

## 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 maintaining and challenging the quality of financial reporting and the control environment.

### Chair's Overview

I am pleased to present the Audit Committee Report describing the work undertaken by the Committee to discharge its responsibilities.

It has once again been a busy year, the Committee has continued to focus on the key issues relevant to the group's financial reporting, including consideration of key accounting judgements, and ensuring the integrity of the Annual Report.

The Committee has also spent a significant proportion of its time considering the additional accounting and auditing judgements, particularly IFRS 9, as a result of Covid-19. This has also included monitoring the effectiveness of the control framework, as the group has adapted to working remotely.

Alongside this, the Committee's time has been focused on its principal roles and responsibilities, which are to:

- assess the integrity of the group's external financial reporting;
- review the effectiveness of the group's internal controls; and
- monitor and review the activities and performance of both internal and external audit.

Further details of work in respect of these and other key areas are set out in the sections below.

### Membership and Meetings

The Committee comprises solely of independent non-executive directors, being Geoffrey Howe, the senior independent director, Lesley Jones and Bridget Macaskill who chair the Risk and Remuneration Committees respectively, and me as Chairman. In January 2020 the Committee welcomed Sally Williams as an independent non-executive director.

The qualifications of each of the members are outlined in the biographies on pages 60 and 61. 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 met formally five times during the year with meetings aimed to coincide with the group's financial reporting schedule. Additional informal meetings and discussions were held as appropriate. Details of members' attendance are set out on page 71.

In addition to the Committee members, standing invitations are extended to the chairman of the board and the executive directors. In addition, the group head of internal audit, the group head of compliance, the group chief risk officer and the group financial controller 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. Additional meetings were also held to discuss the ongoing formation of accounting judgements regarding Covid-19.

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.

## Audit Committee Report continued

### Committee Effectiveness

As described in more detail on pages 76 and 77, the performance of the Committee was assessed internally through a formal and rigorous annual effectiveness evaluation. This was undertaken during the year as part of the broader evaluation of the effectiveness of the board and its committees, the process involved completion of a tailored questionnaire by Committee members.

The results confirm that the Committee is operating effectively, and it continued to have access to sufficient resources to enable it to carry out its duties. I discussed the specific conclusions of the evaluation relating to the Committee with the group finance director and the company secretary, and we will explore opportunities for incremental enhancements in the way the Committee operates during the 2021 financial year.

### Activity in the 2020 Financial Year

#### Key accounting judgements

The Committee spent considerable time reviewing the interim report and full-year 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.

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; however, Covid-19 has required the Committee to discuss at length with management the continued appropriateness of the conclusions reached.

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

#### IFRS 9

This year IFRS 9 continued to be a major focus for the Committee as models were further embedded, validated and refined. At all Committee meetings updates were provided by management on the group's expected credit loss ("ECL") models and the related IFRS 9 judgements and disclosures.

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 impact and implications of Covid-19, lockdown and the related economic shock being the first time the group's IFRS 9 models and judgements have operated under stress. As a result, the Committee has reviewed the group's IFRS 9 models in detail;
- the use and approval of post-model adjustments where it was inappropriate to apply existing ECL methodologies mechanically;
- the need to ensure that application of IFRS 9 met regulatory guidance, and took account of the extensive government support measures and the specific circumstances of our businesses and customers. These and other factors were considered in arriving at reasonable and supportable provisions; and
- the high level of estimation uncertainty in setting forward-looking macroeconomic assumptions due to Covid-19.

The Committee will continue to pay close attention to how post-model adjustments, underlying models and macroeconomic scenarios perform over time.

In addition, the Committee has overseen the enhancement of credit risk disclosures in the context of Covid-19. In the next financial year, the Committee will still continue to monitor IFRS 9 processes and further enhancements to our 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. The Committee also considered management's approach in respect of modification losses as a result of Covid-19.

### Standards adopted during the year

#### IFRS 16

The Committee also oversaw the successful implementation of IFRS 16, which was adopted by the group on 1 August 2019, and was satisfied that the disclosures made in respect of IFRS 16 in the financial statements were appropriate.

### Other Financial Reporting

#### Financial Reporting Council review of 2019 Annual Report

In May 2020, the Financial Reporting Council's ("FRC") Conduct Committee wrote to the group confirming an ordinary course review of the Annual Report for the year ended 31 July 2019 was being performed. As is its custom and practice, the FRC's review was based solely on the 2019 report and accounts with no detailed knowledge of the group or underlying transactions entered into.

At the end of its review, the FRC raised no questions or queries and required no formal response from the group. The FRC made a number of detailed suggestions to improve certain disclosures. We welcome the FRC's feedback and these points have been considered by the Committee and as part of the drafting process for this year's Annual Report.

### Going concern and viability statement

The Committee reviewed a paper from management in support of the going concern basis and the longer-term viability of the group. The Committee noted the proven stability of the group's business model which is supported by a diverse portfolio of businesses, its successful track record, 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 such as its lending exposures, economic factors including the Covid-19 pandemic and operational risk which may affect future development, performance and financial position. It also considered in detail the implications of Covid-19 given the nature of the business and the group's financial structure and position.

Overall the Committee concluded that it remained appropriate to prepare the accounts on a going concern basis and recommended the viability statement to the board for approval, set out on pages 66 and 67.

### 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. This included the extended quantitative and qualitative disclosures on expected credit loss provisions, and also the consistency of narrative covering the wider impacts of Covid-19 on business performance, operational resilience and sustainability.

The Committee considered the overall 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.

#### 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. Historically, the Committee has overseen the group's whistleblowing arrangements but in the 2020 financial year this responsibility was transferred to the full board in line with the new Corporate Governance Code. Further information on the board's activities in this area can be found on page 76 of the Corporate Governance Report.

#### 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.

#### Internal Audit

The Committee reviewed, challenged and approved the internal audit plan for the year, and supported the introduction of a more agile audit planning approach. This approach has facilitated flexibility to provide assurance over controls impacted by Covid-19 and the internal audit function's ability to meet ad hoc requests from the Committee, business or regulator.

In reviewing the audit plan, the Committee continued to assess the level of internal audit resource and the appropriateness of the skills and experience of the internal audit function. Ongoing feedback on the performance of the co-source provider was presented to the Committee throughout the year.

The Committee 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. Thirty audits were delivered during the period under review. These were summarised by the group head of internal audit at each of the Committee's meetings.

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.

Per its policy, the Committee reviews annually 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.

The Committee welcomed the new group head of internal audit in November 2019.

#### 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. PwC has been auditor to the group since 1 August 2017.

Mark Hannam has been the group's lead audit partner since the transition from Deloitte LLP in 2017 and attends all meetings of the Committee.

During the year the Committee reviewed the external audit plan including the underlying methodologies PwC follow and their risk identification processes along with the findings from their audit. Principal matters discussed with PwC are set out in their report on pages 115 to 121.

The company has complied 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 2020.

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; and
- the quality of service including consistency of approach and responsiveness.

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 re-appointment of the auditor at the company's AGM.

The Committee oversees the group's policy on the provision of non-audit services by the external auditor. 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 it sees benefits for the group where:

- 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.

During the year total non-audit fees including those relating to services required by legislation amounted to £0.5 million and represented 25% of the audit fee.

	£ million
Assurance work on systems and controls	0.5

The corresponding amounts for the prior year were £0.6 million and 43%. 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

22 September 2020