RISK MANAGEMENT & MITIGATION STRATEGIES

The Group is fully committed to its robust system of internal controls and risk management.

The Group manages risk under an overall strategy determined by the Board of Directors and supported by the Board Risk Committee and an Internal Audit department. Formed in August 2003 to assist the Board of Directors, the Board Risk Committee, comprising four directors, reviews and enhances the effectiveness of the Group's risk management plans, systems, processes and procedures. The Board Risk Committee also reviews the Group-wide risk policies, guidelines and limits as well as the risk exposure and risk treatment plans.

ENTERPRISE RISK MANAGEMENT

In 2003, the Group Risk Management Department was formed to develop a coherent Enterprise Risk Management framework for implementation across the Group under the direction of the Board and Management. In line with the Group's commitment to deliver sustainable value, the objective of this risk framework is to provide a comprehensive approach to identifying and managing the risks that our businesses face. This framework applies to the action of all employees of the Group and is implemented at each operating unit. Within this framework, critical and major risks of the Group and the operating units are identified and assessed to determine the appropriate type of risk treatment plans to be implemented and are monitored at the Group level as well as by each Strategic Business Unit (SBU).

A systematic and on-going process for identifying, evaluating, controlling and reporting risk comprises the following key elements:

- Identification and assessment of all risks
- Formulation of risk management strategies
- Design and implementation of risk management action plans to execute risk management strategies
- Monitoring and reporting of risk management performance and risk exposure levels
- Continuous improvement of risk management action plans and capabilities

These processes are put in place to manage and monitor the Group risk management activities on a regular and timely basis.

SYSTEM OF FINANCIAL DISCIPLINE

Since 2003, a systematic approach has been in place for SembCorp Industries and its subsidiaries to ensure financial discipline across the Group. We have set up a self-check, review and certification process called the System of Financial Discipline for all subsidiaries to confirm their commitment to and compliance with a prudent financial discipline framework. The framework provides for management at various levels in the SBUs to systematically review and ensure compliance with the requirements of new accounting standards and the treatment of transactions and ensures that acceptable accounting policies are followed. It allows early identification of areas of potential exposure that can be addressed to minimise adverse impact to the Group as well as ensure the adequacy of provisions made in the accounts.

SBU operating and finance heads are required to review, report and ensure adequate provisioning for project losses, asset impairment, significant long outstanding debtors, significant inter-company balances, contingent liabilities, fraud incidents and any transactions and/or events with material impact or potential material impact on the SBU's financial results. These financial impacts (if any) are reported on a quarterly basis to SembCorp Industries and accounted for in the interim accounts of the respective SBU.

SBUs are also required to complete the review and certification of financial discipline for revenue recognition, cost recognition, profit or loss recognition, recognition of liabilities, recognition of assets, consolidation and internal controls.

WHISTLE-BLOWING

Since 2005, SembCorp Industries has had a whistle-blowing policy and procedures, which provide employees with well-defined and accessible channels within the Group through which they may, in confidence, raise concerns about possible improprieties in matters of business activities, financial reporting or other matters to the Audit Committee. This arrangement facilitates independent investigation of such matters for appropriate resolution.

INTERNAL AUDIT

The Group also has an Internal Audit department, which focuses on providing an independent resource and perspective to both the Board and the Audit Committee on the processes and controls that help to mitigate major risks.

The Group has the following types of risks:

a. Financial risk
b. Operational risk
c. Investment risk
d. Compliance and legal risk
e. Interested person transaction risk
f. Human resource risk

MITIGATION STRATEGIES

a. Financial risk management

The Group's activities expose it to a variety of financial risks, including changes in interest rates, foreign exchange rates and commodity prices as well as credit risk.

As part of the Group's Enterprise Risk Management framework, Group treasury policies and financial authority limits are documented and reviewed periodically. The policies set out the parameters for management of Group liquidity, counterparty risk, foreign exchange and derivative transactions and financing.

The Group utilises various financial instruments to manage exposures to interest rate, foreign exchange and commodity price risks arising from operational, financing and investment activities. Transactions such as swaps, options and contracts for difference hedge the Group against fluctuations in the market prices of the underlying instruments. The Group monitors and hedges, where appropriate, its exposure to fluctuations in interest rates, foreign exchange rates and commodity prices. Exposures to foreign currency risks are also hedged naturally where possible.

