Risk management

Enterprise risk management as a fully integrated risk management process was systematically applied in 2014 at all levels of the Corporation. The three divisions, the Corporate Staff, and all important Corporate Companies prepared a semi-annual risk map elaborating on the most important 25 to 30 risks with regard to the topics of strategy, markets, operations, management and resources, financials as well as sustainability. The structure of the likelihood was classified into four categories. Whenever possible and suitable, the risks listed were quantified taking into consideration already planned and executed measurements. Alternatively, a qualification of the risk exposure was applied.

The Risk Council, consisting of representatives of the divisions and the Corporate Staff and headed by the Chief Risk Officer, met for two meetings and dealt with the following topics: optimization of the recently implemented reporting tool, business continuity management, link of strategic planning and enterprise risk management, coordination of all activities in the area of enterprise risk management, and analysis of risk maps.

In accordance with the semi-annual risk reporting process, the Executive Committee and the management of the divisions discussed the risk maps twice during the year under review. They defined the top risks of the Corporation and the divisions and determined adequate measures to mitigate the risks. The Board of Directors dealt with enterprise risk management in February and September 2014 to analyze the corporate and divisional risk maps and to define the top risks and the measures to mitigate these risks.

The stepwise procedure, including workshops at the levels of division management, Executive Committee and Board of Directors, has proven to be very effective. Additionally, having Internal Auditing assess the risk maps prepared by the Corporate Companies has led to a clear improvement in reporting quality.

The following were identified as key risks: lack of achievement of strategic financial targets 2015 leading to a loss of reputation, cyclicality of certain business units of the divisions considering a potential slow down of the markets, product quality, and product competitiveness, and the development of foreign currencies.

Clear measures in order to reduce the risk exposure of the factors mentioned above as well as other identified risks were defined and are in the process of execution. They are in line with strategic targets of the three divisions and the Corporation.

Financial risk management

The Board of Directors bears ultimate responsibility for financial risk management. The Board of Directors has tasked the Audit Committee with monitoring the development and implementation of the risk management principles. The Audit Committee reports regularly to the Board of Directors on the current status.

The risk management principles are geared to identifying and analyzing the risks to which the Corporation is exposed and to establishing the appropriate control mechanisms. The principles of risk management and the processes applied are regularly reviewed, taking due regard of changes in the market and in the Corporation's activities. The ultimate goal is to develop controls, based on the existing training and management guidelines and processes, that ensure a disciplined and conscious approach to risks. The Audit Committee is supported by the Head of Finance & Controlling in this task.

Owing to its business activities, GF is exposed to various financial risks such as credit risk, market risk (including currency, interest rate, and price risk), and liquidity risk. The following sections provide an overview of the extent of the individual risks and the goals, principles, and processes employed for measuring, monitoring, and hedging the financial risks.

Credit risk // The credit risk is the risk of suffering financial loss if a customer or counterparty of a financial instrument fails to meet its contractual obligations. At GF, the main credit risks arise from trade accounts receivable and bank deposits.

GF invests its cash worldwide and predominantly as deposits in leading Swiss and German banks with at least a BBB– rating. In accordance with the investment policy of GF, these transactions are entered into only with creditworthy commercial institutions. As a general rule, the investments have a maturity of less than three months. In addition, Corporate Companies hold current bank accounts. Cash is allocated to several banks to limit counterparty risk.

Transactions involving derivative financial instruments are also entered into only with major counter parties with at least a BBB– rating. The purpose of such transactions is to hedge against currency risks and price fluctuations for the purchase of raw materials and electric power for the Corporation.

The danger of cluster risks on trade accounts receivable is limited due to the large number and wide geographic spread of customers. The extent of the credit risk is determined mainly by the individual characteristics of each customer. Assessment of this risk involves a review of the customer's creditworthiness based on their financial situation and past experience. In monitoring default risk, customers are classified according to relevant factors such as geographic location, sector, and past financial difficulties.

The maximum credit risk on financial instruments corresponds to the carrying amounts of the relevant financial assets. GF has not entered into appreciable guarantees or similar obligations that would increase the risk over and above the carrying amounts. The maximum credit risk as of balance sheet date was as follows:

CHF million	**2014**	2013
Cash and cash equivalents	374	641
Other accounts receivable[1]	27	23
Accrued income	15	13
Trade accounts receivable	643	568
Derivative financial instruments	2	9
Other financial assets[2]	19	14
Total	**1 080**	1 268

1 Without tax credits.
2 Relates to loans to third parties, security deposits, and long-term-invested securities for the settlement of pension liabilities.

Market risk // Market risk is the risk that changes in market rates and prices, e.g. exchange rates, interest rates, or share prices, may have an impact on the profit and market value of financial instruments held by GF. The aim of managing such market risks is to monitor and control these risks in order to ensure that they do not exceed a defined limit.

