

Report of the Audit Committee

Committee membership	No. of meetings 2015: 4	Main committee responsibilities
Director	Attendance	
I.B. Duncan	4	■ the Audit Committee is a sub-committee of the Board whose main role is to encourage and safeguard the highest standards of integrity, financial reporting, financial risk management and internal controls.
E. Lindqvist	4	■ monitor the integrity of the financial statements including annual and half-yearly reports, trading updates and any other formal announcements relating to its financial performance. Reviewing and reporting to the Board on significant financial reporting issues and judgements.
R. Rajagopal	4	■ where requested by the Board, review the content of the Annual Report and advise the Board whether taken as a whole it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.
J.A. Biles	2	■ monitor and review the adequacy and effectiveness of the Company's internal financial control and risk management systems including the robust assessment of principal risks.
		■ oversee the relationship with the external auditor including consideration of fees, audit scope, terms of engagement and recommendation to the Board for approval by shareholders, the appointment, reappointment or removal of the external auditors.
		■ monitor and review the effectiveness of the Company's internal audit function.
		■ review the adequacy and security of the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters.

Introduction

The Committee has continued to focus on the integrity of Bodycote's financial reporting, risk management and internal controls and on the quality of the external and internal audit processes. The Committee will continue to keep our activities under review as the regulatory environment changes.

Membership

The members of the Audit Committee are all independent non-executive directors. Their biographical details are shown on pages 36 and 37 and their remuneration on page 71. The Group Company Secretary is the secretary to the Audit Committee. In April 2015, J.A. Biles stepped down as a Non-Executive Director of the Company.

I.B. Duncan was appointed Chairman of the Audit Committee as of March 2015 and was appointed as a Non-Executive Director of the Company on 17 November 2014. The Board considers that I.B. Duncan has recent and relevant financial experience. He qualified as a Chartered Accountant with Deloitte & Touche, served as a plc Finance Director (Royal Mail Holdings plc 2006-2010) and has chaired the Audit Committee of several other plcs.

Objective

The Committee's objective is to provide effective governance over the Group's financial reporting, including the adequacy of related disclosures, the management and oversight of the Group's systems of internal control, financial risks and the performance of internal audit and the appointment and performance of the external auditor.

Committee meetings

The Audit Committee met four times during 2015 and in February 2016 and all members attended all meetings that they were eligible to attend. The Committee Chairman also invited the Chairman, Group Chief Executive, Group Finance Director, Group Financial Controller and Group Head of Risk (who is responsible for internal audit) to attend all meetings. Other executives from the Group were also invited, as appropriate, to attend certain meetings to provide a deeper level of insight into key issues. The Committee Chairman also invited the external auditor, Deloitte LLP ("Deloitte"), to every meeting.

I.B. Duncan also held preparatory meetings separately with Deloitte, the Group Financial Controller and the Group Head of Risk prior to most Committee meetings to review their reports and discuss issues in detail. The external auditor met with the Audit Committee without the executives present.

Main activities of the Committee during the year

As part of the process of working with the Board to carry out its responsibilities and to maximise effectiveness, meetings of the Committee generally take place just prior to Board meetings.

At its meetings, the Committee focused on the following main areas:

Financial reporting

The primary role of the Committee in relation to financial reporting has been to review with management and the external auditor the appropriateness of the interim and annual financial statements concentrating on, amongst other matters:

- the quality and acceptability of accounting policies and practices;
- the application and impact of significant judgements or matters where there was significant discussion with the external auditor;
- the clarity of disclosures and compliance with Financial Reporting Standards; and
- whether the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's strategy, business model and performance.

Reports from management were considered on significant matters, including in respect of litigation, treasury and tax matters and also reports from the external auditor on the outcome of their work. The Committee challenged both management and Deloitte to ensure that the scope of the audit was appropriate and that Deloitte had applied the necessary level of professional scepticism in their work.

