

## Managing risk responsibly

Tullow has comprehensive risk management systems in place, with clear targets and responsibility.

Effective risk management is critical to achieving the Group's strategic objectives and protecting its people and reputation. Tullow manages and mitigates risk by maintaining a balanced portfolio, compliance with the terms of its licences, the application of policies and procedures appropriate for an international oil and gas company of its size and scale, and through the recruitment and retention of skilled personnel throughout its business.

The Group has a systematic approach to risk identification and management combining both a 'top-down' (driven by the Board) and a 'bottom-up' (originating from the business units and operations) review and approval process.

### **Detailed assessment in 2008**

The Board completed a detailed update of strategy during 2008 and a key component of this process was an assessment of risks critical to strategic delivery. This assessment was completed with each Board member and senior managers from production, exploration and finance.

One of the main outcomes is that responsibility for managing and monitoring key risks has been assigned to individual Executive Directors and senior managers.

Other key outcomes are that risk management is now integrated with the Group's performance management tools and will be reported on a quarterly basis to the Board.

### **Assigned responsibility**

While the Tullow Board and Executives have collective responsibility for the management of risk, the Group has Board sponsors with responsibility for key risks and these are outlined here.

Aidan Heavey, Chief Executive Officer, has responsibility along with the executive team for strategic delivery consistent with shareholders' expectations.

Cost and capital discipline is the responsibility of Paul McDade, Chief Operating Officer and Angus McCoss, Exploration Director. 70% of 2009 capital expenditure is allocated to P&D and 30% to E&A activities. Paul, with the Head of EHS, Graham Brunton, has responsibility for ensuring the Group achieves its EHS targets and maintains the security of its employees, contractors and operations.

In addition, P&D has direct operational responsibility for the specific targets to achieve the fast-track development of major projects in Ghana and Uganda.

Ian Springett, Chief Financial Officer, has responsibility for managing liquidity and developing the Group's longer-term financing strategy. He is also responsible for external risks such as cost inflation and oil and gas price volatility and internally focuses on ensuring the Group's processes and systems develop in line with the increased scale of Tullow.

Graham Martin, General Counsel and Company Secretary, is responsible for legal and governance issues, and along with Aidan Heavey, he is also tasked with developing and maintaining successful relationships with governments and developing the Group's political risk profiling process.

In each area the Executive Directors are supported by members of the senior management team or managers with key functional responsibilities.

### **Performance reporting processes**

Tullow undertakes a detailed annual business planning and budget process. This includes annual objectives and targets covering production, development, exploration, EHS and financial performance, which are set at a business unit and asset level with key risks to the delivery of these targets identified. Actual performance is reported on a monthly basis with narrative explaining key variances. On a quarterly basis senior management assess the Group's performance through a series of reviews with business units. These reviews include an assessment of risks to delivery of targets and performance, and measures being implemented to manage these potential risks.

