

Audit Committee Report



Dear Shareholder

On behalf of the board, I am pleased to present the report of the Audit Committee (“the Committee”) for 2024, outlining how the Committee discharged its responsibilities and met its objectives.

The Committee oversees and challenges the group’s financial reporting and maintenance of an effective internal control environment. This year the Committee’s schedule has been full, with focus on the key accounting judgements and estimates set out on the following pages, assessing the integrity and fair presentation of the group’s financial reporting and reviewing the group’s internal controls.

Looking ahead to 2025, along with the core responsibilities, the Committee will continue to remain focused on the implications of the FCA review into motor commission arrangements and the resultant accounting and reporting impacts across the group, and readiness for the corporate governance and audit reform changes.

Kari Hale
Chair of the Audit Committee

19 September 2024

Membership

Kari Hale (Chair), Patricia Halliday, Tesula Mohindra and Sally Williams.

Other regular attendees by invitation

- Chairman of the board
- Executive directors
- Group head of internal audit
- Group chief risk officer
- Group financial controller
- Group financial planning and analysis director
- Group head of operational risk and compliance
- External auditor

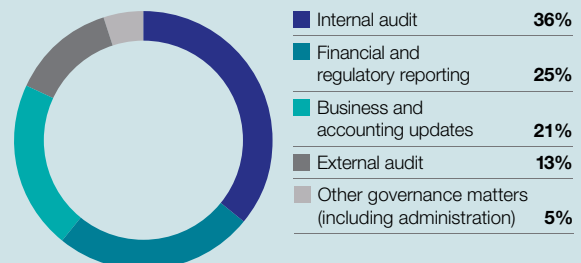
Meetings

- Number of scheduled meetings: five
- For details of attendance, see page 132

Interaction with other committees

The chair of the Audit Committee must be a member of the Risk Committee. The Audit Committee jointly oversees, along with the Risk Committee, the recommendations of the Group’s internal and external auditors and the effectiveness of the Group’s internal control and risk management systems.

How time was spent



2024 highlights

- Challenging key accounting judgements with focus on expected credit loss provisions, impairment assessments of goodwill, revenue recognition, and the implications of the FCA review in to motor commission arrangements.
- Assisting in the 2024 dividend recommendation which took into account the group’s capital position and going concern assessment.
- Reviewing the integrity of the group’s financial reporting and considering key disclosure matters.
- Assisting with the determination of the appropriateness of adopting the going concern basis of accounting and in performing the assessment of the viability of the group.
- Monitoring the group’s readiness for the revised UK Corporate Governance Code.
- Reviewing, challenging and approving the annual internal audit plan and internal audit reports.
- Overseeing the effectiveness and continuous improvement of internal control.
- Overseeing and challenging the external audit plan and reports, including materiality, risk assessments and scope.

Key Responsibilities

The Committee’s key responsibilities, on behalf of the board, are to:

- monitor significant accounting judgements and estimates;
- monitor the integrity of financial reporting including recommending to the board whether it is fair, balanced and understandable;
- oversee the effectiveness of the group’s internal controls;
- review the activities and effectiveness of the group internal audit function;
- review the effectiveness and quality of the external audit process and the independence of the external auditor;
- recommend the external auditor of the group and their fees; and
- review the plan and findings of the audit with the external auditor.

The Committee reports to the board on how it discharges its responsibilities and makes recommendations to the board, all of which have been accepted during the year.

Committee Composition, Operation and Effectiveness

The Committee acts independently of management to ensure the interests of shareholders are properly protected in relation to financial reporting and internal control.

On 16 November 2023, Oliver Corbett resigned as a director of the board. Following Oliver’s resignation, Kari Hale was appointed Chair of the Committee.

The Committee members continue to bring a diverse range of experience in finance, risk, control and business, with particular experience in the financial services sector. The board has confirmed that the members of the Committee have the necessary expertise to provide effective challenge to management; this includes the chair. The qualification for each of the members is outlined on pages 124 to 126.

During the course of the year, the Committee held separate sessions with the internal and external audit teams, without management present.

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, as described on page 134. The evaluation found that the Committee continues to operate effectively. The Committee considers that it has access to sufficient resources to enable it to carry out its duties and it has continued to perform effectively.

External Audit

The Committee oversees the relationship with PricewaterhouseCoopers LLP (“PwC”), its external auditor, covering engagement terms, fees and independence. The Committee and the external auditor have policies and procedures designed to protect independence and objectivity. PwC has been auditor to the group since August 2017, following the group’s last competitive tender during the financial year ended 31 July 2017. Heather Varley has been the group’s lead audit partner since March 2022. Heather attended all meetings of the Committee. Matters discussed with PwC are set out in its report on pages 180 to 191.

