

Audit Committee Report



Oliver Corbett Chair of the Audit Committee

This report sets out the principal responsibilities of the Audit Committee, its membership and meetings as well as the key activities under review during the year. The Audit Committee has a key role in ensuring oversight of financial reporting and the control environment.

Chair's Overview

The work undertaken by the Committee to discharge its responsibilities is set out below.

The Committee has again had a full agenda and continued to focus on the key matters across its principle roles and responsibilities, including overseeing the additional and ongoing impacts of the Covid-19 pandemic. Focus has been given to challenging the key accounting judgements across the group, assessing the integrity and fair presentation of the group's external financial reporting and reviewing the maintenance and effectiveness of the group's internal control framework. The Committee has also monitored the activities and performance of internal and external audit, along with oversight of non-audit services.

Further details on this work and other key areas are set out in the sections below.

Membership and Meetings

The Committee comprises solely of independent non-executive directors, being Lesley Jones who chairs the Risk Committee, Sally Williams, Tesula Mohindra who joined the Committee in July 2021, Patricia Halliday who joined the Committee in August 2021 and me as chair. During the year, at the Annual General Meeting in November 2020 Geoffrey Howe did not seek reappointment having served as a director for more than nine years, and in March 2021 Bridget Macaskill stepped down from the Committee as part of wider committee membership changes. More details on this change can be found on page 95. I would like to extend my thanks to Geoffrey and Bridget for their extensive contribution.

The qualifications of each of the members are outlined in the biographies on pages 68 and 69. The Committee brings a diverse range of experience in finance, risk, control and business, with particular experience in the financial services sector. The composition of the Committee satisfies the relevant requirements of the UK Corporate Governance Code. The board has confirmed that the

members of the Committee have the necessary expertise required to provide effective challenge to management. The board also considers that I have the appropriate recent and relevant experience.

The Committee held five scheduled meetings during the year with dates fixed around the group's financial reporting schedule. In addition, it held two ad hoc meetings to consider an interim update on the 2020 Annual Report & Accounts and to review the group's 2020 recovery plan. Additional informal meetings and discussions were held as appropriate. Details of members' attendance are set out on page 80. I provide the board with a formal update on the key matters discussed at each meeting of the Committee.

In addition to the Committee members, standing invitations are extended to the chairman of the board and all other directors. The group head of internal audit, the group head of compliance, the group chief risk officer and the group financial controller also attend meetings by invitation. I meet with this group as well as the group finance director ahead of each meeting to agree the agenda and to receive a full briefing on all relevant issues.

Invitations to attend are extended to other members of management to brief the Committee on specific issues as necessary. The external auditor attends each meeting and I had regular contact with the lead audit partner during the year. The Committee held private sessions with internal and external audit following each meeting of the Committee, without members of management.

Committee Effectiveness

As described in more detail on page 86, an external evaluation of the board and its Committees was undertaken during the year in line with the requirements of the UK Corporate Governance Code. The results confirm that the Committee is operating effectively. The Committee considers that it continued to have access to sufficient resources to enable it to carry out its duties during the year.

Audit Committee Report continued

Activity in the 2021 Financial Year

Key accounting judgements

The Committee spent considerable time reviewing the interim report and Annual Report. The Committee discussed and challenged the key areas of accounting judgement taken by management in preparing the financial statements and the external auditor's work. This also included consideration of the internal controls over financial reporting. The Committee noted that there were no new material standards, or amendments to standards, relevant to the group that had become effective for the reporting period.

The key judgement areas were largely unchanged from the prior year, reflecting the group's adherence to its business model and consistency of its approach to financial reporting. Covid-19 has required the Committee to discuss at length with management the continued appropriateness of the conclusions reached during the 2020 financial year, and the implications on reporting in 2021.

The main areas of focus are outlined below. Each of these matters were discussed with the external auditor and, where appropriate, have been addressed in the external auditor's report.

IFRS 9

Given the materiality of the group's loan book, ensuring the group's expected credit loss ("ECL") models and the related IFRS 9 judgements and disclosures are appropriate remains a key priority for the Committee, particularly given the ongoing impacts of the Covid-19 pandemic. Regular updates were provided to the Committee.

