The Audit Committee report

In 2019, the committee continued to oversee the quality and integrity of the Group's financial reporting, financial control and compliance processes, as well as the implementation of IFRS 16 and related disclosures.

JOHN RAMSAY
AUDIT COMMITTEE CHAIRMAN

Responsibilities

The committee ensures that there is effective governance of the Group's financial reporting and internal controls to ensure the integrity of its financial statements and the adequacy of related disclosures, and assists the board in relation to its consideration of whether or not the annual report of the Group is fair, balanced and understandable. The committee also has oversight of the performance of both the internal audit function and the external auditor and, in light of the new Code, has reviewed the external auditor's objectivity as well as its independence.

During the year, the terms of reference of the Audit Committee were reviewed and amended to ensure alignment with the new Code. These are available at g4s.com/investors. The terms of reference will be reviewed again in 2020.

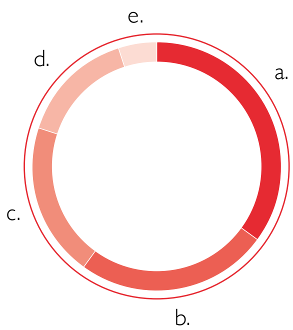
Committee membership during 2019

	Member since
John Ramsay (Chairman)	January 2018
John Daly[a]	May 2015
Steve Mogford	May 2016
Paul Spence[b]	January 2013

a. John Daly retired from the board and as a member of the Audit Committee on 16 May 2019.
b. Paul Spence retired from the board and as a member of the Audit Committee on 31 March 2020.
c. Barbara Thoralfsson joined the Audit Committee on 24 April 2020.

There were four scheduled meetings held during the year ended 31 December 2019. Members' attendance is shown on page 102.

Main activities (%)



a. 35% – Financial reporting
b. 25% – Effectiveness of financial controls and risk management procedures
c. 20% – Internal audit
d. 15% – External audit and non-audit services
e. 5% – Whistleblowing/Fraud allegations

Link to strategic priorities

People, culture & values
Profitability
Financial discipline
Annual bonus scheme

Committee membership

The Audit Committee consists of three independent non-executive directors. The chief executive officer and chairman of the board also attend meetings when invited by the chairman. John Ramsay, chair of the Audit Committee, is the member with recent relevant financial experience. The board is satisfied that Mr Ramsay as well as the other members, taken together, bring significant and relevant experience gained at senior management level and that the committee's composition during the year met the requirements of both the Code and DTR7.1. Their skills and experience are set out on page 93. Following Paul Spence stepping down from the board on 31 March 2020, Ms Thoralfsson joined the committee on 24 April 2020.

Regular attendees include the chief financial officer, the Group financial controller, the Group director of risk and internal audit, and representatives of the Group's external auditor.

Committee work

The committee has an annual agenda, which includes standing items that the committee considers regularly, as well as specific matters that require the committee's attention.

At the end of each meeting, a private session is held by the Audit Committee with representatives of the Group's external auditor or with the Group director of risk and internal audit, without members of the executive management team being present.

After each meeting, the chairman of the committee reports to the board on the matters which have been discussed.

The committee receives regular updates on changes in regulation and current trends. During 2019 these included updates on publications and recommendations from the FRC, the market trends in the audit sector, including the Competition and Markets Authority's market study of the audit sector and the Kingman review of the FRC, as well as recommendations from the Brydon Review of the quality and effectiveness of audit.

Committee performance

Again this year, the assessment of the committee's performance was conducted with assistance from external consultancy Lintstock. The conclusion was that the committee continued to work effectively, with particular strengths identified in its review and assessment of the work of the external and internal auditors and oversight of whistleblowing and other similar arrangements.

During 2020, the committee's focus will be on ensuring the robustness of the Group's internal control environment and that the risk framework and control environment are fit for purpose to support adequately the Group's changing shape.