External Auditor Effectiveness and Appointment

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. The evaluation includes consideration of quality, independence and objectivity, technical competence and auditor challenge.

The process was facilitated by a group-wide survey, a survey of the PwC senior audit team and a review of audit and non-audit fees. Overall, the Committee has concluded that PwC remains independent, and it was satisfied with the auditor’s performance and recommended to the board a proposal for reappointment at the AGM. Looking ahead, subject to shareholder approval, PwC will undertake the audit of the company and the group for the year ending 31 July 2025.

In conformance with the required provisions and UK Corporate Governance Code in respect of audit tendering and rotation, the group will be required to tender for the external audit in the 2027 financial year end. Rotation of senior members of the audit team from 2022 onwards has reduced the potential familiarisation threat and therefore a tender has not been completed. Instead during the 2025 financial year, the Committee will commence planning for the next tender, taking into account shareholder interests as well as the FRC’s Audit Committees and the External Audit: Minimum Standard.

Financial Reporting and Critical Accounting Judgements and Estimates

The Committee spent considerable time reviewing the Interim Report and Annual Report. The Committee discussed and challenged the key accounting judgements made by management in preparing the financial statements. 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 became effective for the reporting period. The Audit Committee reviewed and challenged the accounting and disclosure considerations surrounding the non-adjusting post balance sheet event for the agreed sale of CBAM.

Summary of Financial Reporting and Critical Accounting Judgements and Estimates

Key issue	Committee review and conclusion
<p>Expected credit loss (“ECL”) provision</p> <p>31 July 2024: £445.8 million 31 July 2023: £380.6 million</p> <p>The group’s ECL provision is dependent on management’s judgements and estimates.</p> <p>Given the materiality of the group’s loan book, ensuring that the group’s ECL models and related IFRS 9 judgements and disclosures are appropriate remains a key priority for the Committee.</p>	<p>Regular IFRS 9 updates were provided to the Committee throughout the year. 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:</p> <ul style="list-style-type: none"> • the latest macroeconomic backdrop and the extent to which models are able to capture these risks; • the ongoing use, approval and exiting of model adjustments; • whether coverage levels continue to reflect the economic risks for customers and the credit risk in the loan book; and • single name loss risks and appropriateness of specifically assessed provisions. <p>Credit risk and provision disclosures were discussed to ensure they gave a balanced articulation of the group’s credit risk profile, and key drivers of the ECL charge.</p> <p>Conclusion: the Committee was satisfied that the impairment provision and the disclosures provided in the financial statements were appropriate.</p>

Key issue	Committee review and conclusion
<p>Goodwill</p> <p>31 July 2024: £102.9 million 31 July 2023: £94.6 million</p> <p>Goodwill is allocated to nine (31 July 2023: eight) cash generating units (“CGUs”), all of which must be tested annually for impairment. This assessment is based on management judgement.</p>	<p>The Committee was presented with goodwill impairment assessments throughout the course of the year. The Committee challenged the appropriateness of the assessment, conclusions and resulting disclosures. Particular focus was given to the cash flow assumptions for Winterflood Securities, which continued to record lower profits driven by difficult market conditions, and Motor Finance where the market and regulatory backdrop is expected to present challenges to the future cash flows.</p> <p>Committee updates included comprehensive information on the impairment assessment methodology, results and sensitivity analysis. Enhancements to the methodology were discussed and challenged including the cash flow approach which takes into account capital requirements as well as the timing and extent of cash flow recovery for certain CGUs, the discount rate used, and the assessment of allocation of central assets to CGU carrying values.</p> <p>Conclusion: the Committee was satisfied that there was no impairment and the disclosures provided in the financial statements were appropriate.</p>
<p>Revenue recognition</p> <p>The group offers a range of products and services for which revenue is recognised under IFRS 9, IFRS 15 and IFRS 16. Appropriate recognition is a key focus of the Committee.</p>	<p>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 the detailed assessment that is performed by management and challenged by PwC.</p> <p>Conclusion: the Committee was satisfied that revenue recognition for each of the group’s key businesses is appropriate.</p>
<p>Motor finance commission arrangements</p> <p>During the 2024 financial year the accounting judgements surrounding the FCA’s review of historical motor finance commission arrangements was identified as a critical accounting judgement.</p>	<p>The FCA review of historical motor finance commission arrangements is progressing to determine whether there has been industry-wide failure to comply with regulatory requirements which has caused customers harm and, if so, whether it needs to take any actions.</p> <p>Taking into account all available information, significant judgement is required in determining whether the criteria for recognition of a provision or a contingent liability under IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” have been met. The Committee was presented with detailed analysis comparing the current facts and circumstances with the decision tree contained within IAS 37. In addition, the Committee discussed and challenged the qualitative disclosure approach for the contingent liability and the conclusion it was also not practicable at this early stage to estimate or disclose any financial impact range arising from this issue.</p> <p>Conclusion: the Committee was satisfied with the matter being disclosed as a contingent liability and the qualitative disclosures provided in the financial statements were concluded to be appropriate.</p>
<p>Going concern and Viability Statement</p> <p>The directors are required to confirm whether they have a reasonable expectation that the company and the group will be able to continue to operate and meet their liabilities as they fall due for a specified period. The Viability Statement must also disclose the basis for the directors’ conclusions and explain why the period chosen is appropriate.</p>	<p>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.</p> <p>The Committee reviewed and challenged papers which were in support of the going concern basis and the longer-term viability of the group. The analysis took in to account a severe but plausible scenario for the outcome of the FCA’s review into motor finance commission arrangements and downside risks, including consideration of wider impacts such as economic deterioration, Basel 3.1, cost of funding, and liquidity. In addition to these factors, the capital action plan disclosed in the interim results announcement and the underlying performance of the group were taken into account. The Committee focused on the strong capital loss absorption capacity of the group and the sound liquidity position in a range of scenarios. The Committee reviewed the disclosures, including the information provided on a severe but plausible scenario.</p> <p>Conclusion: 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, as set out on pages 117 to 119.</p>