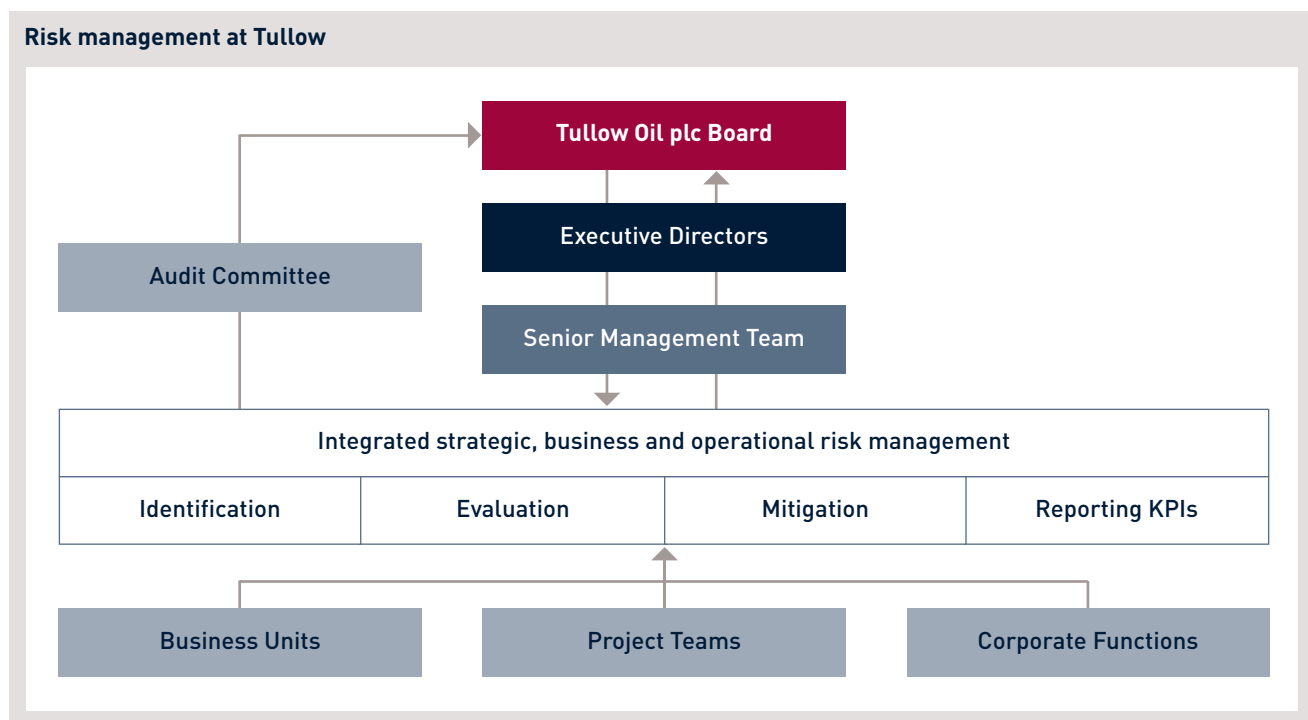
### **Dedicated major project management**

Dedicated teams have been established to manage developments in Ghana and Uganda. Project milestones have been established with progress reported on an ongoing basis. Risk identification, mitigation and monitoring are completed as part of the day-to-day management of the developments. Detailed risk analysis is completed with input from partners as appropriate to identify key risks to project costs and timetable delivery. Plans to mitigate these risks are developed, monitored and reported regularly by the project teams to the Executives and the Board.

### **Appropriate policies and procedures**

Detailed procedures support risk management across Tullow and the application and consistency of these procedures is regularly reviewed by the Group's Internal Audit function. These procedures include:

### Risk management at Tullow



- Delegation of authority covering commitment and approval limits for work programmes, activities and expenditure;
  - Integrated Management Systems which set minimum business standards to be used throughout Tullow including risk management guidelines;
  - Business ethics includes a code of business conduct and ethics and integrity and whistleblowing policies;
  - Human resource policies establish a consistent set of values and standards for managing employees and contractors throughout the Group;
  - Contract and procurement detail procedures for tendering, evaluation, selection and award of contracts; and
  - Exploration business procedures integrate technical, portfolio and financial controls with associated assurance and approval processes.
- Further, Tullow has successfully applied for external certification of critical processes such as International Organization for Standardization (ISO) 14001 certification for environmental management in the UK, Dublin, Cape Town, Bangladesh, Pakistan and Mauritania. The review process for this standard involves an assessment of the management of material risks and business and operational controls employed to mitigate such risks.
- Tullow groups risk into strategic, financial, operational and external risks. Risks identified are closely aligned with the Group's KPIs, as set out on page 18 to 19 of this report.

**Risk management and risk factors continued**

Risk analysis outlining key risks facing Tullow together with their potential impact and the mitigation strategies developed is contained below.

**Strategic risk**

**Impact** – Ineffective or poorly executed strategy fails to create shareholder value or fails to meet shareholder expectations.