Significant judgments and issues considered by the Audit Committee

The primary judgments and issues considered by the committee in respect of the 2019 financial statements, and how these were addressed, were:

Onerous contract provisions

Description

The Group delivers certain long-term outsourcing contracts that are complex in nature. Some of those contracts may evolve to become loss making, such that net unavoidable losses are expected over their life. In such a situation the net present value of estimated future losses needs to be determined in order to calculate an appropriate onerous contract provision. The identification and measurement of such provisions require significant judgment, given the extended time periods often involved and the number of variables that may impact on future losses.

In particular, judgment is required in assessing the future expected revenue and costs, including determining the expected impact of any profit improvement plans, the level of any related lifecycle funds and the estimated costs for the remaining life of the contract, and an appropriate discount rate to apply to future cash flows.

Details of the outcome of the assessment of contract provisions are set out in the Chief Financial Officer's review on page 54.

Action taken

The committee discussed the process for the identification and assessment of onerous contracts. In respect of material low-margin contracts and for onerous contracts, the committee reviewed the critical assumptions made by management, and enquired about the robustness of the assumptions, the appropriateness of any changes in the level of provisions, the sensitivities to changes in the assumptions and the disclosure provided in relation to the key material judgments.

The committee also reviewed the disclosure provided in relation to these contracts.

Conclusion

The Audit Committee was satisfied that the level of provisions and the related disclosures as at 31 December 2019 were appropriate.

Compliance with foreign ownership restrictions and consolidation of undertakings

Description

In markets where foreign ownership restrictions (FORs) apply, the Group seeks to ensure that it complies with foreign ownership laws and regulations and relevant accounting standards (IFRS10). Professional advisors are typically retained to help establish and maintain contractual ownership structures, which comply with local laws and regulations relating to foreign ownership.

When restrictions apply to direct share ownership, the Group typically seeks to exercise influence or control through arrangements, including shareholder agreements.

Changes in FORs can limit the Group's ability to do business or invest in certain markets and may, in certain circumstances, result in a loss of management control.

Consolidation of any of these entities would be at risk if the Group's ability to enforce its rights of control were to be undermined by changes or different interpretations to FORs.

Action taken

The committee received reports in relation to FORs in a number of countries, which provided an update on relevant changes in laws and regulations, their potential impact on the Group, and, where relevant, reviewed mitigation plans. During the year, the committee also reviewed the impact of changes in certain shareholder agreements and the accounting implications of these.

Conclusion

The committee was satisfied with the Group's processes and approach to foreign ownership and consolidation of undertakings.

This will remain an area of focus to ensure that the committee remains abreast of changes in laws, regulations and the relevant accounting standards.

Alternative performance measures

Description

The Group uses Adjusted PBITA and other alternative performance measures (APMs) for the purposes of consistent internal and external reporting, given that management views these measures as being more representative of the normal course of business and more comparable period to period. Adjusted PBITA excludes strategic restructuring costs, amortisation of acquisition-related intangible assets, goodwill impairments, costs associated with the cash separation and specific and other separately disclosed items which the Group believes should be disclosed separately by virtue of their size, nature or incidence (see page 52 for further details). Judgment is required when defining those items to be disclosed separately and when applying the classification criteria to each period's results. Further details on separately disclosed items are set out in note 8.

Action taken

The Audit Committee reviewed guidance issued by the Financial Reporting Council (FRC) and the European Securities and Markets Authority (ESMA) together with management's response to the results of the FRC review of the 2016 Integrated Report and Accounts and disclosures included in the Integrated Report and Accounts in relation to APMs. The committee assessed whether the Group's accounting policies were being applied consistently from year to year, and considered whether specific items were being identified in line with group policies and that these items included both debits and credits as appropriate.

The committee also reviewed information from management to satisfy itself that changes in estimates related to items that were classified as specific items were treated consistently as specific items, for both increases and decreases.

Conclusion

The committee was satisfied that the Group's definition of APMs, and in particular in relation to specific and other separately disclosed items, had been applied correctly and that the designation of specific items was subject to objective and balanced criteria. The committee noted the disclosure and explanation of APMs and considered that these give a meaningful and balanced view of the operations of the Group.