Currency risk // Owing to its international activities, GF is exposed to currency risks. These financial risks occur in connection with transactions (in particular the purchase and sale of goods) which are effected in currencies different from the functional currency of the company in question. Such transactions are effected mainly in Swiss francs, euro and US dollar. Currency risks can be reduced by purchasing and producing goods in the functional currency ("congruency" rule). In some cases, US dollar or euros are hedged generally for a maximum of twelve months by means of forward exchange contracts.

The fair value hedges relate to foreign exchange contracts, which serve to hedge loans to Corporate Companies in foreign currencies. Unrealized gains and losses from changes to fair value are reported for these contracts in the financial result. The fair value hedges also include foreign exchange contracts which serve to hedge currency risks on receivables and liabilities. Like the currency effects on the underlying balance sheet item, gains and losses from changes to the fair value of these contracts are recognized in "Other operating income".

The cash flow hedges mainly serve to hedge currency risks on future sales in foreign currencies. The volume of the foreign exchange contracts is limited to maximal 67% of the expected sales. This results in an entire effectiveness of the hedge. In individual cases, cash flow from orders is fully hedged. Unrealized gains and losses from changes to fair value are recognized directly in equity. They are transferred to the income statement when the service is performed and invoiced; as a result, the foreign exchange contracts become fair value hedges. Currency risks with respect to future inventory purchases were also hedged to a lesser extent during the reporting period.

The table below shows the contract values and market values of the foreign exchange contracts (net) as of balance sheet date:

Foreign exchange contracts, net

CHF million	Fair value hedges	Cash flow hedges	**2014**	2013
Contract value	249	99	348	250
Replacement value[1]	7	3	10	–9
Market value	256	102	**358**	241

1 Corresponds to the carrying amount recognized as other liabilities.

The fair value hedges cover not only US dollar contracts but also contracts for the euro, the Japanese yen and the other currencies. All open foreign exchange contracts fall due and have an effect on liquidity and the income statement within twelve months after the balance sheet date. Assuming unchanged exchange rates, a cash outflow of CHF 358 million (gross) would be offset by a cash inflow of CHF 348 million (gross), giving a negative replacement value of CHF 10 million. Cash flow hedges account for cash outflows of CHF 102 million and cash inflows of CHF 99 million.

Contract values, net by currencies

CHF million	**2014**	2013
USD/CHF	314	221
TRY/USD	6	11
TRY/EUR	9	
JPY/CHF	4	12
SGD/CHF	8	4
Others	7	2
Total	**348**	250

Interest rate risk // The interest rate risk may involve either changes in future interest payments owing to fluctuations in market interest rates or the risk of a change in market value, i.e. the risk that the market value of a financial instrument will change owing to fluctuations in market interest rates.

Market value sensitivity analysis for interest-bearing financial instruments with a fixed interest rate:
Market value fluctuations of fixed-interest financial instruments are not recognized in the Corporation's income statement. Therefore, a change in interest rates would not have any effect on the income statement. Hedge accounting was not applied for interest rate hedging.

Cash flow sensitivity analysis for financial instruments with variable interest rates:
A one-percentage-point increase in interest rates would have increased net income by CHF 2.3 million (previous year: CHF 5.3 million). A reduction in the interest rate by the same percentage would have reduced net income by the same amount. The underlying assumption for this analysis is that all other variables remain unchanged.

Price risk // The securities held for trading of CHF 4 million are exposed to price risks (on the stock market). Since the value of the securities held for trading is modest, there is no great sensitivity to changes in share prices. The shares held are those of Swiss blue chip companies.

Liquidity risk // The liquidity risk is the risk that GF is unable to meet its obligations when they fall due.

Liquidity is constantly monitored to ensure that it is adequate. Liquidity reserves are held in order to offset the usual fluctuations in requirements. At the same time, the Corporation has unused credit lines in case more serious fluctuations occur. The total amount of unused credit lines as of 31 December 2014 was CHF 617 million. The credit lines are spread over several banks so that there is no excessive dependence on any one institution.

The following tables show the contractual maturities (including interest rates) of the financial liabilities held by GF at the end of the reporting period and in the previous year:

CHF million	Carrying amount	Contractual cash flows	Up to 6 months	6 to 12 months	1 to 5 years	More than 5 years
2014						
Trade accounts payable	419	419	419			
Other liabilities current/non-current[1]	120	120	59	10	50	1
Accrued liabilities and deferrred income	181	181	181			
Bonds	497	553	7	6	379	161
Other financial liabilities	210	230	130	36	61	3
Total	**1 427**	**1 503**	**796**	**52**	**490**	**165**

CHF million	Carrying amount	Contractual cash flows	Up to 6 months	6 to 12 months	1 to 5 years	More than 5 years
2013						
Trade accounts payable	421	421	421			
Other liabilities current/non-current[1]	106	106	51	9	45	1
Accrued liabilities and deferrred income	175	175	175			
Bonds	796	874	7	320	388	159
Other financial liabilities	183	194	121	36	32	5
Total	**1 681**	**1 770**	**775**	**365**	**465**	**165**

1 For more details see note 16.