from significant outages or interruptions.</p>
<p>Non-compliance/illegal behaviour by third parties acting outside the law or De La Rue policies</p> <p>In some countries De La Rue relies on the services of third parties to represent its interests. There is a risk that third parties such as suppliers or agents could operate in a manner contrary to the Group's strict policies on ethical business conduct or the law, exposing us to potential financial and reputational damage.</p>	<p>During the year, the Group implemented the recommendations of Lord Woolf arising out of the investigation into allegations of corrupt payments by BAE Systems, insofar as they relate to the use of agents. A rigorous assessment of all processes involving third party appointments is conducted and audited independently of the sales team. In addition, a number of further control measures have been introduced such as dedicated training for sales personnel, senior managers and agents on the Code of Conduct, anti-bribery and corruption issues. Controls on the use of cash and advance payments are in place and external advisers are engaged to undertake due diligence on sensitive agents identified as a result of a full risk assessment. Greater visibility has also been given to the Whistleblowing policy to encourage employees to report any suspicious conduct.</p>