Principal areas of judgement

The principal areas of judgement considered by the Committee in relation to the 2015 accounts were as follows:

- Impairment of goodwill, intangible and tangible fixed assets. The Committee challenged the assumptions, particularly the discount rate and growth factors, used in the discounted cash flow calculations for each cash generating unit, the sensitivity analysis applied and the projected future cash flows used to support the carrying values of the goodwill and intangibles and tangible assets. Details of the sensitivity analysis applied to key assumptions used in the impairment review are set out in note 11 to the Financial Statements on pages 102 and 103. The Committee has concluded that no impairment charge is required in the year, other than those included within reorganisation costs.
- Restructuring, reorganisation and environmental provisions. The Committee received reports, including from professional advisers, and challenged the basis and completeness of the assumptions used to calculate the provisions and the appropriateness of disclosures in the Report. The Committee discussed with management the key judgements behind all provisions, taking note of the range of possible outcomes, and agreed with their recommendations. The Committee reviewed and challenged the assumptions used in calculating the 2015 reorganisation charges.
- Taxation. A number of judgements are involved in calculating tax provisions and the level of deferred tax assets to be recognised. The Committee reviewed the associated risks and challenged management's assessment concerning the Group's key tax risks, noting the work of the OECD in respect of Base Erosion and Profit Shifting (BEPS), and management's forecast of the future taxable profits of the relevant businesses.
- Viability Statement. The Committee challenged the validity of the assumptions used in the preparation of the three year strategic plan, used as the basis of the assessment of the longer-term viability of the Group, in particular considering the Group's forecast for profits and cash generation, its liquidity position, available borrowing facilities and covenant compliance. Sensitivity analysis was undertaken to consider the impact of certain risks and to understand the impact of changes to all key variables.
- Going concern. The Committee challenged the validity of the going concern assumption used in the preparation of the Annual Report, in particular considering the Group's forecast for profits and cash generation, its liquidity position, available borrowing facilities and covenant compliance. Sensitivity analysis was undertaken to understand the impact of changes to all key variables.
- Pension liabilities. Management took external professional advice in determining pension liabilities. The Committee challenged the assumptions used, particularly in respect of inflation, the discount rate, life expectancy and the application of IFRIC 14 to the UK pension scheme, by considering current norms and the sensitivity of the reported liability to changes in the assumptions.

Report of the Audit Committee continued

Risk management

The Committee reviewed a report at each meeting from the Group Head of Risk who has primary responsibility for developing the Group's risk management framework. The Committee reviewed changes to the principal risks and mitigating actions identified by management. The Committee also received quarterly reports on issues raised via the Open Door Line (an external independent service where employees may report matters of concern) and assessed both how such calls are dealt with and whether there was any indication of material risk.

Internal control

At each meeting the Committee considered and challenged reports from the internal auditors on the effectiveness of internal controls and requested certain changes to those controls. The Committee also performed an annual review of the Group's internal control processes and considers the system to be effective and in accordance with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting as issued by the FRC (September 2014).

Internal audit

The internal audit plan for 2016 was presented to the Committee in October 2015 and accepted following discussions and challenge as to the scope and areas of focus. At each meeting the Group Head of Risk presented a report to the Committee on the status of internal audit plans for the current year, points arising from audits completed and follow up action plans to address areas of weakness. The status of these actions is monitored closely by the Committee until they are completed. The Committee also received reports on actual or suspected frauds and thefts by third parties and employees. None had any material financial impact on the Group and, where necessary, systems and procedures were altered to minimise the risk of recurrence.

External audit

At the April and October meetings the external auditor presented their audit plans for the interim review and year-end audit respectively. The Committee considered and challenged both the scope and materiality to be applied to the Group audit and its components. In 2015 the Committee considered carefully the scope in respect of smaller and more remote locations and noted that all local audits are undertaken by Deloitte.

Training

Updates were presented to the Committee on new accounting developments and any changes in corporate governance requirements that may affect the Group. Committee members also attended training briefings by accounting firms and other advisers.

Overview

The Committee examined the 2015 Annual Report and was specifically tasked by the Board to advise it on whether the 2015 Annual Report is fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge to ensure balance and consistency. In doing so the Committee examined these processes, which included the allocation of responsibility for the preparation of certain sections of the Annual Report to individuals in the head office team and a second person taking responsibility for the review process of each section of the Annual Report. Additional reviews were carried out by internal and external personnel including an independent legal review.

The Committee also reviewed the Annual Report. Taken as a whole, in the light of their knowledge of the Group and its performance, the outcome of the activities described above and based on robust discussion with both management and the external auditor, the Committee has concluded that it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's strategy, business model, position and performance, and reported to the Board accordingly.