Goodwill impairment testing

Description

The total value of the Group's goodwill as at 31 December 2019 (including goodwill held in disposal groups held for sale) was £1.6bn (£1.9bn at 31 December 2018), a significant proportion of which was generated by the merger of the security services businesses of Group 4 Falck and Securicor in 2004, which was accounted for as an acquisition of Securicor by Group 4 Falck.

The Group tests goodwill for impairment on an annual basis or more frequently if there are indications that an impairment may have occurred. The impairment analysis consists of the estimation of the recoverable amount of goodwill supported by the Group's cash generating units. This analysis requires significant judgment, primarily in relation to the achievability of long-term business plans and future cash flows. Such achievability is dependent on circumstances both within and outside management's control, in relation to the discount rates adjusted to reflect risks specific to individual assets used, and in relation to the macro-economic assumptions and related modelling assumptions underlying the valuation process.

The result of the annual review of the carrying goodwill identified impairment charges of £291m to goodwill as being required (see note 18). The Group also identified a number of cash generating units for which the goodwill impairment test was sensitive to a reasonably possible change in a key assumption. The full methodology and results of the Group's impairment testing, including disclosure about the sensitivity of goodwill to the key assumptions are provided in note 18.

Action taken

The Audit Committee reviewed the approach taken to identify the cash generating units that were impaired or sensitive to changes in key assumptions. For those that were identified, the committee reviewed the assumptions used in relation to long-term growth, discount rates and forecast cash flows.

In addition, these results were considered against alternative valuation bases such as reference to disposal values, less costs to sell, for similar assets in similar locations, both within the Group and external to the Group.

Finally, the Audit Committee considered the adequacy of the disclosures provided, particularly in respect of cash generating units where changes in key assumptions could give rise to an impairment and in particular considered the observations issued by the Financial Reporting Council ("FRC") during 2019 in relation to disclosures on goodwill impairment and considered the correspondence that the Group had during 2019 with the FRC in relation to its goodwill-related disclosures and the commitments made in this respect.

Conclusion

The committee concluded that the carrying value of goodwill was supportable and that related disclosures were appropriate as at 31 December 2019.

Taxation

Description

The Group operates in around 90 countries and is therefore subject to numerous reviews by individual tax authorities in the ordinary course of business. In some countries, tax legislation is not consistently applied and under some complex contractual structures, the responsibility for tax arising is not always clear. Judgments and estimates are required to determine the appropriate level of tax provisions and disclosure around contingent tax liabilities at each period end.

Provisions for tax liabilities are established for existing matters under dispute with local tax authorities, as well as for matters which it is considered may be disputed by them, where it is probable that a future liability will arise. In some instances, tax reviews may result in claims being raised by tax authorities. Any claims are handled by the local legal entity in the first instance. More complex cases are reviewed by the group tax function and provisions are made, based on the best estimate of the likely outcome.

The Group recognises deferred tax assets in respect of temporary timing differences, mainly in relation to pension arrangements, fixed assets and carried forward losses. At 31 December 2019, total deferred tax assets were £237m (2018: £258m). Recognising such assets requires an assessment of their likely recovery through utilisation, which includes an assessment of the taxable profits expected to be made in each of the relevant jurisdictions in the future. Deferred tax assets can be affected by changes in legislation and in tax rates.

Action taken

The Audit Committee reviewed the Group's tax strategy, including the tax report and tax risk management processes, and the board approved the tax policy, which complies with the UK Confederation of British Industry's seven tax principles.

The committee also reviewed information prepared by management in relation to existing or potential tax exposures, the adequacy of the provisions recorded, their treatment and disclosure in the financial statements and emerging matters arising from the OECD's Base Erosion and Profit Shifting framework.

The committee reviewed information prepared by management supporting the recoverability of deferred tax assets, considered the period of time under which these assets would be recovered and made enquiries of the external auditor on the appropriateness of the Group's tax position.

Conclusion

The committee was satisfied with the Group's approach to tax, with the assessment of recoverability of deferred tax assets and with the accounting treatment and disclosure in respect of tax exposures.

