

# RISK AND RISK MANAGEMENT

De La Rue's reputation is based on security, integrity and trust. 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.

This report 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.

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 on a regular basis 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 UK Corporate Governance Code 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, legal and technology 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.

## 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. Significant changes to the risk assessment procedures were introduced two years ago to improve the management of risks at the business unit and functional levels. These have been maintained with a further review undertaken by external risk advisers which has assisted the Board in identifying some additional structural changes to strengthen further the area of risk management and activities overseen by the Risk Committee. Changes to the Group's risk management framework and processes are underway and these will be reported more fully in the 2013 Annual Report. Details of the Audit and Risk Committees are set out in the Corporate Governance Statement on page 43.

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 reports
- 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, environmental issues and fire risks

# RISK AND RISK MANAGEMENT CONTINUED

## Risk management and governance structure

### Board

- Responsible for governance structure
- Defines high level risk appetite and risk management framework
- Receives reports from Audit and Risk Committees on risk and internal controls

### Audit Committee

- Advises the Board on the adequacy of internal controls and risk management framework
- Receives updates on risk management from the Chairman of the Risk Committee
- Receives reports from internal and external auditors on the status of internal controls
- Details of Audit Committee members can be found on pages 34 and 35

### Risk Committee

- Proposes risk management framework
- Reviews business and Group risk registers
- Considers actions to improve management of risk
- Considers new or emerging risks
- Members include the Chief Executive, Group Finance Director, General Counsel and Company Secretary, business unit managing directors, the Group Director of Security and the Group Director of Risk and Internal Audit

### Risk owners and managers

- Responsible for operational management and oversight of risk within individual businesses or functional areas
- Allocation of appropriate levels of resource for individual risk control

## 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 operating 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 likely to have 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 development of the business. Further details on capital management can be found in note 12 to the accounts on page 78.

## 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 financial risk management can be found in note 12 to the accounts on page 73.

The principal risks identified by the Risk Committee and reported to the Board in 2011/12 are set out below. These are not presented in any particular order of potential materiality or probability of occurrence. It is not an exhaustive list as some risks may be as yet unknown and other risks, currently regarded as immaterial, could become material.

## Health and safety failure

### Risk

All of 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.

### Mitigation

The Group has detailed health and safety standards which are internally audited and supplemented by certification to the OHSAS18001 standard in all major facilities providing regular independent external audit verification. As part of the HSE management system, global audits of legal compliance with HSE requirements are undertaken at all major sites annually. The Group HSE Committee reviews HSE performance regularly. 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. HSE performance is reported to the Board monthly. Travel security for employees is also kept under regular review, with enhanced arrangements introduced this year including for repatriation in the event of a serious illness or injury whilst overseas.

## Non compliance/illegal behaviour by third parties acting outside the law or De La Rue policies

### Risk

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 the Group to potential reputational damage as well as possible financial loss as a result of disbarment from tenders.

### Mitigation

The Group has a process for the appointment and remuneration of third party partners (TPPs) which operates totally independently of the sales function. The process includes a risk assessment of TPPs with external specialists engaged to undertake due diligence as appropriate. The process covers, inter alia, the appointment, reappointment and remuneration of TPPs. Further control measures are also in place such as regular training for sales personnel, senior managers and TPPs on the Code of Business Principles and anti bribery and corruption issues with a particular focus on maintaining compliance with the UK Bribery Act. The TPP processes are subject to regular review by external advisers to provide further assurance. CodeLine (whistleblowing) procedures have also been expanded to encourage employees to report any suspicious conduct (see 'Unethical behaviour by employees' opposite). The behaviours of TPPs are strictly monitored and their management is overseen by the General Counsel and Company Secretary who reports directly to the Board.

## Unethical behaviour by employees

### Risk

There are already many controls across the business to ensure that standards of behaviour by employees are maintained at an appropriate level. However, it is possible that employees acting either individually or in collusion with others could act in contravention of the Group's stringent requirements resulting in major reputational and financial damage to the business.

### Mitigation

The Code of Business Principles underwent a fundamental review and was relaunched. It is kept under regular review and is enforced robustly, including dealing with non compliances through disciplinary procedures where necessary. The Group's whistleblowing policies and procedures form an integral part of the new code and were also relaunched last year under the banner of CodeLine. Reports can be made anonymously, including by email, and are handled by a senior manager and reviewed routinely by the Board. Strict recruitment procedures are maintained including mandatory vetting (screening) processes which are reviewed on a regular basis.

## Adverse movements in foreign exchange

### Risk

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.

### Mitigation

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.

## Product security

### Risk

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 while 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.

### Mitigation

Security remains a key focus across De La Rue and there has been a significant strengthening of the corporate security function over the course of the year. Security performance is reviewed by the Executive Committee and reported monthly to the Board. 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 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 with any incident or non compliance subject to rigorous investigation. De La Rue maintains a comprehensive, global insurance programme.

# RISK AND RISK MANAGEMENT CONTINUED

## Environmental breach

### Risk

De La Rue's main banknote paper manufacturing site is at Overton mill which is located in an environmentally sensitive area. Any significant environmental breach, such as unauthorised discharges, could result in immediate suspension of operations at the site.

### Mitigation

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. Ninety two per cent of our Supply Chain sites have achieved ISO14001:2004 accreditation.

## Breach of competition regulations

### Risk

Breach of competition regulations could result in significant financial penalties as well as reputational damage and disbarment from tenders.

### Mitigation

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.

## Loss of key site

### Risk

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 single source of supply for the business.

### Mitigation

It is a key focus to ensure that site risks are clearly prioritised and resourced and actions taken, wherever possible, to eliminate 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 operations. The Group aims to achieve the highest standards of risk engineering to minimise risks, particularly from fire hazards and the use of flammable solvents.

## Information security

### Risk

The confidentiality, integrity and availability of information systems (IS) 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 the Group's ability to conduct day to day operations and any compromise of the confidentiality of information could impact its reputation with current and potential customers.

### Mitigation

De La Rue keeps all aspects of IS 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. Disaster recovery plans are in place to assist in the prompt recovery from significant system outages or interruptions. Business continuity arrangements, including business impact assessments and regular testing are kept under regular review and are subject to independent external verification.

## Failure to achieve the Improvement Plan

### Risk

As detailed in the Chief Executive's review on pages 8 to 9 the Group is in the process of implementing a major programme of change. Failure to manage this process could result in disruptions to the business or dilution of the intended benefits.

### Mitigation

A dedicated and fully resourced change team has been established under the full time guidance of a member of the Executive Committee. A controlled project improvement process is in place with proactive business engagement and early mitigation of key risks wherever possible.

## Geopolitical instability

### Risk

Political unrest has the potential to delay procurement decisions for sensitive products such as banknotes and passports. Unexpected changes in key government positions may result in the unilateral cancellation of contracts under local jurisdiction. Breakdown of law and order can also disrupt freight schedules and increase shipping and delivery risks.

### Mitigation

Close and regular contact is maintained with all key stakeholders so that any changes in customer requirements can be identified early. Financial risk exposure is mitigated through the use of secured payment mechanisms such as letters of credit or through close management of costs prior to receipt of payments.