

# Corporate governance and risk management

Kumba Iron Ore is committed to the highest standards of business integrity, ethical values and professionalism in all its activities. As an essential part of this commitment, the board supports the highest standards of corporate governance and the directors are responsible to the Kumba Iron Ore shareholders. The key principles underpinning the corporate governance of the group and systems of control that form an integral part of corporate governance, are set out below:

## Board of directors

In preparation for the company's listing on the JSE in November 2006 a number of corporate governance processes, policies and procedures were adopted by the board. These included, *inter alia*, a board charter, terms of reference for the various board committees, a conflict of interest policy, a procedure for directors to have access to professional advice, a policy for trading in shares and a policy for disclosure of information. Additional policies and procedures, including a code of ethics, will be implemented as required during 2007.

The board charter is based on the acknowledgement that the board is responsible to the Kumba Iron Ore shareholders for setting the strategic direction of Kumba Iron Ore through the establishment of strategic objectives and key policies. In terms of its charter, the board meets on a regular basis, at least four times a year. The board considers issues of strategic direction, major acquisitions and disposals and approves major capital expenditure and other matters having a material effect on Kumba Iron Ore. Where relevant, presentations are made to the board by business management on the activities of operations. Opportunities for the board to visit operations and projects are arranged. All the directors participated in a visit to Sishen Mine early in 2007 which included a guided tour of the mining operations as well as presentations by the business management teams of both Sishen and Thabazimbi Mines on their expansion plans. This opportunity was also used by the board to discuss issues of strategic importance to the group with the business' management teams.

The composition of the board, with a strong independent element, ensures that no one individual has unfettered powers of decision and authority.

The chairman is responsible for leading the board and for its effectiveness. The company secretary, with the support of the CEO, is responsible for ensuring that the directors receive timely, accurate and clear information before board meetings and updates of issues arising between meetings. The executive committee is responsible for the overall day-to-day management of the group.

The directors have a wide range of expertise as well as significant experience in financial, commercial and mining activities. All directors have full access to internal and external auditors, and are encouraged to stay fully abreast of the group's business through meetings with senior management and site visits. Induction, training and briefings are available to all directors on appointment and subsequently, as necessary, taking into account existing qualifications and experience.

All directors have access to management, and to the advice and services of the company secretary, and to such information as is needed to carry out their duties and responsibilities fully and effectively. Furthermore, all directors are entitled to seek independent professional advice concerning the affairs of the group at its expense.

Six board meetings were held during 2006 in preparation for the listing of the company on the JSE and one meeting took place following the listing in November 2006. The November 2006 meeting was attended by all the directors except for Dr Moyo, based in London, who tendered his apologies due to other commitments.

All non-executive directors are subject to election by shareholders at the first opportunity following their appointment. In addition, non-executive directors retire by rotation and stand for re-election by Kumba Iron Ore shareholders at least once every three years in accordance with the company's articles of association.

## Executive management

### Executive committee

The executive committee is a management forum chaired by the CEO and includes the CFO, a number of senior managers, and the company secretary. The executive committee meets on a monthly basis to assist the CEO in formulating strategies, monitoring performance, defining the group's risk tolerance capacity and acting as a sounding board on issues to be presented to the board and board committees.

## Committees of the board

Subject to specific fundamental, strategic and formal matters reserved for its decision, the board delegates certain responsibilities to a number

of standing committees, which operate within defined terms of reference laid down by the board. The terms of reference of the committees deal *inter alia* with the composition, number of meetings and responsibilities of each committee. All members of the committees are appointed on recommendation of the human resources, remuneration and nomination committee. Except for the audit and risk committee, none of the committees met during 2006 and formal committee meetings commenced in accordance with the agreed meeting schedule for 2007. The board committees consist only of non-executive directors.

These committees are:

- Human resources, remuneration and nomination;
- Safety and sustainable development; and
- Audit and risk.

### Human resources, remuneration and nomination committee

The human resources, remuneration and nomination committee, comprising solely of non-executive directors, is responsible for:

- setting human resources and remuneration policies and practices for the group in general; and
- making recommendations on the composition of the board and board committees and ensuring that the board of directors consists of individuals who are equipped to fulfil the role of director of the company.