Laws and regulations

Description

The Group operates in many jurisdictions globally, with complex and diverse regulatory frameworks. As a result, the Group faces many associated risks, such as litigation including class actions; bribery and corruption; obtaining and retaining operating licences; complying with local tax regulations; changes to and application of employment and employee remuneration legislation; complying with human rights legislation; and new or changed restrictions on foreign ownership. Furthermore, the Group may face new or changing regulations which may require modification of its processes and staff training. Not being compliant with applicable laws and regulations can have far-reaching consequences, including higher costs from claims and litigation; inability to operate in certain jurisdictions; loss of management control; and damage to the Group's reputation.

Action taken

During the year the committee received regular updates on significant areas of exposure to claims and areas where labour laws and regulations are complex and there is therefore an inherent risk to the judgment made as to whether the Group was compliant with those laws and regulations. In light of the size of the California class action settlement, a review of on-going labour litigation across the Group was carried out and the level of provisioning required was confirmed with management. The committee also received an update from legal counsel on other legal claims, on-going legal matters and disputes and expectations based on existing information in relation to the prospects of these claims.

Conclusion

The committee was satisfied that the provisions booked at 31 December 2019 were appropriate. The committee was satisfied that the enhanced disclosure around the judgments made in relation to contingent liabilities was clear and appropriate.

Risk of accounting errors and management override of internal controls

Description

The Group operates in around 90 countries and has around 600 legal entities, with a significant number of local financial systems and processes. This leads to an inherently diverse set of processes and controls that rely on local capabilities for implementation and maintenance of control. As set out on page 80, the Group has adopted a three-lines-of-defence model to control and manage risks across the Group.

Over the course of the last five years the Group has made significant investment in strengthening capability in finance, internal audit and risk, and has introduced additional internal controls and enhanced Group oversight to mitigate these risks. These include monthly reviews of the quality of earnings, a comprehensive internal audit plan and a regular cycle of reviews of local business unit or country balance sheets and controls.

Action taken

The committee oversaw the progress made in embedding the Group's Financial Controls, that were updated and relaunched in 2019 with the aim of providing a higher degree of transparency and enabling a more effective control environment, and received regular updates on the overall control environment of the Group, including results of internal audits, training and up-skilling of capabilities across the Group, as well as regular reports from the external auditor and the Group's whistleblowing process.

The committee also considered progress made in reducing reliance on manual controls, by developing and integrating financial and operational systems across the Group.

Conclusion

The committee acknowledged the progress made in relation to the strengthening of controls and the plans in place to reduce the number of systems and reliance on manual controls across the Group, but noted that, although good progress has been made to date, significant work remains to be done.

Viability statement

At the March 2020 meeting, the committee reviewed a paper prepared by management which examined the longer-term solvency and viability of the Group. The committee tested the underlying assumptions and analysis performed by management, reviewed assurance work carried out and considered the appropriateness of the timeframe of the assessment. The committee also considered the announcement made on 26 February 2020 in relation to the disposal of the majority of the conventional cash solutions business expected to be completed mostly during 2020, and the increased financial strength of the Group following this transaction. The committee was satisfied that the three-year period covered by the viability statement remains appropriate in that it aligns with the Group's regular business planning period, over which management has a reasonable level of confidence in its projections reflecting the life cycle of the majority of the Group's contracts, and takes account of the limited visibility on material bidding opportunities in the pipeline beyond that period. The committee also reviewed and challenged the outcome of the stress testing of projections by management.

At its meeting held in April 2020 the committee considered the potential impact of the Covid-19 pandemic on the viability assessment and concluded that the stress testing remained appropriate.

The committee recommended to the board that the directors confirm that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period of the assessment, as set out on page 113.

Fair, balanced and understandable

One of the key compliance requirements in respect of a group's financial statements is for the annual report, taken as a whole, to be fair, balanced and understandable. Guidelines on APMs were issued by the ESMA and have been applicable since July 2016. ESMA published a report on the use of APMs and on the compliance with its guidelines in December 2019. The FRC issued a "Frequently Asked Questions" guidance document and published the results of its thematic review on this matter in November 2017. Attention was also paid to guidance on disclosure of judgments and estimates and other key areas of interest set out in the FRC's Annual review of corporate governance and reporting 2018/2019 published in October 2019. The committee considered each of the above in assessing whether the Group's annual report was fair, balanced and understandable.