During the year, and with consideration to Covid-19, the Committee challenged the level of provisions held by the group, and the judgements and estimates used to calculate these provisions. Particular focus was given to:

- the significant increase in provisions against the Novitas loan book reflecting updated assumptions for case failure and recovery rates in this business;
- the impact of lockdown restrictions, the reopening of the UK economy, government support measures and the planned end of such measures to the specific circumstances of the group's businesses and customers, including the distinction between retail and commercial portfolios;
- the ongoing use and approval of heightened levels of model adjustments, and the evolution of these adjustments during the course of the financial year;
- the high level of estimation uncertainty in setting forward-looking macroeconomic assumptions; and
- management's model enhancement plan which this year focused on the Asset Finance and Invoice Finance businesses.

Credit risk and provision disclosures were discussed to ensure they were clear and gave a transparent articulation of the group's credit risk profile, key drivers of the expected credit loss charge and the approach taken in light of Covid-19. In the next financial year, the Committee will continue to monitor IFRS 9 provisions and disclosures.

Revenue recognition

The Committee reviewed management's approach to revenue recognition, highlighting the key areas where judgement is required across interest, fee and commission income. The Committee noted the consistency of approach with prior years and concluded that revenue recognition for each of the group's key businesses is appropriate.

Other Financial Reporting and Control Matters

Going concern and viability statement

The Committee assisted the board in determining the appropriateness of adopting the going concern basis of accounting and in performing the assessment of the viability of the group. The Committee reviewed a paper from management in support of the going concern basis and the longer-term viability of the group.

The Committee assessed the proven stability of the group's business model which is supported by a diverse portfolio of businesses, the results of internal stress testing, and that the group is strongly capitalised, soundly funded and has adequate access to liquidity.

The Committee discussed the group's principal risks as well as the Covid-19 pandemic which may affect the future development, performance and financial position of the group. The Committee considered whether a period of three years remained appropriate for the viability statement, particularly when taking into account changes in the economic, technological and regulatory environment.

Overall the Committee concluded that it remained appropriate to prepare the accounts on a going concern basis, advised the board that three years was a suitable period of review for the viability statement, and recommended the viability statement to the board for approval, set out on pages 74 and 75.

Fair, balanced and understandable

On behalf of the board, the Committee reviewed the financial statements as a whole in order to assess whether they were fair, balanced and understandable. The Committee discussed and challenged the balance and fairness of the overall report with the executive directors and also considered the views of the external auditor. During this review the Committee carefully considered the clarity and coherence of disclosures made in respect of the impact of Covid-19, the strategic review of Novitas and resulting impairment, the significant increase in credit provisions in Novitas due to the latest case failure and recovery rate assumptions, the classification and disclosure relating to the VAT refund and climate risk.

The Committee considered the presentation of the financial statements and was satisfied that the Annual Report could be regarded as fair, balanced and understandable and proposed that the board approve the Annual Report in that respect.

Impairment of goodwill and intangible assets acquired on acquisition

The Committee was presented with the annual goodwill impairment review and, except for Novitas, was satisfied that there were no impairment indicators. A detailed presentation on the impairment indicators, methodology and underlying assumptions used to determine the full impairment of goodwill and intangible assets acquired on acquisition in respect of Novitas was also reviewed. The Committee challenged the appropriateness of the assessment, including discussing the outcome with the group's auditor, and concluded the approach was reasonable.

Whistleblowing champion

I act as the group's Whistleblowing Policy champion. The group continues to place a high priority on employees' understanding of the process to enable them to speak out with confidence when appropriate. Further information on the board's activities in this area can be found on page 85 of the Corporate Governance Report.

Restoring trust in audit and corporate governance

The Committee has, and will continue to, evaluate the impact of the Department for Business, Energy and Industry Strategy ("BEIS") consultation and resulting proposals for restoring trust in audit and corporate governance on the group.

