

## RISK MANAGEMENT & MITIGATION STRATEGIES

# Sembcorp 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, supported by the Board Risk Committee and the 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

The Group has established an Enterprise Risk Management Framework to standardise the risk management methodologies within the Group. In line with Sembcorp's commitment to deliver sustainable value to its shareholders, the objective of the Enterprise Risk Management Framework is to provide guidance to the operating units in implementing a comprehensive and consistent approach to identifying and managing the risks that they face. The Enterprise Risk Management 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 which are to be monitored at the Group level as well as by each strategic business unit (SBU).

The Enterprise Risk Management Framework sets out a systematic and ongoing process for identifying, evaluating, controlling and reporting risk, comprising the following key elements:

- Identification and assessment of all risks.
- Formulation of risk management strategies.
- Design and implementation of risk management and mitigation action plans.
- Monitoring and reporting of risk management performance and risk exposure levels.
- Continuous improvement of risk management and mitigation 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 and associated companies, 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 process 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 to ensure that acceptable accounting policies are followed. It allows early identification in 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.

SBUs' 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, liabilities recognition, assets recognition, 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 Sembcorp Group also has a Group 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.

### MITIGATION STRATEGIES

The Group has identified 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

#### 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 Sembcorp's Enterprise Risk Management Framework, the Group's treasury policies and financial authority limits are documented, reviewed periodically and communicated to the Group's entities. The policies set out the parameters for management of Group liquidity, counterparty risk, foreign exchange and other 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. The commodities involved basically include fuel oil, coal and natural gas. Transactions such as foreign exchange forwards, interest rate swaps, commodities swaps, purchase of options and contracts for differences are used, as appropriate, to manage these risks. It is the Group's overall Treasury Policy that transactions for speculative purposes are strictly not allowed. Transactions are allowed only for hedging purposes based on the underlying business and operating requirements. 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 Sembcorp Group's policy is to maintain an efficient and optimal interest cost structure using a mix of fixed and variable rate debts and long-term and short-term borrowings. The Group enters into interest rate swaps to minimise its interest rate risk. A minimum of 50% of the Group's loan portfolio having fixed interest rates is targeted for the Group.

#### *Foreign exchange risk*

The Group operates globally and is exposed to foreign currency exchange rate movements, primarily for the US dollar, British pound, euro, Australian dollar and Chinese yuan. Such risks are either hedged by forward foreign exchange contracts in respect of actual or forecasted net currency exposures or hedged naturally by a sale or purchase of a matching asset or liability of

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the same currency and amount. No speculative foreign exchange transactions are allowed.

### *Commodity risk*

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

Contracts for differences are entered into with appropriate counterparties 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, exposures to fluctuations in price are hedged through the use of forward contracts or purchase of options that fix the purchases at an agreed price. The quantum of commitment is based on actual or forecasted requirements.

### *Credit risk*

The Sembcorp Group monitors its exposure to credit risk arising from sales to trade customers on an ongoing basis, and credit evaluations are done on customers who 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 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 Sembcorp Group manages its working capital requirements with the view to balance the cost of funding and an optimal 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 in 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*

It is not practicable to insure every insurable risk event to the fullest extent as the insurance market may lack the capacity, both as to breadth and extent 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 arranged a global insurance programme for property damage, business interruption and public liability for its operations in Singapore and the UK under the advice of Marsh (Singapore) and maintained insurance levels deemed appropriate in the light of the cost of cover and risk profiles of the businesses.

The Group has also established a wholly-owned captive insurance subsidiary, Sembcorp Captive Insurance (Captive), which is advised and managed by Marsh Management Services. Captive essentially participates in the property damage and business interruption portion of the Group's global insurance programme as a reinsurer, retaining a 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 Sembcorp 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 are in line with the Group's strategic business focus, meeting the relevant hurdle rates of return, and all other relevant risk factors, such as operating currency and liquidity risks.

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 may adversely affect results, particularly in the areas of corporate law, 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 Sembcorp's Group Legal Department.

Legal risk is the risk that the business activities of the Group may have unintended or unexpected legal

consequences. This 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' logo and other 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. Sembcorp's 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" 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 (IPTs) 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 25, 2008. These internal control procedures are intended to ensure that IPTs are conducted at arm's length and on normal commercial terms that are not prejudicial to the interests of minority shareholders.

The Sembcorp Group maintains a register of all

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

The Audit Committee periodically reviews Group Internal Audit's IPT Reports to ascertain that the guidelines and procedures on IPTs have been complied with. The review includes the examination of the nature of the IPTs and relevant 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 Sembcorp Group and to grow our businesses internationally, it is necessary to hire and retain skilled and professional employees with the relevant expertise. The implementation of the Group's strategic business plans could be undermined by failure to recruit or retain competent key personnel, the unexpected loss of such key senior employees or failure in the Company's succession planning.

In this respect, the Sembcorp 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, its skilled workforce and competent senior management, are nurtured and retained, so that 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. Further details on the Executive Resource & Compensation Committee as well as Sembcorp's human resources management may be found at pages 74 and 90 to 93 of this annual report.





West Triton, a Baker Marine Pacific Class 375 jack-up rig, was delivered by Sembcorp Marine's PPL Shipyard to Seadrill in December 2007.