

risk management

The Sembcorp Marine Group continued to manage the multitude of risks faced in the pursuit of its goals through a sound and effective risk management framework. The effective management of these risks was instrumental in the Group's overall performance in the year 2012.

The current enterprise risk management (ERM) framework remains effective and relevant. This framework comprises systems of internal controls and risk management policies, procedures, processes and limits. It also includes the governance structure comprising risk committees which focus on their respective significant risk areas of concern to the Group. In these committees, the directors and management work together to formulate and implement risk management strategies, policies and procedures. These activities are then integrated into the Group's business processes and operations.

Risk Governance Structure

The Board Risk Committee (BRC) assists the Board of Directors to institute risk governance in the Group and set the appropriate tone at the top. This entails overseeing the design, implementation and monitoring of the Group's risk management and internal control systems as well as assessing the adequacy and effectiveness of these systems. With the Board of Directors' approval, the BRC endorses the Group's risk tolerance levels and assessment of its top risks, treatment and execution plans. To this end, the BRC conducts regular reviews and discussions with management staff from the Group's corporate functions and strategic business units at committee meetings, covering strategic, operational, financial and compliance risks, amongst others. A total of four BRC meetings were held in the year, supplemented with other engagements via electronic mail and teleconferencing.



The management is responsible for identifying, managing and reporting the key risks faced by the Group to the BRC. This is achieved through a management committee, namely the Enterprise Risk Management (ERM) Committee.

Chaired by the President & CEO and supported by the Group Chief Risk Officer, this committee comprises the strategic business unit heads, their chief risk officers and management staff who are appointed as champions of key risk areas. The ERM Committee reviews risk issues at both the strategic business unit and Group levels. The areas of review cover risk policy matters, risk profiles and treatment plans as well as other Group risk initiatives.

Supporting the ERM Committee are sub-committees which look after their respective areas such as Health, Safety, Security and Environment, Human Resource, Project Management, Finance, Information Technology, Procurement and Critical Assets, amongst others.

The organisation of the Group's risk governance structure is illustrated on the left.

Risk Management System

In line with its risk management system, the Group reviews its risk policies, profiles and plans at least once every year. Seminars and talks by external and internal speakers on pertinent and current topics are organised to raise awareness and enhance understanding of the subject matters. These activities, among others, are core components of the Group's annual risk management workplan. Initiatives carried out during the year included:

- A survey for the ERM Committee to obtain feedback from the Committee members to improve the Group ERM efforts and initiatives
- Quarterly internal controls awareness sessions by Group Risk Management and Group Internal Audit to educate employees on the fundamentals of corporate governance, internal controls, risk management and internal audit and to inculcate a sense of accountability, which ultimately strengthens the Group's risk culture
- Formation of two new ERM sub-committees for insurance and information technology to accord greater emphasis and focus on these two areas that are assessed to be critical
- Formation of a formal risk governance and assurance framework with the assistance of external consultants to strengthen the current framework
- A talk by external consultants on the topic of risk governance with a special focus on risk appetite

Key Risks and Mitigation Strategies

The key risks faced by the Group and the mitigation measures are set out in the following sections. They were identified during the Group's annual risk review.

Sembcorp Marine's top risk profile was developed during the Group's annual risk review, with due considerations given to the top risk profile of each strategic business unit.

The year in review was marked with catastrophic natural disasters, political upheavals, leadership transitions and the continuing economic malaise in the Eurozone and to a lesser extent, in the United States. These factors helped shape the Group's top risk profile, which will continue to evolve with the ever-changing external environment.

External Environment Risks

The significant external environment risks to the Group include volatility in the commodity markets, in particular the oil market; the state of the global economy and trade; the stability of the global financial and banking systems; foreign exchange fluctuations; political risks; regulatory landscape; and natural disasters.

On the governmental regulatory front, transfer pricing which has been previously identified as a key area of focus is now governed by a Group policy and procedure. Transfer pricing documentation has been prepared to defend significant cross-border related party transactions and pricing in the foreign tax jurisdictions that the Group operates in.

Potential risk exposures brought about by changes and developments in the external environment are identified and evaluated for potential impacts to the Group. Recognising that risks of this nature are inherently volatile, unpredictable and usually cannot be completely eliminated, the Group continues to adopt a balanced approach to mitigate such risks to as low as reasonably practicable in commensuration with its risk appetite.

Strategic Risks

Strategic risk considerations impact the Group's strategies and plans to grow its business in Singapore and internationally. They typically encompass business performance, customers, markets, industry, competition and new business opportunities. These risks are discussed at both the BRC and ERM Committee meetings and are

key inputs and considerations in the annual strategic planning meeting with the Board of Directors to formulate strategies to steer the Group forward.

