Risk and risk management
How we manage our principal risks and uncertainties

How we manage risk

Risk management is the responsibility of the Board, supported by the Risk Committee which comprises members of our Executive Leadership Team. The Risk Committee is accountable for identifying, mitigating and managing risk. Further details about the Committee can be found on page 69. We have a formal risk identification process which evaluates and manages our significant risks in accordance with the requirements of the UK Corporate Governance Code. Our Group risk register identifies the risks, their potential impact and likelihood of occurrence, and the key controls and management processes we have established to mitigate these risks.

The Risk Committee meets twice a year to review risk management and monitor the status of key risks as well as the actions we have taken to address these at both Group and functional level. Any material changes to risk are highlighted at the monthly Executive Leadership Team meetings, while the Audit Committee also reviews the Group's risk report.

Management is responsible for implementing and maintaining controls, which have been designed to manage rather than eliminate risk. These controls can only provide reasonable but not absolute assurance against material misstatement or loss. See page 62 for further information regarding internal controls.

Principal risks and uncertainties

The following pages set out the principal risks and uncertainties that could crystallise over the next three years. The Board has undertaken a robust risk assessment to identify these risks, which are listed in order of potential impact. There may be other risks that we currently believe to be immaterial. These could become material, either individually or simultaneously, and significantly affect our business and financial results. We have modelled potential scenarios of these risks crystallising to support the disclosures in the Viability Statement. See page 37 for further details. Due to the nature of risk, the mitigating factors stated cannot be viewed as assurance that the actions taken or planned will be wholly effective.

De La Rue's risk management framework

Risk appetite

The Board has reviewed our principal risks and considered whether they reflect an acceptable level of risk. Where this is not the case, the Board has also considered what further investment is being made to reduce the likelihood and potential impact of the risk. The Board either approves the level of risk being taken, or requires management to reduce the risk exposure.

For core areas of the business, the Board uses a number of methods to ensure that management operates within an accepted risk appetite. These include delegated authority levels, the approval of specific policies and procedures and the approval of the annual insurance programme. The Board receives regular feedback on the degree to which management is operating within acceptable risk tolerances.

This feedback includes regular operational and financial management reports, internal audit reports, external audit reporting and any reports to the whistle blowing hotline. All members of the Executive Leadership Team have individual ownership for one or more of the principal risks. Management of those risks forms part of their personal objectives.

Key for strategic focus

1. Addressing key issues
2. Driving efficiency
3. Diversifying revenues
4. Investing in innovation
5. Strengthening financial position
6. Driving culture change

Key for risk outlook

- ↑ Increasing
- → No change
- ↓ Decreasing

Principal risks and uncertainties ranked by net predicted impact

Risk	Exposure	Impact	Mitigation	Impact on strategy	Outlook
Breach of legal and regulatory requirements	It is possible that our employees or overseas representatives, either individually or in collusion with others, could act in contravention of our stringent requirements in relation to bribery and corruption, anti-competitive behaviours and management of third party partners (TPPs).	Major reputational and financial damage.	We are accredited to the Banknote Ethics Initiative, which provides governments and central banks with assurance regarding our ethical standards and business practices. Our commitment to ethical standards is articulated in the Code of Business Principles. This is supported by underlying policies which are reviewed regularly and enforced robustly. Where necessary, non-compliances is dealt with through disciplinary procedures. We have a particular focus on raising awareness as well as training on anti-bribery and corruption, and competition law. Our policies and processes are independently audited. Our process for the appointment, management and remuneration of TPPs operates independently of the sales function. The behaviours of TPPs are strictly monitored and the TPP process is overseen by the General Counsel and Company Secretary, who reports directly to the Board on these matters. Our whistle blowing policy and associated procedures are integral aspects of the compliance framework.	6	→
Failure to win or renew a material contract	While we operate globally and have a diversified geographic, product and customer profile, we rely heavily on a small number of medium and longer term material contracts.	Failure to win or renew a key contract could restrict growth opportunities and have a material impact on our financial performance and reputation.	Our track record of delivering product innovation and our commitment to quality, combined with a commercial approach to tendering, means we are well positioned to win or renew strategic or significant contracts. We are focused on retaining key contracts, as and when they fall due for renewal, and on winning new opportunities as they arise.	1, 3	→
Pension fund deficit	The Group's UK defined benefit pension scheme (the Scheme) is in deficit. As at 25 March 2017 the post-tax deficit as accounted for under IAS 19 was £196.7m (26 March 2016: £178.4m).	We have created a joint working group with the pension trustees to proactively manage our pension obligations. If at the next triennual valuation in 2018 the deficit increases further under actuarial valuation, the future cash flow commitments may put future capital investment and dividends at risk.	We are working with the pension trustees to explore methods of improving the return of the Scheme's assets and reducing the Scheme's liabilities.	5	↑