The members of the committee are:

Mr Peter Matlare – Chairman  
 Mr Allen Morgan  
 Mr Philip Baum  
 Mr Lazarus Zim.

The committee did not meet during 2006.

### Safety and sustainable development committee (S&SD)

The S&SD committee is responsible for developing framework policies and guidelines for the management of sustainable development issues, including safety, health and environmental matters, and ensuring the progressive implementation of these throughout the group. The S&SD committee meets three times each year, including visits to operations, and business unit heads will be invited to attend S&SD meetings. Each business unit head will make an annual safety and sustainable development presentation to the S&SD committee.

The members of the committee are:

Ms Dolly Mokgatle – Chairman  
 Mr Allen Morgan  
 Mr Peter Matlare.

The committee did not meet in 2006.

### Audit and risk committee

The primary objectives of the audit and risk committee are to ensure the integrity of financial reporting and the audit process, and that a sound risk management and internal control system is maintained. In pursuing these objectives, the committee oversees relations with the external auditors and reviews the effectiveness of the internal audit function.

In fulfilling its responsibility of monitoring the integrity of financial reports to shareholders, the committee reviews accounting principles, policies and practices adopted in the preparation of public financial information and examines documentation relating to the annual report, interim report, preliminary announcements and related public reports.

The committee reviews regular internal and external audit reports on the results of audits at various operations.

The internal audit function, which has been outsourced to ABAS (Anglo Assurance Business Services) from 2007, reports directly to the committee and is accountable for maintaining company auditing standards, including risk reporting. The internal auditor's mandate and annual audit coverage plans are approved by the committee, and the committee will consider reports on the results of internal audit work and risk management information. The effectiveness of the internal audit function will be evaluated by means of annual assessments against predetermined criteria and periodic external peer reviews, the results of which will be reported to the committee.

The members of the committee are:

Mr Gert Gouws – Chairman  
 Ms Dolly Mokgatle  
 Dr Nkosana Moyo.

The committee met twice following the listing of the company on the JSE in November 2006 and all members of the committee were in attendance at the meeting.

### Policy on external auditors' independence

Kumba Iron Ore's policy on auditors' independence is consistent with the ethical standards promulgated by the Auditing Practices Board and published in December 2004.

### Internal control

The executive committee is responsible for establishing a system of internal control to manage significant group risks. The board's approach to risk management encompasses all significant business risks to the

# Corporate governance and risk management

continued

group, including financial, operational and compliance risk, which could undermine the achievement of business objectives. This system of risk management is designed so that the different businesses are able to tailor and adapt their risk management processes to suit their specific circumstances. There is clear accountability for risk management, which is a key performance area of line managers throughout the group. The requisite risk and control capability is assured through board challenge and appropriate management selection and skills development. Managers are supported in giving effect to their risk responsibilities through policies and guidelines on risk and control management. Continuous monitoring of risk and control processes provides the basis for regular and exception reporting to business management and the boards of subsidiary companies, the executive committee and the board of directors of the company. The risk assessment and reporting criteria are designed to provide the board with a consistent perspective of the key risks. The reports to the board, submitted via the audit and risk committee, include an assessment of the likelihood and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.

The system of internal control, which is embedded in all key operations, provides reasonable, rather than absolute, assurance that the group's business objectives will be achieved within the risk tolerance levels defined by the board. Kumba Iron Ore seeks to have a sound system of internal control, based on the group's policies, in all material associates and joint ventures. In those companies that are independently managed, the directors who are represented on these organisations' boards seek assurance that significant risks are being managed.

The group's internal audit function has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. The internal audit function will be responsible for providing independent assurance to the executive committee and the board on the effectiveness of the risk management process throughout the group.

## Whistleblowing programme

A whistleblowing policy has been implemented by the group. This programme, which is monitored by the audit and risk committee, is aimed at enabling employees, customers, suppliers, managers or other stakeholders, on a confidential basis, to raise concerns in cases where conduct is deemed to be contrary to ethical behaviour.

