

# INTERNAL CONTROLS and Risk Management

Terra's success as an organisation depends on its ability to identify and exploit the opportunities generated by its business and the markets it operates in. While ultimate responsibility for risk management rests with the Board, the effective day-to-day management of risk is in the way Terra conducts its business and the culture of its team. Terra takes an embedded approach to risk management that puts risk and opportunity assessment at the core of the leadership team agenda.

Terra's approach to risk management is designed to provide reasonable assurance that its assets are safeguarded and to ensure that the risks facing the business are being assessed and mitigated, and that all information that may be required to be disclosed is reported to Terra's senior management.

As part of the overall corporate governance framework, the Board has ultimate responsibility for overseeing the risk governance framework and determining the nature and extent of the principal risks it is willing to accept to achieve its strategic objectives. The Board is also responsible for maintaining a sound system of risk management and internal controls. The Audit and Risk Committee assists the Board by taking an active role in monitoring the risk management and internal control systems across Terra.

## Internal Controls and Audit

In delivering its responsibilities in respect of internal controls and audit, the Committee has to:

- Review the Group's statement on internal control systems prior to endorsement by the Board, and in particular to review:
  - the procedures for identifying business risks and controlling their impact on the Group
  - the Group's policies for preventing or detecting fraud
  - the Group's policies for ensuring that the company complies with relevant regulatory and legal requirements
  - the operational effectiveness of the policies and procedures.
- Consider whether or not the objectives, organisation, staffing plans, financial budgets, audit plans and standing of the internal audit function provide adequate support to enable the Committee to meet its objectives
- Review the results of work performed by the internal audit function in relation to corporate governance, internal control and any significant investigations and management responses
- Review co-ordination between the internal audit function and the external auditors, and deal with any issues of material or significant dispute or concern
- Review such significant transactions not directly related to the Group's normal business as the Committee might deem appropriate
- Review significant cases of employee conflict of interest, misconduct or fraud, or any other unethical activity by employees or the Group

- Review the controls over significant risks
- Consider other relevant matters referred to it by the Board.

The Board has also established key processes for monitoring the system of internal control as follows:

- A detailed organisational structure has been established, including the delegation of appropriate responsibilities from the Board to Board Committees, the Group Managing Director, members of Senior Management and heads of operating units
- The effectiveness of internal controls, continually assessed by the Board when it considers the recommendations of the Audit and Risk Committee, reports of the internal auditors and feedback from management and the external auditors
- A proper enterprise resource planning system to provide financial and operational performance data for management accounting purposes
- A review of accounting information on a regular basis at Audit and Risk Committee and Board level, with remedial action taken promptly as necessary
- A Code of Ethics (first adopted in 2005, reviewed in 2013 and revised in 2014) to govern staff conduct, setting out the standards of integrity and professionalism required within the Group, monitored by the Ethics Committee
- Appropriate operational and compliance controls in all operating units.

## Mission and scope of internal auditing

Internal auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve Terra's operations. It assists the Group in accomplishing its objectives by bringing a systematic and disciplined approach to evaluating and improving the effectiveness of the organisation's governance, risk management and internal controls.

## Internal auditors

Except for Grays, which has its own in-house internal auditor, and Terrarock, which has retained the services of UHY & Co, the Group's internal audit function is outsourced to Ernst & Young (EY). The scope of the internal function is to assist the Board to discharge its responsibilities and maintain the internal control framework.

## Reporting and independence

The internal auditors have a direct reporting line to the Audit and Risk Committee and maintain an open and constructive communication channel with the executive management team. They also have direct access to the chairpersons of the Committees and the Board. This reporting structure allows the internal auditors to remain independent and to report all items of significance to the Board and the Audit and Risk Committee.

# INTERNAL CONTROLS and Risk Management (cont'd)

Twenty-two persons from the management team attended a two-days training in business risk management that provided them methodologies to enhance the existing risk management process.