Risk	Mitigation
<b>Strategy fails to meet shareholder expectations</b>	Strategy focused on delivering Ghana and Uganda developments and selective high-impact exploration programme. Effective communication with all stakeholders based on uniform, open and transparent dialogue.
<b>Ineffective capital allocation</b>	Consistent investment appraisal through application of agreed criteria with ranking of opportunities validated by executive management. Material acquisitions and disposals and new country entry require Board approval.
<b>Loss of key staff and succession planning</b>	Remuneration policies to attract and retain staff, staff appraisal, specific development and training policies implemented. Board succession plan to be reviewed in 2009.

**Financial risk**

**Impact** – Asset performance and excessive leverage results in the Group being unable to meet its financial obligations.

Risk	Mitigation
<b>Insufficient liquidity, inappropriate financing strategy</b>	Prudent approach to debt and equity balance maintained through refinancing and equity placing. Regular Board review and approval for financing options. Short- and long-term cash forecasts reported to senior management and Board monthly.
<b>Inadequate or excessive hedging</b>	Hedging strategy agreed by the Board utilises a mix of physical and derivative products appropriate to Tullow's size and production base. Hedging activity is reported to the Board monthly and accounting reviewed by external audit.
<b>Underperforming assets</b>	Monthly asset financial and operational performance reporting and KPI measures established. Detailed senior management review completed quarterly with business unit teams. Active portfolio management and review of carrying values.
<b>Cost and capital discipline</b>	Comprehensive annual budgeting process covering all expenditure approved by the Board. Executive management approval required for major categories of expenditure effectively managing capital allocation. Monthly reporting vs budget with variance analysis.
<b>Uninsured events</b>	Comprehensive insurance programme approved annually with business interruption cover for key producing assets.

## Operational risk

**Impact** – Operational event impacting staff, contractors, communities or the environment leading to loss of reputation and/or revenue.

Risk	Mitigation
<b>EHS</b>	EHS performance standards set and monitored regularly across the Group through KPI reporting. EHS management system implemented.
<b>Security incident</b>	Integrated Management System covers day-to-day operational risks. Crisis management system implemented.
<b>Key development failure</b>	Technical, financial and Board approval for all projects, dedicated project teams established. Risk evaluation and progress reporting initiated for all projects. Project milestone KPI's established for Ghana and Uganda.
<b>Ineffective management processes / increased scale of business</b>	Policies and procedures developed for all significant business processes appropriate for Tullow's size and scale. Application validated through management and internal audit review.
<b>Failure to secure equipment, services and resources</b>	Rigorous contracting procedures and competitive tendering. Major contracts require senior management and partner approval.
<b>Corruption or reputation risk</b>	Consistent ethical standards established and applied through code of business conduct and contract and procurement procedures.
<b>Corporate and Social Responsibility</b>	Social and community programmes overseen by CSR Committee, policies established and regular reporting of progress and financial commitment implemented.
<b>Sustained exploration failure</b>	Exploration process validates programmes prior to Board approval, KPI measuring success of exploration spend reported monthly to Board.

## External risk

**Impact** – The overall external political, industry or market environment may negatively impact on the Group's ability to independently manage and grow its business.

Risk	Mitigation
<b>Political risk and fiscal change</b>	Developing and maintaining successful relationships with governments and communities.
<b>Lack of control of key assets</b>	Joint venturing with partners and governments. Enforceability of licence and production agreements.
<b>Corporate governance failings</b>	Regular review of compliance requirements with periodic Board reporting.
<b>Oil and gas price volatility</b>	Hedging strategy agreed by Board, monthly reporting of hedging activity.
<b>Hostile acquisition</b>	Robust defence strategies against hostile acquisitions. Effective investor engagement and ongoing communications programmes.
<b>Industry cost inflation</b>	Rigorous contracting procedures and competitive tendering required for all significant expenditures.