The committee also reviewed a paper setting out the approach taken by management in the preparation of the annual report to ensure it met the requirements of the FRC's Code and the ESMA guidance, including the reasons for and clear explanation of the non-GAAP measures used by the Group in reporting its results for the year. The paper described the process and procedures followed and detailed the steps taken in each of the sections of the annual report to ensure that the information presented was complete and accurate. This paper also described the review processes carried out internally to ensure that the annual report is fair, balanced and understandable. In addition, an external verification exercise was carried out to confirm that the information contained in the annual report is supported either by factual evidence, or by confirmation from management where such information is a statement of belief or intent.

The committee was satisfied with the work performed and advised the board that the annual report, taken as a whole, presents a fair, balanced and understandable view of the business and its performance for the year under review.

Internal control

Since 2013, the Group has had a heightened focus on improving its systems of internal control and risk management for financial reporting. The main features of these control systems include clearly defined reporting lines and authorisation procedures, a comprehensive budgeting and monthly reporting system, written policies and procedures and the use of a single global consolidation system for internal management reporting, budgeting and planning as well as for external reporting.

The system is designed to ensure the integrity of financial reporting and the committee's responsibility is to ensure that these internal controls remain effective. The committee does this primarily through receiving reports from management, from the internal audit function and from the external auditor.

The committee received updates on initiatives being implemented by the Group to continue its progress in strengthening internal controls and reviewed progress made. During 2019 Group Internal Audit followed a targeted audit plan for those areas where control issues had been identified.

Further details on internal controls are set out on page 80. The Risk Committee reported to the Audit Committee on its work on the Group's risk management framework, the Audit Committee confirmed to the board that it is satisfied that progress continues to be made in improving the Group's risk management and internal control processes and procedures and that these are appropriate and effective. However, strengthening of the internal control environment remains a key area of focus for the Group.

As such, in January 2019 the Group reviewed and relaunched its financial controls. The new Group Financial Controls are a more comprehensive suite of controls that are expected to provide a higher degree of transparency to management, enabling a more effective control environment and decision making. During the course of the year, the committee oversaw the launch of a new operating model in the UK replacing previous systems and processes including recruitment, core HR, talent management, procurement, finance, contract management, payroll, billing, scheduling and control systems with a single cloud based platform. The committee will review the effectiveness of the controls operating in this system, ahead of the launch in North America planned in early 2021.

CMA Order Compliance

The committee confirms that the company has complied with the Audit Services for Large Companies (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the Order). The company is mindful of the requirement of Article 4.1 of the Order and believes that it is in the company's members' best interests not to complete a competitive tender for the Group's external audit until the contours of the resulting Group following completion of the cash transaction have settled down. Such process is unlikely to be carried out until financial year 2021 or later, but the matter will be kept under review.

Regulators and our financial report

In late October 2019, the FRC wrote to the company asking certain questions arising from its limited scope review of Group's 2018 Integrated Report and Accounts on the impairment of non-financial assets. The review did not benefit from a detailed understanding of the underlying transactions entered into by the Group, nor is it the FRC's role to verify the information given to it. Its limited review and subsequent correspondence provide no assurance that the accounts are correct in all material respects. The FRC (which includes the FRC's officers, employees and agents) accepts no liability for reliance placed on it by the company or any third party including, but not limited to, investors and shareholders.

Management reviewed and improved its disclosure in light of the FRC's correspondence. In particular, for 2019, the Group has enhanced the disclosure in respect of the assumptions made in determining recoverable amounts of its cash generating units, the sensitivity of its goodwill impairment test to changes in those assumptions; and the circumstances leading to the impairments that were recognised within the year. As a result of the response provided the FRC was able to close its enquiries.

Internal audit

During 2019, the internal audit function continued to provide support and guidance to business units to improve awareness of and compliance with Group Financial Controls.