## Risk-management Framework

The role and responsibilities of the Audit and Risk Committee regarding risk management consist in carrying out a robust assessment of the main risks facing Terra, including those that would threaten its business models, future performance, solvency and liquidity. The Committee has also the task of reviewing the Group's capability to identify and manage new risk types, and keeping under review the effectiveness of internal controls and risk management. In order to fulfil these responsibilities the Committee has more specifically to review:

- With the assistance of the legal advisers, the status of any legal matter that could have a significant impact on the Company's business
- Management reports detailing the adequacy and overall effectiveness of the Company's risk-management function and its implementation by Management, reports on internal controls, together with any recommendations, and confirmation that appropriate action has been taken
- Compliance with risk philosophy, strategy and policies, and with the Group's overall risk profile. Risk in the widest sense includes market risk, credit risk, liquidity risk, operation risk and commercial risk, which together cover detailed combined risks
- The adequacy of insurance coverage.

The Committee also assists the Board in fulfilling its oversight responsibilities by monitoring the integrity of the Group's financial statements and other financial information before publication.

In 2017, the Board, through the Audit and Risk Committee, reviewed the assessment of risks, internal controls and procedures in operation within Terra. They also considered the effectiveness of any remedial action taken during the year.

Terra's Board monitors the principal risks and controls through:

- Levels of authority for transactions requiring Board approval for investments and capital expenditure
- Executive Directors' oversight of all significant day-to-day decisions
- The Managing Director reporting on strategic and key operational matters at each scheduled Board meeting
- The Finance Director reporting on the Group's forecasts, including actual and prospective metrics.

## Risk-based internal audit approach

- A risk-based methodology is applied, through which the auditors first establish a preliminary understanding of the business, operations and key risks through discussion with Terra's Audit and Risk Committee, directors and management, and review the risk register to identify high risk areas.
- Based on the risk identification, a three-year audit plan, which is established by the auditors, is approved by the Audit and Risk Committee.
- The approved three-year internal audit plan is thereafter rolled out and audit visits at business units are undertaken by the auditors.
- Audit reports are presented and discussed at the Audit and Risk Committee.
- The Audit Plan also includes dedicated follow-up visits undertaken in business units and areas where significant high risk issues have been reported in prior audit reports.

The risk based audit approach is illustrated in the chart below:



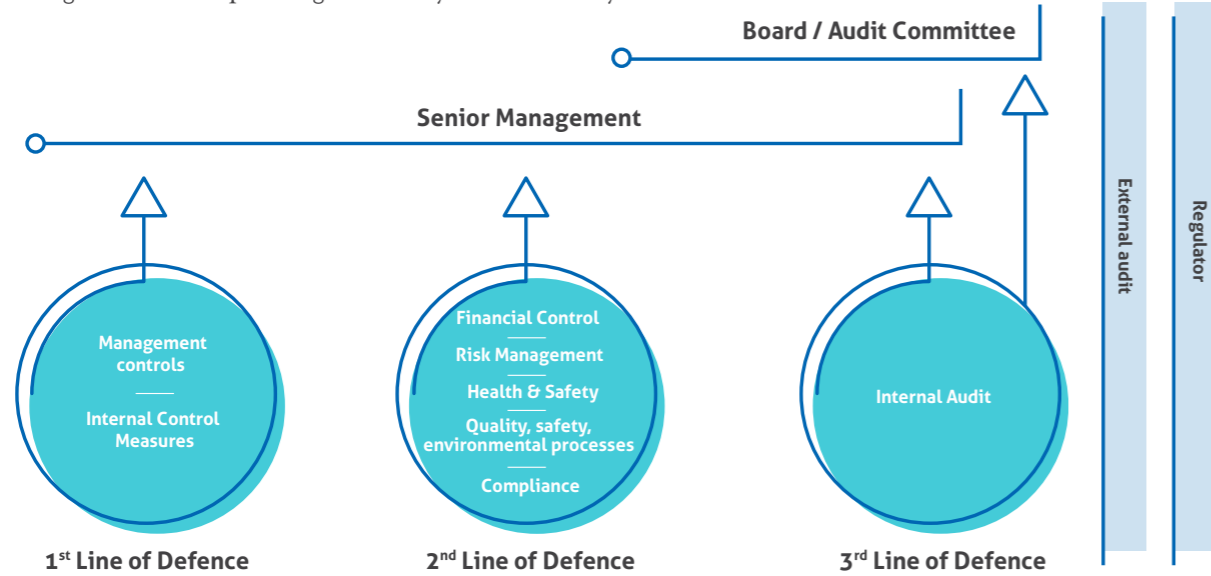
During 2017, EY performed three internal audit visits, which were in line with the audit plan approved by the Audit and Risk Committee. EY also performed one special assignment at Grays at the request of the Audit and Risk Committee. In addition, UHY & Co performed two visits at Terrarock Ltd, while Grays' internal auditor realised four assignments and submitted four follow-up reports. Findings and observations made were discussed with management of the respective business units, action plans to address internal control gaps were agreed with management, incorporated in the internal audit reports and reported to the Audit and Risk Committees. The auditors had unrestricted access to the Group's records, management and employees in undertaking their work.

