THE AUDIT COMMITTEE

Paul Spence
Audit Committee Chairman

"In 2016, the Audit Committee's work focused on monitoring progress made on the implementation of an updated financial controls framework, designed to improve the effectiveness of the Group's internal risk management and control environment. We reviewed how these new controls are being embedded in a sustainable way in the business and the progress made in the culture change that is required along with the change in controls.

We also continued our focus on ensuring that matters of judgement were subject to rigorous review, and supported the board with the analysis of the viability statement and with an assessment on the preparation of the annual report on a fair, balanced and understandable basis, particularly considering the guidance on alternative performance measures issued during 2016 by the European Securities and Markets Authority ("ESMA") and the Financial Reporting Council ("FRC").

We have also welcomed three new members onto the committee, two of them as a result of directors stepping down from the committee and one to strengthen further the committee's experience. Looking forward to the 2017 financial year, the committee will remain focused on the Group's control environment and on monitoring how the changes instigated in 2016 are working in practice."

Committee membership and attendance during 2016

	Meetings attended
Paul Spence[1] (Chairman)	4 of 4
John Daly	3 of 4
Adam Crozier[2]	2 of 2
Steve Mogford[3]	2 of 2
Tim Weller[1] (Chairman)	3 of 3

1. Tim Weller stepped down as chair and as a member of the Audit Committee on 15 August 2016. Paul Spence was nominated to chair the meeting of the committee in December 2016.
2. Adam Crozier retired from the board and the Audit Committee after the AGM on 26 May 2016.
3. Steve Mogford became a member on 27 May 2016.
4. Other regular attendees include the chief financial officer, the Group financial controller, the company secretary, the Group director of risk and internal audit and representatives of the Group's external auditor. The chairman of the board, a chartered accountant who spent his executive career with Deloitte, also attends most meetings. In addition the chief executive also attends meetings from time to time when invited by the chairman.

Committee Membership

The membership of the committee changed substantially in the year, with Adam Crozier stepping down from the board after the AGM in May 2016, and Steve Mogford joining the committee following his appointment to the board on 27 May. Tim Weller stepped down from his role as chairman of the committee in August 2016 prior to his appointment as the Group's chief financial officer in October 2016.

During the search for a new non-executive director qualified to act as the chairman of the committee, Paul Spence was nominated by his fellow committee members to chair the December meeting. The Company applied all of the principles and provisions of the Code relevant to the committee throughout the year under review, except that during the period following Tim Weller having stepped down from his role as chairman, the Audit Committee did not have a member with recent and relevant financial experience for the remainder of the year. Only one meeting took place during that period and no financial results were considered at that meeting. The board remains satisfied therefore that formal and transparent arrangements for considering how the corporate reporting and risk management and internal control principles should be applied and for maintaining an appropriate relationship with the company's auditor were in place at all times.

As reported previously, Ian Springett was appointed to the board and as chair of the Audit Committee with effect from 1 January 2017. Unfortunately, in January Ian had to take an extended leave of absence in order to undergo treatment for a medical condition. Accordingly with effect from 20 January 2017, Paul Spence was appointed interim chairman of the Audit Committee and Winnie Fok became a member. Mr Spence was already a member of the committee. Ms Fok brings an accounting and audit background and both Mr Spence and Ms Fok together with the other members of the committee bring significant and relevant experience gained at senior management level. Their skills and experience are set out on page 59. In order to ensure continued compliance with main principle C.1 of the Code, until Mr Springett is able to take up his role, certain additional steps are being taken. These include the provision of further support and additional training to the interim chair, as well as the promotion of greater interaction between Mr Spence and the company's external auditor. The chairman engages with the external auditors on a regular and in depth basis.

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.

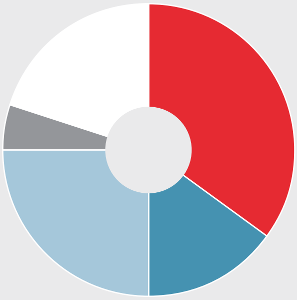
After each meeting, the chairman of the committee reports to the board on the matters which have been discussed.

Responsibilities

The committee ensures that there is effective governance of the Group's financial reporting and internal controls to safeguard 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.

During the year, the terms of reference of the Audit Committee were updated, to reflect the requirements of the EU Audit Regulation and Directive, the CMA's Statutory Audit Services Order and the UK Corporate Governance Code 2016 ("New Code"). While the New Code required the members of the committee as a whole to have competence relevant to the sectors in which the Company operates, other changes include the requirement for the committee to approve the fee for the external audit and the provision of advice to the board at its request in relation to the viability statement and any assumptions underpinning it.

Main activities of the Audit Committee during the year (%)



Further details can be found in the committee's terms of reference available at www.g4s.com/investors

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.