Key issue	Committee review and conclusion
<p>Fair, balanced and understandable</p> <p>Under the UK Corporate Governance Code, the board is required to perform an assessment of fair, balanced and understandable reporting.</p>	<p>On behalf of the board, the Committee reviewed the Annual Report as a whole to assess whether they were fair, balanced and understandable. Ahead of presentation to the Committee, a robust review process was conducted to ensure disclosures were balanced and accurate.</p> <p>The Committee reviewed the group's performance in light of the principal and emerging risks, along with the uncertainties surrounding the FCA's review in to motor finance commission arrangements and the capital plan. Challenge was given the use of adjusted measures. The Committee discussed and challenged the balance and fairness of the overall report with management and considered the views of the external auditor.</p> <p>Conclusion: the Committee was satisfied that the Annual Report, taken as a whole, could be regarded as fair, balanced and understandable and proposed that the board approved the Annual Report in that respect.</p>

Financial reporting controls

Risk management and internal controls

In conjunction with the Risk Committee, we have satisfied ourselves that the group's internal financial control framework is effective and adequately aligned with the group's risk profile. We are also satisfied that internal financial controls are appropriately designed and effective in identifying risks faced by the group. Full details of the internal control framework are given within the Risk management section on pages 74 to 79.

At each meeting the Committee is presented with a report from the head of internal audit, and reviews major findings relating to control weaknesses and management's response. In addition, metrics and updates are provided to the Committee throughout the year covering the Group Financial Control Framework.

Revised UK Corporate Governance Code 2024

The Committee received a number of updates through the course of the year covering the group's preparations for the revised UK Corporate Governance Code 2024. Committee discussions particularly focused on controls transformation requirements.

Group Internal Audit

The Committee continued to have oversight of Group Internal Audit through quarterly reports provided to the Committee and through one-to-one meetings with the group head of internal audit. The Chair also met members of the function through a roundtable discussion.

The Committee reviewed, challenged and approved the six-monthly internal audit plans and amendments made during the year. It also approved an updated internal audit charter, which sets out the mandate and remit of the function.

It received regular reports on internal audit activities across the group, including thematic root cause analysis, detailing areas identified during audits for strengthening across the group's risk management and internal control framework and management's progress on remediation of issues. On occasion, the Committee invited relevant members of management to attend the Committee and provide progress updates on remediation of issues.

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 the Committee and Executive Management. The internal audit function was found to be working well with a good culture of engagement between management and internal audit.

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. It concluded the function was adequately resourced with additional co-source available for specialist skills.

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 where there is an actual or potential threat to independence. However, the Committee will give permission where the service complies with the group policy and where work is closely related to the audit, a detailed understanding of the group is required and the external auditor can provide a higher quality and/or better value service. The group follows the mandatory regulatory cap requirement of 70% which compares the annual value of non-audit services to the average of three years' audit fees.

During the year, total audit fees amounted to £5.0 million (2023: £3.9 million) while total non-audit fees including those relating to services required by legislation amounted to £1.4 million (2023: £0.8 million), representing 28% (2023: 21%) of the current year audit fee. This includes non-audit services not required by legislation of £0.7 million (2023: £0.2 million), 14% (2023: 5%) of the audit fee, predominantly relating to the review of the group's interim financial statements and funding assurance work.

The Committee was satisfied that these fees, individually and in aggregate, were consistent with the non-audit services policy and did not believe that they posed a threat to the external auditor's independence.

Statutory Audit Services Order 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 2024.