Financial Risks

The Group's international presence and worldwide clientele inevitably exposes it to various counterparty and related risks within the global financial market. Policies and procedures covering key areas – including treasury, foreign exchange, credit, accounting, inter-company transactions and others – have been established and implemented throughout the Group to mitigate the associated risks. These policies also set out approval limits for significant transactions and guidelines to minimise cost of capital, adverse effects of fluctuations in foreign currencies and interest rates on income as well as to ensure that sufficient funds are available to meet financial obligations and operational needs.

Tasked to enhance the Group's financial risk management framework, the Finance Committee, a sub-committee of the ERM Committee, looks into the areas of financial system integrity, regulatory reporting, accounting, risk management and compliance systems, including internal and external audit issues. Chaired by the Group Chief Financial Officer, the committee comprises key finance personnel from the strategic business units and the corporate functions of treasury, tax, internal audit and risk management.

The Group's financial risk management is discussed in detail in Note 37 to the financial statements.

Project Management Risks

Given the project-centric nature of the Group's business, project management risks account for a significant proportion of its overall risks. The Group's ability to deliver projects safely, timely and within budget, while meeting quality standards, demonstrates the effectiveness of the risk mitigation measures throughout the project management process, from project tendering, contract negotiation, construction to delivery.

Project risk management addresses third-party risks such as contractors, suppliers or vendors who fail to fulfil their contractual obligations. This could in turn affect the Group's ability to meet its own contractual obligations to customers on a timely and cost-effective basis, subjecting it to risks of incurring liquidated damages. This is especially so if there are limited substitutes, in particular for specialised equipment. As a mitigation measure, the Group has in place processes like stringent selection criteria when working with third parties, combined with constant monitoring and assessment, allowing for warning signs to be flagged out early.

The year in review saw a significant milestone when Sembcorp Marine secured its first drillship order from Brazil, based on the Group's proprietary Jurong Espadon drillship design. This is also the first project secured by the new Brazilian shipyard, Estaleiro Jurong Aracruz. Since then, the Group went on to secure another six drillships of the same design. This will undoubtedly be a challenging undertaking, by a greenfield yard no less. The Group has an established track record of working in Brazil and the necessary plans have been put in place to address the project execution risks.

The Project Risk Management Committee, another sub-committee of the ERM Committee, is chaired by the President & CEO. This committee provides a platform for the strategic business units to report and discuss their project risk matters, including project schedule, costs, work variations, financial and contractual issues.

Health, Safety, Security and Environment Risks

Of paramount importance to the Group is to provide a safe and healthy work environment for its customers, employees, contractors and the community. This is championed by the Group Health, Safety, Security and Environment Committee, another sub-committee of the ERM Committee, involving key health, safety, security and

environment personnel from all the yards. This committee sets the direction and ensures the adoption of leading industry practices across the Group. Among other things, it also monitors closely the Group's safety performance and reports regularly to the management and the BRC.

To foster a strong safety culture, the Group has in place a performance appraisal system which includes safety as an integral part of management's key performance indicators. This demonstrates the importance of safety across the Group. The Workplace Safety and Security section of this annual report further illustrates the activities carried out in the year to mitigate risks in this area.

Human Resource Risks

The Group believes in the importance of having the right number of people with the requisite qualifications, skills and expertise to support its strategic business plans. In particular for the new yard in Brazil, the human resource plan has been activated to man up the operations in line with the progress of the projects. While actively recruiting and retaining talents to maintain and enhance its competitive edge, the Group also has in place comprehensive human resource policies and procedures for recruitment, compensation and staff development. These activities are driven by the Group Human Resource Committee which also addresses key risk areas including management succession, staff turnover, work-life balance as well as compensation and benefits. Measures have been put in place to address recent changes in the foreign worker quota and increased levies. The Group's human resource activities are discussed in detail in the Nurturing People section of this report.

Investment Risks

The Group seeks to grow its business through the acquisition of business entities or operating assets, the development of new capacities and the expansion of its existing capabilities, facilities and activities. Investment

activities, ranging from the identification of targets to the undertaking of due diligence exercises, are supported by a team of experienced managers and augmented by external professionals for specialised services. Business proposals are risk assessed and evaluated by senior management before the approval deliberations by the Board of Directors.

Ongoing investments – such as the New Yard Facility at Tuas View Extension in Singapore, Estaleiro Jurong Aracruz at Espirito Santo in Brazil, Sembmarine Kakinada in India, Sembmarine SLP in the United Kingdom and Ecospec Global Technology, a Singapore company – are continuously monitored and followed up against plans and budgets for smooth execution and implementation. The Group has also acquired a 34.5-hectare site for the second-phase development of the New Yard Facility.