In addition, in 2016, the committee reviewed and approved management's draft responses to queries raised by the FRC in respect of the 2014 Annual Report. Subsequent to the issue of the 2015 Annual Report the FRC confirmed that their enquiries into the 2014 Annual Report were closed.

Changes reflected in the 2015 Annual Report following resolution of the FRC's queries largely comprised enhancements to disclosures, particularly in respect of revenue recognition, taxation, and specific and other separately disclosed items.

Significant judgements and issues considered by the Audit Committee

The primary judgements and issues considered by the committee in the 2016 financial statements, and how these were addressed, were:

ONEROUS CONTRACT PROVISIONS

Description

The Group delivers certain long-term outsourcing services that are complex in nature. Some of those contracts may evolve to become loss-making and lead to a position where future net unavoidable losses over their life are expected. This requires determining the net present value of future estimated losses in order to calculate an onerous contract provision. The identification and measurement of such provisions requires significant judgement, given the often extended time periods involved and the number of variables that are not all within management's control.

During the year, management operated the enhanced processes and controls introduced in 2014, including a review by the chief financial officer on a quarterly basis of the top 25 contracts and those with low profitability for each region.

Details of the outcome of the assessment of contract provisions are set out in the Chief Financial Officer's Review on page 35.

Action taken

The committee reviewed in respect of each onerous contract, the critical assumptions provided by management and enquired about the judgements made, the robustness of the assumptions, the sensitivities to changes in the assumptions and the disclosure provided in relation to the key material judgements. The committee also considered the implications of the extension of the Compass contract to August 2019 announced in December 2016 and the related sub-contractor dispute.

Conclusion

The Audit Committee was satisfied that the level of provisions and the related disclosures as at 31 December 2016 were appropriate.

PORTFOLIO RATIONALISATION PROGRAMME

Description

The Group has continued to make progress in the portfolio rationalisation programme announced in 2013, identifying operations in a further 10 businesses or countries to be sold or closed. Given that the size of the operations in these businesses or countries is individually not significant for the Group, they do not meet the definition under IFRS 5 to be classified as discontinued operations. Management presents them separately in the adjusted performance measures in the preliminary results announcement and in the Chief Executive Officer's Review and provides a detailed reconciliation to the statutory financial statements. Management classifies these entities within assets held for sale when it is expected that the carrying amount of these entities will be recovered principally through a sale transaction in the next 12 months.

During 2016, for 14 of the businesses previously reported as portfolio businesses, management focus and changing market conditions have resulted in improved performance and we have formally concluded that we will retain these businesses. We have therefore reported the results of these businesses in continuing businesses in 2016 and have restated the 2015 results accordingly.

During 2016 16 businesses related to the portfolio rationalisation programme were sold or closed.

Action taken

The committee reviewed progress made on the portfolio rationalisation programme against the Group's strategy announced in November 2013, checked that the businesses that management had identified for sale or closure were in line with that strategy and reviewed the related accounting and disclosure judgements.

Conclusion

The committee was satisfied with the progress made, that the adjusted performance measures in respect of the programme were presented in a balanced way, and that the information provided to enable stakeholders to reconcile adjusted performance measures to statutory results was appropriate.

GOODWILL IMPAIRMENT TESTING

Description

The total value of the Group's goodwill as at 31 December 2016 was £2.0bn, 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 estimation of the recoverable amount of goodwill supported by the Group's cash generating units requires significant judgement, 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.

As a result of the annual review of the carrying value of goodwill, £9m of goodwill was impaired, relating to a business closure and the balance remaining at the 2016 financial year end was £1,990m (see notes 4 and 18 to the consolidated financial statements). Details of the Group's goodwill, impairment test and related disclosures are provided in note 18.

Action taken

The Audit Committee reviewed the methodology and results of the impairment test prepared by management.

The Audit Committee reviewed the assumptions used in relation to long-term growth, resulting headroom and sensitivities applied by management. In addition, these results were considered against alternative valuation bases such as reference to transactions for similar assets in similar locations, both within the Group and external to the Group.

For those businesses that are expected to be sold as part of the strategic portfolio management programme, the Audit Committee reviewed the recoverable value on the basis of expected sale price less costs to sell, whereas for those portfolio businesses that are expected to be closed, goodwill was impaired fully and the recoverable value of the assets was considered.

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.

Conclusion

The committee was satisfied with the carrying value of goodwill and related disclosures as at 31 December 2016.

TAXATION

Description

The Group operates in around 100 countries and is therefore subject to numerous reviews by individual tax authorities in the ordinary course of business. In some instances, these may result in claims being raised by those 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, where necessary, 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 2016, total deferred tax assets were £285m (2015: £187m). 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.