The representatives of the internal auditors, or the internal auditor himself in the case of Grays, attended the respective Audit and Risk Committee, when progress on internal audit activities were reported, and reports on completed audit visits were reviewed and discussed.

# INTERNAL CONTROLS and Risk Management (cont'd)

## Terra's lines of defence

Terra has also adopted the three-lines-of-defence approach, with the aim of bringing about a greater understanding of the roles and responsibilities throughout the various risk-management and control functions. This also assists executive management, the Audit and Risk Committee and, ultimately, the Board to have confidence that the control framework within the organisation is operating efficiently and effectively.



- The first line of defence refers to the process of assessment by Management, providing a level of assurance over the design and effectiveness of the risk and control processes. At Terra, operational line managers and heads of department and business units are responsible for proper monitoring and reporting of risks, and the implementation of adequate and timely response activities to manage those risks.
- The second line of defence refers to functions established by Management with the aim of monitoring and reporting on the effectiveness of the first line of defence in fulfilling its roles and responsibilities regarding risk management. At Terra, these monitoring functions include risk management, compliance and HSEQ processes.
- The third line of defence consists of objective, independent control, evaluation and monitoring functions, outsourced to EY as internal auditors. The internal auditors provide an independent and objective assurance and consulting activity.

## Risk-management approach

Terra has generally adopted the principles of the Enterprise Risk Management Model for managing its risks.



The Board has previously agreed its Risk Management Framework, the development of which was facilitated by EY, and a Group Risk Champion designated to maintain the risk register and report thereon regularly to the Audit and Risk Committee. The Risk Management Framework allows the Group to continuously monitor its risk environment and develop risk-mitigating strategies accordingly, as well as assist Management to better recognise the extent to which risks are being properly managed. The risk register is maintained and updated on a continuous basis by the Group Risk Champion as outlined below. The actual framework is being enhanced to guarantee an effective and efficient risk management process.

# INTERNAL CONTROLS and Risk Management (cont'd)



## Key risk profile of the Group

Risks identified relate to the following areas:

- Cost competitiveness – Risks which might prevent the Group from remaining economically viable
- Stakeholder confidence – Risks which might prevent the Group from maintaining or building on strong relationships with stakeholders
- Customer reach – Risks which might prevent the Group from taking maximum advantage of market opportunities for its products and services
- Operational agility – Risks which might inhibit the Group from improving its ability to respond effectively in a quickly changing market.

Financial risks form part of the Risk Management Framework. These may be defined as the risk that cash flows and financial assets, if not managed cost-effectively, may affect the Group's ability to:

- Maximise cash availability
- Reduce any uncertainty around currency matters, interest rates, and credit and other financial assets
- Move cash funds quickly and without loss of value to wherever they are most needed.

## Risks in decision-making

The Board, advised by the Audit and Risk Committee where appropriate, reviews the significant risks when taking decisions that could have a material impact on Terra. These reviews consider the level of risk that Terra is prepared to take in pursuit of the business strategy and the effectiveness of the management controls in place to mitigate risk exposure.

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Chairperson of the Audit and Risk Committee  
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