

# 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 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. It is not an exhaustive list as some risks may be as yet unknown and other risks, currently regarded as immaterial, could become 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.

### 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. This is the first full year since significant changes to the risk assessment procedures were implemented to improve the management of risks at the business unit and functional levels. A further review has been undertaken since year end by external risk advisers to assist the Board in determining whether, in the light of events during the year, further strengthening is necessary in the area of risk management and activities overseen by the Risk Committee. It is anticipated that, as a result of this review, further changes will be made to the Group's risk management framework and processes and these will be reported in the 2011/12 Annual Report. Some measures already undertaken are set out on page 37. Details of the Audit and Risk Committees are set out in the Corporate Governance Statement on pages 40 and 41.

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

### 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 division 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 future development of the business. Further details on capital management can be found in note 14 to the accounts on page 72.

### 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 14 to the accounts on page 71.

# Risk and risk management continued

Each division 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 principal risks identified by the Risk Committee and reported to the Board in 2010/11 are set out below. These are not presented in any particular order of potential materiality or probability of occurrence.

Risk	Mitigation
<p><b>Non compliance/illegal behaviour by third parties acting outside the law or De La Rue policies</b>            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 financial and reputational damage.</p>	<p>The Group has a process for the appointment and remuneration of third party partners which operates independently of the sales function. This process was reviewed during the year in anticipation of the implementation of the UK Bribery Act (the 'Act') and the changes will be reviewed by external advisers to provide further assurance. The process includes a risk assessment of overseas agents and external advisers are engaged to undertake due diligence as appropriate. The process covers, inter alia, the appointment, reappointment and remuneration of agents. Further control measures have been introduced such as dedicated training for sales personnel, senior managers and agents on the Code of Conduct and anti bribery and corruption issues with a particular focus on achieving compliance with the Act. Whistleblowing procedures have also been improved to encourage employees to report any suspicious conduct.</p>
<p><b>Illegal behaviour or serious misconduct by employees</b>            There are already many controls across the business to ensure that standards of behaviour by employees are maintained at an appropriate level. However, as has been demonstrated during the year, it is possible that employees acting either individually or in collusion with others could act in contravention of the Group's stringent requirements. This could result in major reputational and financial damage to the business.</p>	<p>The business Code of Conduct is kept under regular review and is enforced robustly, including dealing with non compliances through disciplinary processes where necessary. The code has been fundamentally reviewed during the year and was relaunched in May 2011 as the Code of Business Principles. All employees will receive a briefing on the code from a senior manager. As part of the new code, the Group's whistleblowing policies and procedures will also be relaunched. Strict recruitment procedures are maintained including mandatory vetting processes and probationary periods for all employees.</p>
<p><b>Loss of key site</b>            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.</p>	<p>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 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.</p>
<p><b>Health and safety failure</b>            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 providing regular independent external audit verification. The Health, Safety and Environment Committee reviews HSE performance regularly. The Committee is chaired by the General Counsel and Company Secretary and is constituted of representatives from the Executive Committee, including the Chief Executive and managing directors of each division, as well as functional heads. 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.</p>

Risk	Mitigation
<p><b>Product security</b> 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 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.</p>	<p>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 always fully investigated.</p>
<p><b>Environmental breach</b> 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.</p>	<p>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.</p>
<p><b>Adverse movements in foreign exchange</b> 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><b>Breach of competition regulations</b> 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><b>Information security</b> 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.</p>	<p>De La Rue keeps all aspects of its 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 help recover from significant outages or interruptions and a major business impact assessment has recently been undertaken to improve the effectiveness of business continuity arrangements.</p>
<p><b>Geo political instability</b> 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.</p>	<p>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.</p>
<p><b>Failure to manage change</b> As detailed in the Chief Executive's review on pages 6 to 9 the Group will be undertaking a major programme of change in 2011/12. Failure to manage this process could result in disruptions to the business or dilution of the intended benefits.</p>	<p>A dedicated and fully resourced change team will be established under the full time guidance of a member of the Executive Committee.</p>