External audit

Appointment

The Committee considers the re-appointment of the external auditor each year and as part of this process considers the independence of the auditor and the effectiveness of the external audit process. Having reviewed the performance of Deloitte in 2015, the Committee has decided to recommend to the Board that Deloitte be reappointed for the 2016 audit and a resolution to this effect will be put to the 2016 AGM. The Committee reviewed and agreed the fee for 2016.

The external auditor is required to change the lead partner every five years and other partners periodically in order to protect independence and objectivity and provide fresh challenge to the Group. Mr M. Mullins replaced Mrs N. Mitchell as current lead partner in 2015.

Deloitte has been the Group's auditor for 14 years.

In accordance with the transition arrangements of the Competition and Markets Authority Audit order, the Group has until 2023 to hold a competitive tender for external audit services; it is the intention of the Group to hold a competitive tender, at a time which coincides with the next change of the lead audit partner.

The Group complies with the provisions of the "Statutory Audit Services for Large Companies Market Investigation Order 2014".

Independence

The independence of the external auditor has been confirmed by Deloitte every half year and was last confirmed in February 2016. The Committee considered Deloitte's presentation and confirmed that it considered the auditor to be independent.

Effectiveness of the external audit process

The Committee has adopted a formal framework for the review of the effectiveness of the external audit process and audit quality which includes the following aspects:

- assessment of the engagement partner, other partners and the audit team;
- audit approach and scope, including identification of risk areas;
- execution of the audit;

- interaction with management;
- communication with and support to the Audit Committee;
- insights, management letter points, added value and reports; and
- independence, objectivity and scepticism.

An assessment questionnaire has been completed by each member of the Committee, by the Group Finance Director and other senior finance executives. The feedback from the process is considered by the Audit Committee and provided to the external auditor and management. The full formal questionnaire is completed every three years with key areas being completed every year.

The Committee assessed the effectiveness of management in the external audit process by considering timely identification and resolution of areas of accounting judgement, the quality and timeliness of papers analysing those judgements and other documents provided for review by the external auditor and the Committee.

The Committee considered the FRC Audit Quality Review Team report on Deloitte LLP dated May 2015. If the audit is selected for quality review, the Committee understands that any resulting reports will be sent to the Committee by the FRC.

After considering the above matters the Committee felt that the external audit had been effective.

Non-audit services

The external auditor may be invited to provide services where their position as auditor renders them best placed to undertake the work. However, no contracts in excess of £20,000 can be awarded to the external auditor without prior approval from the Chairman of the Committee or, in his absence, another member of the Committee. Non-audit fees paid to the auditor are shown in note 3 on page 99 and amounted to 23% of the audit fee.

Internal audit

The internal audit programme is managed by the Group Head of Risk and provides independent assurance over the key financial processes and controls in operation across the Group. The Group has engaged Ernst & Young LLP ("Ernst & Young") to provide certain internal audit services. The Committee reviewed and approved the annual internal audit plan before the start of the financial year and considered it appropriate to retain Ernst & Young as an internal audit service provider. The plan takes account of the Group's strategic objectives and risks and provides the degree of coverage deemed appropriate by the Committee.

Additional assurance has been obtained through control self-assessment. Internal auditors have received self-certification from every plant and shared service centre that internal controls have been complied with and noting any non-compliance. A summary of results is presented to the Committee. The accuracy of returns is monitored by Internal Audit by verification visits to a random sample of sites.

The effectiveness of internal audit is reviewed and discussed annually with the Group Head of Risk and the Ernst & Young engagement partner. The review takes into account the views of directors and senior management on matters such as independence, proficiency, resourcing and audit strategy, planning and methodology. The review confirmed that the Internal Audit function was independent and objective and remained an effective element of the Group's corporate governance framework.

Committee evaluation

The Committee's activities formed part of an external review of Board effectiveness which was undertaken in October 2015. Based on this, and as a result of the work done during the year, the Committee has concluded that it has acted in accordance with its terms of reference and carried out its responsibilities effectively. On behalf of the Audit Committee:

I.B. Duncan

Chairman of the Audit Committee

25 February 2016