Risk and risk management continued

Principal risks and uncertainties ranked by net predicted impact continued

Risk	Exposure	Impact	Mitigation	Impact on strategy	Outlook
Failure to maintain and exploit competitive and technologically advanced products and services	We operate in competitive markets. Our products and services are characterised by continually evolving industry standards and changing technology, driven by the demands of our customers. Longer term threats could include the growth of eCommerce, the emergence of cashless societies and lower barriers to manufacturing.	Failure to maintain and exploit technical innovation and intellectual property may result in lower demand, loss of market share and lower margins.	We maintain sustained levels of investment in research and development to ensure a steady flow of ideas into our innovation pipeline. Our product roadmaps are designed to meet our customers' needs. Our materials science expertise and software science team are centralised in the UK. These teams follow defined technology management processes, which include regular pipeline and portfolio reviews. We continue to invest in new technologies to enable us to advance our R&D capabilities, and have increased our focus on digital technologies since the strategy review in 2015. We aim to double our R&D investment in the five years to 2020.	4	→
Failure to adopt performance driven culture	In order to ensure our continued success and growth, we carried out an internal organisational redesign in 2015/16. The focus for this programme is to achieve sustained cultural change in order to enable us to adapt to a rapidly changing market environment.	Without a change in our culture, we may not be able to execute the strategy laid out in May 2015.	In 2016/17 we delivered leadership training to build on the achievements of the 2015/16 strategic leadership skills programme. The new training focused on cross-functional working, especially in the areas of influencing and managing competing interests. We have set specific targets for performance appraisal and employee engagement. The results of the employee engagement survey in late 2016 have been cascaded throughout the business, and we have developed appropriate response plans. The strategic plan envisaged a three year programme of training, communication and recruitment to fill capability gaps. This plan is on track – and the outcome is expected to be a change in behaviours and skills that will enable us to be a more dynamic, agile and high performing organisation.	6	↓
Failure to secure strategic partnerships to address key issues	Our ability to address the key issues of volatile demand in banknotes and over capacity in the paper business depend on third party agreements.	The predictability of future revenue streams and our ability to increase the return on capital employed may be compromised.	If third party agreements cannot be concluded, we will continue to use existing strategic initiatives to mitigate this risk. These are: continue to drive efficiency; diversify revenues; innovate; and strengthen the overall financial position of the Group.	1	→
Information security risk	The confidentiality and integrity of our customer, employee and business data could be affected by factors that include human error, ineffective design or operation of key data security controls, or by the breakdown of IT control processes.	Any compromise in the confidentiality of information could impact our reputation with current and potential customers.	Our corporate information systems are accredited to the ISO27001 Information Security standard. We maintain a strict control environment to enforce disciplined information security practices and behaviours. A number of key technical controls are in place to manage this risk, including network segregation, access restrictions, system monitoring, security reviews and vulnerability assessments of infrastructure and applications. We regularly review all aspects of information security arrangements, and our employees undertake mandatory information security e-learning.	1 2 3 4 5	→
Loss of a key site	A number of our manufacturing sites are exposed to business interruption risks.	The total loss of any one of these key sites could have a major financial impact, particularly where the site represents a single source of supply.	Our head office and the banknote production operations in Debden, UK are both accredited to the ISO22301:2012 Business Continuity standard. We maintain a high degree of interoperability across our banknote production and security printing sites. We aim to minimise risk by adopting the highest standards of risk engineering in our production processes. In recognition of our customers' increasingly high requirements regarding business continuity, we continue to enhance the resilience of our major facilities in line with the ISO standard.	1 2 3 4 5	→

Risk	Exposure	Impact	Mitigation	Impact on strategy	Outlook
Health, safety or environmental failure	All of our activities are subject to extensive internal health, safety and environmental (HSE) procedures, processes and controls. Nevertheless, there is a risk that any failure of an HSE management process could result in a serious incident.	Failure of an HSE management process could lead to a serious injury or an environmental breach.	At all major facilities, we have a robust HSE management system which is internally audited and certified to the OHSAS18001 and ISO14001 standards. All of our activities are subject to extensive internal HSE procedures, processes and controls. The Group HSE Committee regularly reviews HSE performance. This is also monitored by the Chief Operating Officer's leadership team and reported to the Board monthly. Each manufacturing 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.	1 2 3 4 5	
Quality management failure	Each of our contracts has a unique specification on product quality and delivery. Some of these contracts demand a high degree of technical specification.	A shortfall in quality management may expose us to additional cost to remake as well as to any associated warranty costs.	We operate an established quality management system across all production sites. All major sites are certified to ISO9001 quality management standards. In 2012, we introduced an Operational Excellence programme to further drive continuous improvement across our manufacturing sites. This programme is well established and continues to deliver operational enhancements.	2	
Supply chain failure	We have close trading relationships with a number of key suppliers, including unique producers of specialised components that we incorporate into our finished products.	Failure of a key supplier, the inability to source critical materials or poor supplier performance in terms of quality or delivery could disrupt our supply and ability to deliver on time and in full.	Our exposure is reduced because we source many components from within our own organisation. Where we rely on external supply, we have established procedures for identifying possible risks for each supplier. Key suppliers are managed through a supplier relationship management programme. This incorporates checks on their financial strength and their ability to deliver to our quality standards and security, as well as their business continuity arrangements. Key suppliers are audited on a rotational basis. As a contingency, alternative suppliers are pre-qualified wherever possible and where necessary we retain higher levels of stocks.	3	
Unpredictability in the timing and size of substantial contract awards	Political and other factors can delay government procurement decisions for sensitive products such as banknotes and passports.	The timing and size of contract awards is often uncertain. Delays lead to volatility in our order book and financial performance.	We maintain close and regular contact with customers so that any changes in timing and requirements are recognised promptly. We monitor our sales activity, order pipeline and forward order book to optimise production planning and ensure that delivery to customers is on time and in full. We also monitor any delays in order confirmation on a weekly basis. This enables us to maintain flexibility in the supply chain and to accommodate any changes to production planning. To minimise future unpredictability, we proactively pursue longer term commitments from customers. We also aim to grow recurring revenues by expanding our digital and service offerings.	1 5	