Critical Assets Risks

Certain assets are critical to the Group's operations in Singapore and overseas. The Group Critical Assets Committee was formed as a sub-committee of the ERM Committee in 2011. The major categories of assets identified by the committee are power and utilities; material handling equipment; docks and quays; workshops, and launching facilities.

During the year, the committee formulated the Group Critical Assets Management Policy, developed risk profiles and risk mitigation measures for the five categories of assets and shared information and best practices on the operations and maintenance of these assets.

The strategic business units have established policies and procedures for managing their critical assets which cover infrastructure, facilities, machineries and equipment. The performance of such assets is tracked against predetermined indicators like frequency of breakdown, downtime, maintenance and repair costs. Regular monitoring, coupled with a structured maintenance regime, ensures continuity of service.

Business Continuity Risks

Business continuity risks are threats with potentially disastrous impacts to the Group's ability to continue its business operations. To mitigate these risks, the Group has in place a Business Continuity Management (BCM) framework that complements its ERM framework. The BCM framework comprises the Group BCM Policy, a BCM steering committee chaired by the President & CEO, as well as response, escalation and reporting processes which will be activated in times of crises and emergencies. BCM initiatives are featured in the Group's annual ERM Workplan for 2012.

The Group BCM Policy, which is based on the Singapore Standard for BCM (SS540), sets out the methodology to guide the strategic business units in their reviews and updates of their business continuity strategies and plans. Four base disaster scenarios were identified for business continuity planning based on their likelihood and impact, namely: major fire and explosion, prolonged power outages, infectious disease outbreaks and major information technology disruptions or failures. These scenarios were included in the validation of the strategic business units' business continuity plans which started in 2011 and went on through 2012. Following the validation, areas for improvements were identified and carried out.

Fraud and Corruption Risks

The Group takes a zero tolerance stance against fraud and corruption. Acts of fraud committed by employees or parties that provide dishonest or unfair benefits to themselves or related parties to the detriment of the Group are strictly not tolerated. The perpetrators will face consequences, such as disciplinary warnings and termination of employment or other contractual relationships, and will be reported to the appropriate law enforcement or regulatory body.

Under the Group's ERM and Fraud Risk Management frameworks, its strategic business units conduct fraud risk evaluation as part of their overall risk assessment. In

addition, the ERM sub-committees and Group Internal Audit consider fraud risk, among others, in its review of controls.

Augmenting these frameworks and the Group-wide whistle-blowing structure, Group Risk Management and Group Internal Audit continue to conduct a series of in-house training sessions to educate staff on risk governance and internal controls. In 2012, over 300 employees attended these sessions.

Under the whistle-blowing policy, every reported case will be considered and investigated independently on the basis of its merits. During the year under review, there were two confirmed cases of corruption which were dealt with by the authorities, and the offenders are no longer under the employment of the Group.

Other Group-wide Risk-based Activities

In addition to these risk mitigation strategies, the Group has other risk management activities in place including Control Self Assessment and insurance programmes.

Control Self Assessment

The Group's Control Self Assessment (CSA) programme, which was established in 2008, provides a self-checking mechanism to assess if controls within the Group are well-designed and effectively implemented. Identified control lapses will give rise to corrective actions which are tracked and reported to management till completion.

The programme also seeks to raise awareness among staff on risks and controls, promote ownership and accountability through identifying control owners for respective processes, and support management's assurance to the Board on the adequacy and effectiveness of internal controls.

All strategic business units in the Group have implemented the programme, with appointed CSA managers who work in tandem with Group Risk Management and Group Internal Audit. Updates on the programme are also reported at the BRC and ERM Committee meetings.

During the year, a series of workshops targeted at staff who would be embarking on the programme was conducted jointly by Group Risk Management, Group Internal Audit and current CSA practitioners at the strategic business units.

Insurance

The Group uses insurance as a means to transfer risks if practicable and where necessary if it is mandated by legislation like the Work Injury Compensation Act. Where possible, it is also used to protect against foreseeable events with catastrophic financial losses. The Group insures its risks based on an approach that seeks to balance the cost benefits with its risk appetite, risk management capabilities and self-insuring capacity.

To benefit from economies of scale, the Group procures its insurance on an aggregate basis, whenever possible, pooling the needs of its strategic business units to obtain optimal coverage at competitive prices. This is achieved through working closely with insurance brokers who are familiar with its business and operations.

During the year, external consultants were engaged to perform a review of the Group's insurance policies against best practices and a valuation of specified buildings, civil works, plant and equipment to ensure that the insurance coverage is appropriate and adequate. The findings were considered and factored into the insurance plans for 2013 and beyond.