

## Warren East CBE

Chairman of the Audit Committee



I am pleased to present the report of the Audit Committee for the period ended 28 March 2015. This report describes the Committee's ongoing responsibilities and key tasks as well as its major activities over the past year.

### Composition of the Audit Committee

Members of the Committee are Victoria Jarman, Gill Rider, Andrew Stevens and myself, all of whom are independent Non-executive Directors. I have been the chief executive of a listed company and therefore have strong financial experience. In addition, Victoria Jarman is a chartered accountant, is chair of the audit committees at Hays plc and Equiniti Group Limited and has relevant financial experience. The Board is satisfied that the membership of the Audit Committee meets the requirement for relevant and recent financial experience.

At my invitation, meetings are attended by the Chairman, Chief Executive, Chief Financial Officer, General Counsel and Company Secretary, Group Director of Risk and Internal Audit and the external and internal auditors. The internal and external auditors each meet the Committee without Executive Directors or employees being present.

### Role

The Audit Committee provides an independent overview of the effectiveness of the internal financial control systems and financial reporting processes. Its principal responsibilities are:

- The appointment of the external auditors including the agreement of the terms of engagement at the start of each audit, the audit scope and the external audit fee
- Monitoring and reviewing the effectiveness of internal financial controls and internal control and risk management systems and the effectiveness of the internal audit function
- Reviewing the integrity of the interim and full year financial statements
- Reviewing significant financial reporting issues and judgements contained in the financial statements
- Reviewing and monitoring the external auditor's effectiveness, independence and objectivity including the nature and appropriateness of any non-audit fees

- Reviewing reports on the effectiveness of the Group's whistleblowing procedures and arrangements, details of which are set out on page 24

- Advising the Board on whether the Committee believes the annual report and accounts are fair, balanced and understandable

The terms of reference of the Audit Committee are available on the Group's website.

### Activities

During the period, the Audit Committee met on five occasions and dealt with the following matters:

- Group half year results
- Group preliminary announcement and annual results
- Principal judgemental accounting matters affecting the Group based on reports from management and the external auditors
- External audit plans and reports
- Risk and assurance plans and reports including:
  - Group risk profile
  - Internal audit plan
  - Internal audit reports
  - Follow up of internal audit recommendations
  - Annual review of the system of internal controls
  - Quality and security internal assurance reviews
  - Internal control self assessment review
  - HSE legal assurance and compliance audits
- Group disclosure and whistleblowing policy
- Review of controls concerning the management of capital expenditure proposals
- Going concern
- Audit Committee effectiveness
- External auditor effectiveness, independence, re-appointment and fees

# Audit Committee report continued

## Significant accounting matters

The Audit Committee is responsible for reviewing whether suitable accounting policies have been adopted and whether management has made appropriate estimates and judgements in the preparation of the financial statements. In respect of the financial statements for the period ended 28 March 2015, the significant issues reviewed and how these issues were addressed are summarised below:

### Revenue recognition in the Currency division

The Committee considered the Group's revenue recognition and contract accounting policies and procedures to ensure that they remained appropriate and that the Group's internal controls were operating effectively in this area. Feedback was also sought from the external auditors over the application of the revenue recognition policy including a specific review of shipments pre and post year end. Following a review of the varied sources of information received, the Committee concluded that the accounting treatments were reasonable and appropriate.

### Post-retirement benefit obligations

The Committee received and considered reports from management and the external auditors in relation to the valuation of the defined benefit pension scheme and challenged the key actuarial assumptions used in calculating the scheme liabilities, especially in relation to discount rates, RPI inflation rates and mortality. The Committee discussed the reasons for the increase in the net pension deficit and was satisfied that the assumptions used were appropriate and were supported by independent actuarial specialists. Details of the key assumptions used are set out in note 22.

### Valuation of inventory in Currency

The Committee reviewed the Group's policies and procedures over the valuation and recoverability of inventory in Currency (£42.7m). The Committee received confirmation that the valuation principles had been consistently applied and noted that the majority of inventory items were made to order rather than held for generic stock and hence the recoverability risk was low. Accordingly, the Committee concluded that the accounting treatments were reasonable and appropriate.

### Estimation of warranty provisions

The Group holds a number of provisions relating to warranties including present obligations for defective products and known claims as well as anticipated claims that had not been reported at the balance sheet date. In addition a warranty provision has been created in relation to the invocation of guarantees after the balance sheet date (more fully described in note 3). The Committee reviewed and discussed reports from management and the external auditors concerning the significant provisions held for such matters including any provisions with notable movements. The Committee considered the background to such provisions and challenged management over the judgements applied in determining the value of provisions required. The Committee enquired of management and the external auditors as to the existence of other matters potentially requiring a provision to be made. The Committee concluded that it was satisfied with the value of warranty provisions carried.

### Classification of exceptional items

As part of the Committee's deliberations over whether the annual report and accounts, taken as a whole, is fair, balanced and understandable, the Committee also considered the amounts disclosed as exceptional items. The nature of the items classified as operating exceptional items during the period are described in note 3. The Committee considered the accounting treatment and disclosure of these items in the financial statements including seeking the views of the external auditors. On the basis of this review, the Committee concluded that the accounting treatment and disclosures in relation to these items were appropriate.

