

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

18. FINANCIAL RISK MANAGEMENT

We undertake transactions using a range of financial instruments, including:

- cash assets
- receivables
- payables
- negotiable certificates of deposits
- bank deposits
- bills of exchange and promissory notes
- listed investments and investments in other corporations
- various forms of borrowings, including medium term notes, promissory notes, bank loans and private placements
- derivatives.

Our activities result in exposure to operational risk and a number of financial risks, including market risk (interest rate risk and foreign currency risk), credit risk and liquidity risk.

Our overall risk management program seeks to mitigate these risks and reduce volatility on our financial performance and support the delivery of our financial targets. We manage our risks with a view to the outcomes of both our financial results and the underlying economic position. Financial risk management is carried out centrally by our Treasury department, which is part of our corporate areas, under policies approved by the Board. The Board approves written principles for overall risk management such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and liquidity management.

We enter into derivative transactions in accordance with Board approved policies to manage our exposure to market risks and volatility of financial outcomes that arise as part of our normal business operations. These derivative instruments create an obligation or right that effectively transfers one or more of the risks associated with an underlying financial instrument, asset or obligation. Derivative financial instruments that we use to hedge risks such as interest rate and foreign currency movements include:

- cross currency swaps
- interest rate swaps
- forward foreign exchange contracts.

We do not speculatively trade in derivative financial instruments. Our derivative transactions are entered into to hedge the risks relating to underlying physical positions arising from our business activities.

Section (a) of this note sets out the key financial risk factors that arise from our activities, including our policies for managing these risks.

Sections (b) and (c) provide details of our hedging strategies and hedge relationships that are used for financial risk management. In particular, these sections give context to our hedge transactions and the resulting economic and risk positions.

(a) Risk and mitigation

The risks associated with our main financial instruments and our policies for minimising these risks are detailed below. These risks comprise market risk, credit risk and liquidity risk.

Market risk

Market risk is the risk that the fair value or future cash flows of our financial instruments will fluctuate because of changes in market prices. Components of market risk to which we are exposed are discussed below.

(i) Interest rate risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates.

Interest rate risk arises from interest bearing financial assets and liabilities. Our interest rate liability risk arises primarily from long term foreign debt issued at fixed rates, which exposes us to fair value interest rate risk. Our borrowings, which have a variable interest rate attached, give rise to cash flow interest rate risk.

Our debt is sourced from a number of financial markets covering domestic and offshore, short term and long term funding. The majority of our debt consists of foreign currency denominated borrowings. We manage our debt in accordance with targeted currency, interest rate, liquidity, and debt portfolio maturity profiles. Specifically, we manage these risks on our net debt portfolio by:

- adjusting to our target ratio the ratio of fixed interest debt to variable interest debt, as required by our debt management policy
- ensuring access to diverse sources of funding
- reducing risks of refinancing by establishing and managing in accordance with target maturity profiles
- undertaking hedging activities through the use of derivative financial instruments.

Under our interest rate swaps we agree with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract interest rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts. Refer to note 17, Table D, for our residual post hedge fixed and floating interest positions on a contractual face value basis.