Risk and risk management continued

Principal risks and uncertainties ranked by net predicted impact continued

Risk	Exposure	Impact	Mitigation	Impact on strategy	Outlook
Product security	Loss of product or high security components from a manufacturing site could occur as a result of negligence or theft. Loss of product while in transit, particularly during transhipment, 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.	Any loss of product or high security components has the potential to cause reputational and financial damage. In certain circumstances, customer contracts may mean that we are liable for those losses.	We have robust physical security and materials control procedures at our production sites, which reduce the risk of inadvertent loss or theft during manufacturing. We apply stringent operational procedures – and use carefully selected carriers and personnel – to handle movements of security materials between our sites and onward delivery to customers. All movements are risk managed and monitored globally on a 24/7 basis. We also maintain a comprehensive global insurance programme.	1 2 3 4 5	→

Risks and uncertainties where the net impact has reduced since prior year, and which are no longer regarded as principal risks and uncertainties

Risk	Exposure	Impact	Mitigation	Impact on strategy	Outlook
Political risk	A number of the countries that we sell to have a history of unstable government or conflict. There is an ongoing risk that orders may be unexpectedly cancelled or cannot be fulfilled, that outstanding debts do not get paid, or that performance guarantees do not get cancelled because of local political issues, which could lead to financial loss.	Losses from cancelled orders and non-payment of debt could lead to a reduction in operating profit. Where performance guarantees remain outstanding, credit facilities will be tied-up, restricting our ability to utilise such facilities to support new contracts or investment.	We assess the overall risk of all contracts pre-tender, including credit risk. We have defined approval limits for management and the Board regarding material contracts. These are based on risk as well as contract size. In higher risk situations, we negotiate payment terms and request substantial down-payments, and in 2016/17 negotiated credit insurance from UK Export Finance. All performance guarantees are approved by the treasury department prior to contract signature. As a result of the mitigations in place, the exposure to this risk has decreased sufficiently for the Board to consider that it is not currently a principal risk.		↓

Risks and uncertainties where the net impact has increased since prior year, and which are now considered principal risks and uncertainties.

The Board has decided, after review by the Audit Committee, that the continuing pension fund deficit and the challenges experienced in concluding strategic partnerships to address key issues now constitute principal risks and uncertainties in achieving the Group's strategic objectives.

Viability statement

The Directors have considered the longer term viability of De La Rue plc in line with the recommendations under the UK Corporate Governance Code.

Period of review

The Directors have considered the longer term viability of De La Rue plc in line with the recommendations under the UK Corporate Governance Code.

While the Group has a five year strategic planning horizon, the financial performance of the Group is inherently less predictable in years four and five because good visibility of the order book is over a shorter term horizon. Therefore, the Directors believe that an appropriate period to consider the Group's viability is over three years.

In assessing the viability of the Group, the Directors have reviewed the principal risks as set out in pages 33 to 36 and considered foreseeable scenarios of one or more of the principal risks crystallising in the same time period in the context of its strategic plan.

Eight of the principal risks were modelled to test the impact on the viability of the Group. The Directors have focused on principal risks that could more plausibly occur and result in the Group's future operational results, financial condition and future prospects to differ materially from current expectations. These include the ability to maintain a dividend, meet current investment plans, and comply with liquidity ratios.

Scenarios that the Directors view as implausible (or outside the Group's control, such as a terrorist attack or an event of nature) have not been modelled, nor have all potential mitigating responses. The Directors have assumed that the current revolving credit facility remains in place with the same covenant requirements through to December 2021.

Even with all the principal risks above crystallising in a plausible combination, the Group's credit facilities were not exhausted. The Board also considered a reverse stress test; the extent of cash the Group would have to lose against its strategic plan forecast in order to breach its net debt/EBITDA and interest cover covenants.

The result of reviewing plausible scenarios and the reverse stress test is that the Directors have a reasonable expectation that the Group is viable and will be able to meet its obligations as they fall due up to March 2020.