The financial authority limits seek to limit and mitigate operational risk by setting out the threshold of approvals required for the entry into contractual obligations and investments.

Interest rate risk

The Group's policy is to maintain an efficient and optimal interest cost structure using a mix of fixed and variable rate debts and long- and short-term borrowings. The Group enters into interest rate swaps to minimise its interest rate risk. In accordance with the Group's policy, the duration of such interest rate swaps does not exceed the tenor of the underlying debt.

Foreign exchange risk

The Group operates globally and is exposed to foreign currency exchange rate movement primarily for US dollar, pound sterling, euro, Australian dollar and Chinese yuan currencies on sales and purchases of assets and liabilities, which arise from daily operations. Such risks are hedged either by forward foreign exchange contracts in respect of actual or forecasted currency exposures or hedged naturally by a matching sale or purchase of a matching asset or liability of the same currency and amount.

Commodity risk

The Group hedges against fluctuations in commodity prices that affect revenue and cost. Exposures are managed via swaps, options, contracts for difference and fixed price and forward contracts.

A contract for difference is entered into with a counterparty at a strike price, with or without fixing the quantity in advance, to hedge against adverse price movements on the sale of electricity. Exposure to price fluctuations arising on the purchase of fuel is managed via fuel oil swaps, where the price of fuel is indexed to a benchmark fuel price index, for example Singapore High Sulphur Fuel Oil (HSFO) 180-CST.

For precious metal commodities, such as gold, exposure to fluctuations in price are hedged through the use of forward contracts or options that fix the purchases at an agreed price. The quantum of commitment is based on actual or forecasted requirements.

Credit risk

The Group monitors its exposure to credit risk arising from sales to trade customers on an on-going basis, and credit evaluations are done on customers that require credit.

The Group only deals with pre-approved non-trade customers and financial institutions with a good credit rating and imposes a cap on the amount to be transacted with any of these counterparties so as to reduce its concentration risk. To minimise the Group's counterparty risk, the Group enters into derivative transactions only with creditworthy institutions.

At balance sheet date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

Working capital management

The Group manages its working capital requirements with the view to minimise cost and maintain a healthy level of liquidity appropriate to the operating environment and expected cash flow of the Group. Working capital requirements are maintained within the credit facilities established and are adequate and available to the Group to meet its obligations.

b. Operational risk management

Operational risk, which is inherent in all business activities, is the risk of potential financial loss and/or business instability arising from failures in internal controls, operational processes or the systems that support them.

It is recognised that operational risk can never be entirely eliminated and that the cost of minimising it may outweigh the potential benefits. Accordingly, the Group manages operational risk by focusing on risk management and incident management. The Group has also put in place operating manuals, standard operating procedures, delegation of authority guidelines and a regular reporting framework, which encompasses operational and financial reporting. The framework provides for management at various levels in the SBUs to systematically review and ensure compliance with the requirements of new accounting standards and the treatment of transactions and ensures that acceptable accounting policies are followed. It allows early identification of areas of potential exposure, which can be addressed to minimise adverse impact to the Group as well as ensuring the adequacy of provisions made in the accounts. To reinforce the implementation of the Group's risk strategy by the operating units, independent checks on risk issues are undertaken by the Internal Audit function. Where appropriate, this is supported by risk transfer mechanisms such as insurance.

Insurance

With regards to insuring against catastrophic risk events, it is not practicable to insure every risk event to the fullest extent as the insurance market may lack the capacity, both as to breadth and cost of coverage, and in some cases external insurance is simply unavailable or is not available at an economic price. The Group regularly reviews both the type and amount of insurance coverage that it buys, bearing in mind the availability of such cover, its price and the likelihood and magnitude of the risks involved.

During the year, the Group established a wholly-owned captive insurance subsidiary, SembCorp Captive Insurance Pte Ltd, to carry out general insurance under section 8 of the Insurance Act (Cap. 142) and to insure certain risks of the group that the Management deems to be more effectively insured by the Captive. Marsh Management Services Pte Ltd has been appointed as the captive management company. The Group has also arranged a global insurance programme for property damage, business interruption and public liability for the Group's operations in Singapore and the UK and maintains insurance levels determined to be appropriate in the light of the cost of cover and risk profiles of the businesses.