The programme makes available, via an independent service provider, a selection of telephonic, e-mail, web-based and surface mail

communication channels, to any person who has information about unethical practices in the group and its managed operations. Quarterly reports on reported matters and subsequent investigations are submitted to the audit and risk committee for notification.

## Relations with shareholders

Following the listing of the company, Kumba Iron Ore maintains an active dialogue with its key financial audiences, including institutional shareholders and sell-side analysts. Regular presentations will take place at the time of interim and final results as well as during the rest of the year.

## Risk management

### Risk philosophy

Kumba Iron Ore maintains an integrated, enterprise-wide, risk management programme (IRM). The group applies a logical, systematic and repetitive methodology to identify, analyse, assess, treat and monitor all risks, whether they are insurable or not.

The effectiveness of the IRM process is measured by how well it aligns the key fundamentals of governance, business objectives, ethics, policies, standards, strategies and compliance. Kumba Iron Ore recognises the complexity and diversity of risks that face all its operational activities and integrates all efforts to maximise opportunities and minimise exposures to risk and to reduce them, where necessary, to levels commensurate with its risk appetite.

### Risk culture

The group's policy is zero tolerance for compliance failures and its aim is to identify speedily and to rectify any deviation. Promoting a risk-conscious culture is a constant focus throughout the group and this culture proactively supports achieving our strategic business objectives. Each risk owner is responsible for monitoring the existing and ever-changing risk profile of the group on a continuous basis.

To this end, a monthly risk review that covers both internal and external risks has been instituted with findings reported to the executive committee.

Divisional and business unit risk committees play an important role in identifying operational risk and in the development and application of generic mitigating strategies. They also have a risk oversight function by virtue of being closer to activities that could have adverse results. Each committee is chaired by the head of the business centre and meets monthly.

## Risk management objectives

The risk management process is continuous, with well-defined steps, which support better decision-making by contributing a greater insight into risks and their impacts. Risks from all sources are identified and once they pass the materiality threshold, a formal process begins in which causal factors and consequences are identified and the correlation with other risks and the current risk mitigating strategy is reviewed. One of the challenges is to ensure that mitigating strategies are geared to deliver reliable and timely risk information to support better decision-making.

## Reporting

Continuous monitoring of risk and control processes, across headline risk areas and other business specific risk areas, provides the basis for regular and exception reporting to business management and boards.

The headline risk areas are:

- Foreign exchange
- Commodity prices
- Treasury
- Counterparties
- Employees
- Employee safety
- Employee health
- Environmental
- Social
- Political
- Legal and regulatory, finance
- Reserves and resources
- Operational performance
- Capital projects
- Mergers and acquisitions
- Technology
- Infrastructure
- Event risk.

The risk assessment and reporting criteria are designed to provide the executive committee and the board, via the audit and risk committee, with a consistent, enterprise-wide perspective of the key risks. The reports which are submitted monthly to the executive committee and quarterly to the audit and risk committee include an assessment of the likelihood and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.

In conducting its annual review of the effectiveness of risk management, the board will consider the key findings from the ongoing monitoring and reporting processes, management assertions and independent

assurance reports. The board will also take account of material changes and trends in the risk profile and consider whether the control system, including reporting, adequately supports the board in achieving its risk management objectives.

## Risk factors

Kumba Iron Ore's business, financial position, results of operation, growth, strategies and dividend policy could be materially adversely affected by risks, including any of those set out below. These risks could also have an adverse effect on the trading price of the Kumba Iron Ore shares.

The risks described below are not the only risks faced by Kumba Iron Ore. Currently unknown risk factors and risks directors deem immaterial may also impair its business operations.

## Mining exploration and projects

In order to expand its operations and mineral resources and reserve base, Kumba Iron Ore relies on its exploration programme and its ability to develop mining projects. Resource exploration and development are speculative in nature, characterised by a number of significant risks.

Further exploration on, and development of, mines and projects will require additional capital, which will need to be sourced as required. The current buoyant construction market in South Africa may result in an increase in the cost of capital required for major construction projects.