In addition internal audit also assessed the effectiveness of a broader set of mandated controls including HR core standards on screening, health and safety, driver and firearms controls, payroll and IT standards. A risk-based approach continued to be used to determine coverage for HR core standards and human rights. The goal remains to focus local management on the most material control issues specific to their local environment. The group finance function and regional audit committees also provided support to assist in driving improvements where appropriate. Each year, the committee reviews and approves the internal audit plan and receives reports from internal audit which are reviewed at each meeting. The committee also monitors senior management's responsiveness to issues raised in the reports.

2020, being a year of change for the Group with the conventional cash business disposal, the overriding objective for the internal audit programme is to provide assurance over:

- foundational controls by continuing risk based country or business units checks and,
- changing shape of the Group as it completes the disposal of the conventional cash business,
- effective embedding of group values and effectiveness of the Group's standards and controls.

Precise coverage in each country will continue to be determined through risk assessment.

Following the last external review of the internal audit function carried out in 2014, in late 2019, the committee engaged the Institute of Internal Audit (IIA) to conduct an external quality assessment of the internal audit function. The IIA has been tasked with assessing the function against the IIA standards of internal auditing, the quality of skills available across the team, coverage given the function's remit, value provided to the business, and the independence of the team. The review is on-going and as part of their work, the IIA are engaging with a range of relevant personnel across the Group, including the chairman of the Audit Committee, Group CFO, a cross section of regional management, the Director of Risk and Audit, as well as regional audit managers and internal auditors. The findings and recommendations will be reported to the Audit Committee and the board. Preliminary findings were reported to the Audit Committee in March 2020.

External audit

External auditor

Following an audit tender process carried out during 2014, PricewaterhouseCoopers LLP (PwC) was appointed as the Group's new external auditor for the 2015 financial year. PwC was subsequently reappointed at the following AGMs, lastly in 2019, when PwC was reappointed to hold office until the 2020 AGM. Richard Hughes has been lead audit partner since the beginning of 2015. In compliance with the five-year rotation requirement, the committee carried out a selection process during the year and Jason Burkitt was appointed to lead the G4S external audit from financial year 2020. Mr Burkitt shadowed Richard Hughes throughout the 2019 year-end process to develop his understanding of the business.

During the year, the committee reviewed PwC's group audit plan including the scope to be undertaken as well as their reports on external audit findings, with particular focus on the areas set out above.

The committee had private sessions with the external auditor both during the year and at the end of a number of Audit Committee meetings, and approved the fee for the external audit. The committee also considered and approved the representation letter to be issued to the auditor.

Effectiveness of the external audit process and independence & objectivity of the external auditor

A combination of formal and informal processes are used in the assessment of the effectiveness of the external audit process and objectivity of the external auditor.

A formal questionnaire is completed at the end of the audit by members of the Audit Committee, the group finance department and the finance directors of significant operations across the Group. The results of those questionnaires are reviewed by the Audit Committee. In assessing the external auditors' independence and objectivity, the committee considered the safeguards in place. PwC shared the PwC UK's 2019 Transparency Report published in September 2019 with the company and the chair of the Audit Committee. The auditor, PwC, has written to the Audit Committee confirming that, in its opinion, it was independent and objective for the period through to 28 February 2020.

The assessment of the external audit for 2019 and the external auditor concluded that it remained effective and that the external auditor is objective and independent.

Non-audit services

To ensure that the independence of the external audit is not compromised, the committee has a policy in place covering the non-audit services that can be provided by the external auditor, the relevant approval process for certain services, and detailing those services which the auditor is prohibited from providing. In essence, the external auditor is prohibited from providing services that could create a conflict of interest, result in the audit firm auditing its own work, or result in the performance of management functions. Examples of non-permitted services are actuarial services, book-keeping services, internal audit services and legal services.

The committee has pre-approved certain services which can be provided by the auditor subject to specified fee limits, above which further approval is required. All other services require prior approval by the committee. The Audit Committee reviewed this policy in 2019 and adopted an amendment removing the exception relating to tax services provided outside the EU. Details of the fees paid for audit services, audit-related services and non-audit services can be found in note 10 to the consolidated financial statements. The non-audit service fees of £1m paid to PwC during the period related to assurance service which include the half-year review.

John Ramsay
Audit Committee Chairman

29 April 2020