The Captive essentially participates in the property damage and business interruption portion of this global insurance programme as a reinsurer, with the Captive retaining maximum exposure of S$2.5 million for each and every loss with an annual maximum of S$5 million in aggregate in excess of the existing retentions of the business entities within the Group.

c. Investment risk management

The Group's capital investment decision process is guided by investment parameters instituted on a Group-wide basis. All investments are subject to rigorous scrutiny to ensure that they meet the relevant hurdle rates of return and country limits, and all of the relevant risk factors, such as operating currency and liquidity risks, are taken into consideration.

In addition, the Board requires that each major investment proposal submitted to the Board for decision is accompanied by a comprehensive risk assessment and Management's proposed mitigation strategies.

d. Compliance and legal risk management

The Group's operations are subject to regulation and future changes in regulation that could adversely affect results, particularly in the areas of competition law, taxation policy, consumer protection and environmental law. The responsibility of compliance with applicable laws and regulations lies with the respective operating business heads, and oversight of the discharge of their responsibilities is provided by Group Legal Department.

Legal risk is the risk that the business activities of the Group have unintended or unexpected legal consequences. It includes risks arising from:

- Actual or potential violation of laws or regulations (which may attract a civil or criminal fine or penalty)
- Inadequate documentation, legal or regulatory incapacity, insufficient authority of a counterparty and uncertainty about the validity or enforceability of a contract in a counterparty insolvency
- Failure to protect the Group's property (including its interests in its premises and its intellectual property such as the SembCorp Industries and related logos, brand names and products)
- The possibility of civil claims (including acts or other events that may lead to litigation or other disputes)

The Group identifies and manages legal risk through effective use of its internal and external legal advisers. The internal Legal department assists in identifying, monitoring and providing the support necessary to identify and manage legal risks across the Group.

e. Interested person transaction risk management

In respect of transactions entered into by the Group, its subsidiaries and associated companies that are "entities at risk" (the EAR Group), with its Interested Persons (namely its controlling shareholders, Chief Executive Officer, Directors and their respective associates), the Group is guided by and complies with the provisions of Chapter 9 of the Singapore Exchange Securities Trading Limited's Listing Manual, to ensure that such Interested Person Transactions (IPT) are entered into on an arm's length basis and on normal commercial terms, which are generally no more favourable than those extended to unrelated third parties.

The Group has internal control procedures to ensure that transactions carried out with Interested Persons comply with the provisions of Chapter 9 and SembCorp Industries' Shareholders' Mandate. This Mandate is renewed on an annual basis and will be updated at the extraordinary general meeting to be convened on April 23, 2007. These internal control procedures are intended to ensure that IPT are conducted at arm's length and on normal commercial terms that are not prejudicial to the interests of minority shareholders.

The Group maintains a register of all IPT, recording the basis, including the quotations obtained to support such basis, on which they are entered into. The Group's annual internal audit plan incorporates a review of all IPT for the relevant financial year.

The Audit Committee periodically reviews Internal Audit's IPT reports to ascertain that the guidelines and procedures on IPT have been complied with. The review includes the examination of the nature of the IPT and its supporting documents or other such information deemed necessary by the Audit Committee. If a member of the Audit Committee has an interest in an IPT, he or she abstains from participating in the review and approval process of that IPT.

f. Human resource risk management

In order to develop, support and market the products and services offered by the Group, it is necessary to hire and retain skilled employees with particular expertise. The implementation of the Group's strategic business plans could be undermined by failure to recruit or retain key personnel, the unexpected loss of key senior employees or failure in the Company's succession planning.

In this respect, the Group places great emphasis on establishing comprehensive human resource policies for the recruitment, compensation and development of staff. This ensures that the Group's human assets are nurtured and retained, so that the ability to maintain a skilled workforce and the Group's competitive edge is preserved. The Board Executive Resource & Compensation Committee has oversight of the Group's remuneration policies and oversees management, development and succession plans for key Management positions.