

North America. Our objective is to continue to reduce this cyclicity from a regional and application segment perspective. One of the ways in which we are doing so is by continuing to focus further efforts on expanding our Agricultural Machinery application segment, as it follows a different economic cycle to the other application segments.

In the medium and long term, we seek to mitigate regional and application-related sales risks by aligning our development activities with our product strategy and by entering into alliances. Close alliances with our key customers are of considerable importance in enabling us to achieve these sales targets, although there is a risk of becoming dependent on them in the long term. We therefore pursue a strategy of signing up new customers and progressively expanding our business with them. These business development activities are particularly focused on Asia.

We are very well diversified and well positioned for the future in terms of the geographical and sectoral distribution of our customers. We supply the market-leading manufacturers in the various application segments. Despite the countermeasures that are in place, we cannot completely control the external risks. In view of the measures in place, we continue to categorise the market risk as 'moderate' in respect of the achievement of our corporate targets for 2017 because the economic situation in our sales markets remains volatile.

By contrast, the United Kingdom's upcoming departure from the European Union does not constitute a material external risk because our volume of business in the country is comparatively low.

STRATEGIC RISK

Our business strategy is focused on expanding our customer and product base and on further globalisation and internationalisation. This strategy presents the DEUTZ Group with numerous opportunities but is, of course, also associated with risks. Target markets might not grow as anticipated, while new product developments may not be as well received by customers as predicted or may not be able to compete with rival products.

We attempt to mitigate these risks by precisely analysing trends in our markets and by taking into account external market research. For example, our analysis of the future viability of diesel technology confirms that it will continue to play a major role in our application segments over the long term. We also enter into close alliances with our major customers in the target markets. Finally, we closely monitor our strategic projects so that we are able to respond immediately to changes.

In view of the measures in place, we categorise the strategic risks with regard to the attainment of our financial targets as 'low' in 2017 and as 'moderate' in the medium term.

OPERATIONAL RISK

Quality risk The DEUTZ Group is exposed to liability and warranty risks. Potential warranty claims and claims for compensation could have a negative impact on our financial position and financial performance.

We have set up local quality departments to ensure quality in all plants and relevant areas of the Group. These departments systematically analyse sources of errors and defects, optimise production processes, take action to minimise the risk in production start-ups and reduce warranty risks. A central quality management organisation ensures that standardised processes and methods are in place and carries out regular audits. In addition, DEUTZ has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts.

Regular certification audits and additional quality initiatives also enable us to handle the significant technical complexity of engines and to satisfy the steadily increasing quality requirements of our customers. In 2016, for example, we introduced the zero-error strategy. The idea of this quality assurance programme is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order to not repeat them.

Sufficient provisions are recognised on the balance sheet to account for warranty risks. In view of the precautionary measures that have been taken, we categorise any further quality risks that could negatively impact on our financial targets as 'low' for 2017.

Production risk Fluctuations in capacity utilisation in production that result from our level of dependency on the general economic situation can, just like breakdown-related production delays, have a negative impact on profitability.

In order to avoid mistakes in planning and capital expenditure, the necessary production capacity is regularly reviewed and planned using different timescales: over a number of years as part of the medium-term planning process, which is revised each year, and for the following financial year as part of the budget planning process, which is then updated quarterly for the current year. Production programme meetings and capacity planning meetings are held monthly to ensure that our capacity is adjusted in line with sales. We are using temporary employment contracts more and more as a way of flexibly adjusting capacity to the level of orders on hand.

In view of the measures in place to avoid or minimise these risks, we continue to categorise the level of production risk with regard to our financial targets as 'low'.

OTHER RISKS

Cyber risk We are a technology-driven company that is heavily focused on research and development. Being an innovation leader gives us a competitive advantage that forms the basis of our long-term success. The risk associated with this is that strictly confidential information, particularly concerning new technologies or partnerships in research and development, could find its way to our competitors through illegitimate means.

As well as the loss of confidential information, it is conceivable that forged documents could be used to siphon off capital without authorisation. Cyber risks such as these could have a negative impact on our market position and limit our financial flexibility. This might ultimately harm our reputation.

We have put a series of measures in place to protect against cyber risks. As well as regular security training for employees, these include security measures for computer hardware and IT security guidelines that have been laid down by management. In view of the precautions that have been taken, we continue to categorise these risks as 'low'.

Legal risks As a Group with multinational operations, DEUTZ is subject to a variety of regulations under tax, competition and patent law as well as to other legal and statutory requirements. Existing and potential legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and an appropriate amount is recognised in the risk provisions in the accounts. The outcome of legal disputes is uncertain, however. This means that there are further risks, not accounted for through provisions on the balance sheet, that could negatively impact on our financial targets.

Groupwide standards such as the general terms and conditions of business, sample contracts for various uses and implementation provisions in the form of organisational guidelines are refined on an ongoing basis and reduce the level of new legal risks at DEUTZ. The legal affairs department and external lawyers are also regularly consulted about projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business. Given the positive overall progress in ongoing cases and in view of the measures that have been taken either to avoid or minimise risk, we now categorise the legal risk as only 'low'.

OVERALL ASSESSMENT OF THE RISK SITUATION

We identify and evaluate material risks on an ongoing basis using our risk management system. Appropriate action is taken to manage these risks and, as far as possible, bring them under control. Changes in material risks are monitored regularly at Group level. Currently, the DEUTZ Group has not identified any risks that either individually or in their totality could jeopardise the continued existence of the enterprise as a going concern. Legal and short-term strategic risks decreased in comparison with 2015. Other risk factors changed only marginally year on year. Consequently, the overall risk level fell slightly compared with 2015. Because of the precautions that have been taken and our position in the market, we are confident in our ability to successfully manage the existing risks and overcome the resulting challenges – despite conditions remaining difficult.

ACCOUNTING-RELATED INTERNAL CONTROL SYSTEM

The risk management system forms part of, and is closely linked to, the internal control system. Whereas the risk management system focuses on the identification, analysis, assessment, communication and management of risk, the internal control system (ICS) brings together activities aimed at avoiding or limiting risk.

The Board of Management is responsible for setting up, monitoring, refining and ensuring the effectiveness of the ICS. Even a properly structured ICS is unable to provide absolute security; it can only provide a relative amount of security in helping to achieve targets and/or avoid material misstatements.

The aim of the internal accounting-related control system is to ensure that accounting is carried out consistently and in accordance with statutory requirements, generally accepted accounting principles and internal guidelines. The accounting process itself includes those operating processes that provide the value flows for financial reporting, the process for preparing the consolidated financial statements, and all information sources and processes from which the significant disclosures in the consolidated financial statements are derived.

In order to ensure that the consolidated financial statements are properly and consistently prepared, the Group adheres to the fundamental principles of separation of functions, having work checked by a second member of staff and IT access restrictions to prevent unauthorised access to relevant data. There are written procedural instructions and, in particular, Group accounting guidelines that are regularly updated at head office and communicated throughout the Group. Each reporting entity is responsible for compliance with the guidelines, and the data reported to DEUTZ's Group accounting department is validated