Other policies

The Committee has also reviewed and approved the approach to hedging for share awards and the policy for the provision of non-audit services by the external auditor, as well as noting the group's tax policy.

Internal Audit

The Committee reviewed, challenged and approved the annual internal audit plan, and amendments made during the course of the year. It received regular reports on internal audit activities across the group detailing areas identified during audits for strengthening across the group's risk management and internal control framework. 26 audits were distributed to the Committee during the financial year. All audits were summarised at meetings of the Committee together with an update on the status of issues identified by internal audit.

The Annual Internal Audit Assessment, which found the governance and risk and control framework of the group to be generally effective, was received by the Committee in accordance with the Chartered Institute of Internal Auditors' guidance.

The Committee completed its annual review of the effectiveness of the internal audit function and its level of independence. The evaluation for the year under review was completed internally and supported by feedback from stakeholders across the group. The internal audit function was found to be working to all applicable internal auditing standards.

In addition to reviewing the internal audit function's effectiveness, the Committee assessed the level of internal audit resource and the appropriateness of the skills and experience of the internal audit function. The internal audit function appointed a head of technology and change auditor and recruited more auditors to reduce its reliance on the co-source provider for all but highly specialist knowledge and experience.

External Audit

The Committee oversees the relationship with PricewaterhouseCoopers LLP ("PwC"), its external auditor, covering engagement terms, fees and independence. Both the Committee and the external auditor have policies and procedures designed to protect the independence and objectivity of the external auditor.

Following a tender process in 2017, PwC has been auditor to the group since 1 August 2017. Mark Hannam has been the group's lead audit partner from this same date and attends all meetings of the Committee.

During the year the Committee reviewed the external audit plan as well as the resulting findings. Principal matters discussed with PwC are set out in their report on pages 126 to 133.

The Committee assesses the independence and objectivity, qualifications and effectiveness of the external auditor on an annual basis as well as making a recommendation on the reappointment of the auditor to the board. This year our evaluation focused on the following key areas:

- the quality of audit expertise, judgement and dialogue with the Committee and senior management;
- the independence and objectivity demonstrated by the audit team;
- the senior leadership of the audit team;
- the quality of service including consistency of approach and responsiveness; and
- the response to Covid-19.

The process was facilitated by a group-wide survey of finance, a survey of the PwC senior audit team's view on the group and a review of audit and non-audit fees. Overall, the Committee has concluded that PwC remain independent and it was satisfied with the auditor's performance and recommended to the board a proposal for the reappointment of the auditor at the company's AGM.

Statutory Audit Services Compliance

The company confirms compliance with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 for the year to 31 July 2021.

Subject to shareholder approval, PwC will undertake the audit of the company and the group for the year ended 31 July 2022. There are no plans as at the date of this report to conduct a tender exercise for external audit services.

Non-Audit Services

The Committee oversees the group's policy on the provision of non-audit services by the external auditor, which incorporates the Financial Reporting Council's Revised Ethical Standard from March 2020.

The group's policy is that permission to engage the external auditor will always be refused when a threat to independence and/or objectivity is perceived. However, the Committee will give permission where the service complies with the group policy and where:

- the work is closely related to the audit;
- a detailed understanding of the group is required; and
- the external auditor is able to provide a higher quality and/or better value service.

This year the regulatory cap on the annual value of non-audit services being 70% of the average of three years' audit fee has become mandatory, being the fourth financial year following the change of auditor.

During the year, total audit fees amounted to £2.6 million (2020: £2.0 million) while total non-audit fees including those relating to services required by legislation amounted to £0.7 million (2020: £0.5 million), representing 27% (2020: 26%) of the current year audit fee. This included non-audit services not required by law of £0.3 million (2020: £0.2 million), 12% (2020: 10%) of the audit fee, predominantly relating to the review of the group's interim financial statements and third party assurance over certain Asset Management division internal controls. The Committee was satisfied that these fees, individually and in aggregate, were consistent with the non-audit services policy and did not believe they posed a threat to the external auditors' independence.

Oliver Corbett
Chair of the Audit Committee

28 September 2021