## Mining operations

The mining operations of Kumba Iron Ore are subject to the risks and hazards that are normally encountered in open-cast mining operations. These risks include environmental hazards, such as unexpected geological pressures and ground subsidence, and operational risks relating to materials handling, industrial accidents, blasting and removing material from an open-cast pit. If any of these risks should materialise, such event could potentially result in serious harm to employees and contractors, delays in production, increased production costs and a possible increase in the liabilities of Kumba Iron Ore.

Mining operations, development and exploration activities are further subject to extensive legislation and regulations. Changes in this regulatory environment could increase the group's cost of production and, as in most other businesses, its failure to adhere thereto, could result in the revocation of the consents, licences and rights that it requires to conduct its business.

Cost factors such as a rise in the crude oil price, ageing mining and plant equipment, compliance costs, short supply of diesel, electricity

# Corporate governance and risk management

continued

and haul truck tyres as well as rising stripping ratio in the long-term due to geology changes at Sishen Mine may increase production costs. Disruption to the supply of key inputs or changes in their pricing may threaten Kumba Iron Ore's ability to produce products at competitive rates (increase in production cost) and on a timely basis (throughput losses).

## Growth prospects

Sishen Mine is under a contractual obligation to deliver up to 6,25 Mtpa of iron ore to Mittal at a price which recovers the cost of production plus 3 percent. Mittal may, on certain conditions and with proper notice, procure iron ore for use within South Africa in excess of 6,25 Mtpa from Kumba Iron Ore at a price and on terms and conditions to be negotiated in good faith. Under certain circumstances, Mittal may have the right to participate in and proportionately fund future SIOC iron ore expansion projects or new projects in South Africa. Kumba Iron Ore has previously indicated that there was a difference of interpretation with regards to the terms of the agreement with Mittal. Regrettably these differences could not be resolved amicably and the parties have decided to resort to arbitration.

Kumba Iron Ore aims to more than double its output by 2015. The associated challenge of this opportunity is to bring online new growth projects, on time and within budget. Kumba Iron Ore seeks to develop new mining properties and expand its existing operations as a means of generating shareholder value. New mining properties are identified through an active exploration programme whilst current operations are expanded by technology applications to upgrade medium grade iron ore.

## Labour

Kumba Iron Ore is, to a great extent, reliant on the large number of persons employed in its operations. The availability of skills in the mining industry, especially those of artisans, may have an impact on current production and future growth in the industry.

Unionised operations are exposed to the risks posed by organised labour disruption and disputes. The group's production costs may also be increased as a result of increases in wages and employee benefits.

The incidence of HIV/Aids in South Africa is high and may adversely impact on the operations of Kumba Iron Ore through potentially reduced productivity and increased medical and other costs.

Kumba Iron Ore operates in an industry that is subject to numerous safety regulations. Failure to provide a safe working environment may expose the organisation to compensation liabilities, loss of business reputation and other costs.

## Environmental risks

The group's operations are subject to environmental legislation and regulations. If any of the legislation or regulations should be changed, Kumba Iron Ore's production costs could be increased.

Activities harmful to the environment may expose the group to additional costs.

## Commodity price fluctuations

Iron ore prices typically lag the steel commodity cycle by approximately 18 months. Iron ore prices are negotiated annually with the major international steel producers. Kumba Iron Ore has historically followed these international price settlements in its annual price negotiations with its clients.

## Currency fluctuations

Iron ore prices are normally determined in US dollar terms. Strengthening or weakening of the US dollar could, therefore, have a significant effect on the financial position and financial results of the group.

## Risks related to the mining industry in South Africa

South Africa has enacted legislation that promotes the ownership and control of mining companies by HDSA's as set out in the *Mining Charter*. The HDSA's legislation enacted in South Africa at present, requires all mining companies to convert the rights that they held under the previous legislation into rights under the new legislation. Kumba Iron Ore has commenced application for conversion of its old order mineral rights to new order mining rights. The Kumba Resources empowerment transaction was structured to satisfy the 2014 equity ownership requirements of the *Mining Charter* in respect of Kumba Iron Ore.

## Rail and port

Kumba Iron Ore does not own or operate any of its logistical chain assets and exports its iron ore to its international customers through a single channel rail and port. Labour and other operational risks associated with the management of the rail operators' assets fall outside the scope of the group's direct control and may impact on its results.