## Independence and objectivity of external auditors

The Committee ensures that the external auditors (KPMG) remain independent of the Group. The Audit Committee has a detailed policy covering:

- Choosing the statutory auditors and approving the audit fee
- Commissioning non-audit work
- Defining circumstances in which it is appropriate or inappropriate for incumbent auditors to be allowed to provide or be prohibited from providing non-audit work
- De La Rue's procedures for procuring non-audit services from external sources, which specifically prohibits KPMG from undertaking certain types of service (including but not limited to services where it would audit its own work, where it would act in an advocacy role for the Group or where it would participate in activities normally undertaken by management)

It may be cost effective for KPMG to perform certain non-audit services, in particular where the skills and experience required make KPMG the most suitable supplier. Certain categories of non-audit services, including corporation tax compliance and due diligence services must be subject to competitive tender unless it is justifiable in the circumstances not to do so. Areas which would not normally be acceptable non-audit services but in exceptional circumstances may be considered appropriate, such as litigation and compliance services, require my prior approval. The selection criteria include detailed proposals, timescales, local resource, cost and the safeguards put in place by KPMG to avoid conflicts of interest or loss of independence. In addition, the Group's policy is for any individual assignment to be undertaken by KPMG where the fee is likely to be in excess of £50,000 to be approved by myself prior to commencement of work. During 2014/15 the amount of non-audit fees paid to KPMG was £0.1m.

The safeguards KPMG put in place avoid compromising their objectivity and independence. They provide a written report to the Audit Committee on how they comply with professional and regulatory requirements and best practice designed to ensure their independence. Key members of the KPMG audit team rotate and the firm ensures, where appropriate, that confidentiality is maintained between different parts of the firm providing services to De La Rue.

### Appointment of auditors

The Audit Committee assesses annually the qualification, expertise, resources and independence of the external auditors and the effectiveness of the audit process. The Audit Committee's assessment is performed by an audit satisfaction questionnaire completed by the Chairman, relevant senior management and Audit Committee members.

KPMG have been the Company's auditors since 11 October 2006. The Audit Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness. During the year, the Audit Committee considered the tenure, performance and audit fees of the external auditors, and the level of non-audit work undertaken, and has not considered it necessary to date to require KPMG to re-tender for the audit work. Accordingly, the Committee recommended to the Board that a resolution for the re-appointment of KPMG for a further year as the Company's auditors be proposed to shareholders at the AGM.

The Committee acknowledges the recommendation in the new EU legislation and the report of the UK Competition and Markets Authority that the external audit contract should be put out to tender at least every 10 years. Following completion of the 2011/12 audit KPMG's audit engagement partner was rotated providing fresh oversight of the audit process. Given this change, the Committee will keep under review the timing of its next tender process but does not currently intend that the audit will be put out to tender during 2015/16.

The Audit Committee places great emphasis on the objectivity of the Company's auditors, KPMG, in reporting to shareholders.

The KPMG audit partner is present at Audit Committee meetings to ensure communication of matters relating to the audit. The Audit Committee has discussions with the auditors, without management being present, on the adequacy of controls and on judgemental areas and receives and reviews the auditors' highlights reports and management letters which are one of the main outputs from the external audit.

The scope and key focus of the forthcoming year's audit is discussed with, and approved by, the Audit Committee.

### Internal control and risk management

As noted above, the Committee is responsible for reviewing, on behalf of the Board, the effectiveness of the Group's internal financial controls and the assurance procedures relating to the Group's risk management systems. These controls and procedures are designed to manage, but not eliminate, the risk of failure of the Group to meet its business objectives and, as such, provide reasonable but not absolute assurance against material misstatement or loss. The key elements of the Group's internal financial control framework and procedures are set out on page 35. The Committee reviews these topics at each meeting and considers that none of the areas identified for enhancement during the year constituted a significant failing or weakness for the Group.

### Internal audit

Assurance over the design and operation of internal controls across the Group is provided through a combination of techniques. The Board through the Audit Committee monitors the effectiveness of internal control systems through reports received from the internal audit function during the period. The internal audit function has been outsourced since 2009. PricewaterhouseCoopers LLP have performed this role since the start of 2013/14. The Committee periodically reviews whether the internal audit function is likely to be more effective or efficient if provided internally. In view of the nature and scope of the Group's business and its management structure, the Committee considers that it continues to be more effective and efficient for the core internal audit functions to be undertaken by a specialist external service provider.

Internal audit continued to ensure that their efforts were better aligned to the operational risks that the Group faces while maintaining an emphasis on reviewing the adequacy and effectiveness of general finance and IT controls across the Group on a cyclical basis. In addition to internal audit work, there is a system of self assessment internal control reviews by which management are required to detail and certify that controls are in operation to ensure the control environment in their business areas is appropriate. Actions agreed are followed up by senior management to ensure that satisfactory control is maintained. The internal audit plan is set and reviewed by the Audit Committee. Additionally, the Audit Committee reviews reports from the external auditors on internal control matters noted as part of their audit work.

### Fair, balanced and understandable view

At its May 2015 meeting, the Committee reviewed the content of this annual report and accounts and advised the Board that, in its view, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

### Warren East CBE

Chairman of the Audit Committee  
27 May 2015