Action taken

The Audit Committee reviewed the Group's approach to taxation and confirmed that the Group operates under the tax policy approved by the committee in 2015, which complies with the UK Confederation of British Industry 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 risks 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 would be recovered and made enquiries of the external auditor on the appropriateness of the Group's tax position.

The committee considered the Group's enhanced disclosures, recognising that the FRC has undertaken a thematic review in this area during the year.

Conclusion

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

RISK OF ACCOUNTING ERRORS AND MANAGEMENT OVERRIDE OF INTERNAL CONTROLS

Description

The Group operates in around 100 countries and has around 650 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 execution of the controls. As set out on page 51, the Group has adopted a three lines of defence model to control and manage risks across the Group.

Over the course of the last three years the Group has made significant investment in strengthening capability in finance, internal audit and risk and 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 reviewed and approved the internal audit plan for the year as well as the updated financial controls framework rolled out in 2016. The committee received regular updates on the overall control environment of the Group, including progress made on the implementation of the updated financial controls, results of internal audits, training and up-skilling of capabilities across the Group, as well as the regular reports from the external auditor and the output of the whistleblowing process.

The committee confirmed in particular that controls had been strengthened to minimise the risk of re-occurrence of control failures that required the restatement of the 2014 annual results and balance sheet in the 2015 annual report and considered progress made to reduce reliance on manual controls, by developing and integrating financial and operational systems across the Group, covered in further detail by the board.

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 over the next 12 to 24 months.

GOING CONCERN AND LIQUIDITY RISK

Description

The Group has net debt of £1,670 million. The board has set a goal of net debt to EBITDA ratio of <2.5 times over the medium term.

The Group has financial covenants related to its committed bank facilities, and the private loan notes, all of which are subject to one financial covenant based on net debt to EBITDA ratio, measured in accordance with the respective agreements, where net debt to EBITDA should be lower than 3.5 times. Non-compliance with covenants could lead to an acceleration of maturities.

Consideration of whether the Group is a going concern is a fundamental responsibility of the board and the Audit Committee has given this matter its full attention. The going concern assertion has a significant impact on the financial statements in terms of both the valuation of assets and liabilities held and the presentation of assets and liabilities as non-current. The Audit Committee has given due consideration to the guidance issued by the FRC 'Going Concern and Liquidity Risk – guidance for Directors of UK Companies 2009' and its Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014.

Action taken

The committee reviewed the Group's projections of cash flow and net debt, taking into account reasonable risk sensitivities, as well as the financing facilities and funds available to the Group.

The committee also reviewed compliance with covenants, the availability of headroom in relation to those covenants, reasonable downside scenarios considering the risk profile of the Group, as well as the going concern assumptions in the context of the three-year viability statement included on page 55.

Conclusion

The committee was satisfied that the Group should adopt the going concern basis of accounting in the financial statements and recommended the same to the board.

SPECIFIC ITEMS

Description

The Audit Committee reviewed the treatment of items considered as specific items and therefore requiring separate disclosure to assist the reader in understanding the results of the Group. Management prepared documentation to support these items and the disclosure proposed in the financial statements.

Action taken

The Audit Committee reviewed and challenged, in light of the guidance issued by the FRC in December 2013 and October 2016, the disclosures prepared by management in relation to specific items, considered whether the nature of these items was consistent with the Group's accounting policies that were being applied consistently from year to year and confirmed 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 equally and consistently as specific items, in particular for both top-up and reversal of provisions. The committee noted that the volume of specific items was reduced significantly in 2016 following its establishment of a threshold amount below which onerous contracts and other transactions would no longer be considered for classifications as specific items.

Conclusion

The committee was satisfied that the Group's accounting policy on specific and other separately disclosed items had been applied correctly and that the designation of specific items was subject to objective and balanced criteria, with clear disclosure and explanation of non-recurring items, and was appropriate to give a meaningful and balanced view of the continuing operations of the Group.

Viability statement

As mentioned earlier, the committee's terms of reference were updated during the year to clarify that the committee would provide advice to the board at its request in relation to the viability statement. At the March 2017 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 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.

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 55.

Fair, balanced and understandable

One of the key compliance requirements of a group's financial statements is for the annual report, taken as a whole, to be fair, balanced and understandable. Guidelines on Alternative Performance Measures (APMs) were issued by the European Securities and Markets Authority (ESMA) and have been applicable since July 2016. In addition, the FRC issued a "Frequently Asked Questions" guidance document and published the results of its thematic review on this matter. The committee considered each of the above in assessing whether the Group's annual report was fair, balanced and understandable.

The committee 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 by factual evidence or 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 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 both 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 reviewed progress on the strengthening of internal controls, and on plans to continue progress, which included a targeted audit plan for 2016 from Group Internal Audit for those areas where issues have been identified, such as fair value adjustments in respect of legacy acquisitions in Brazil, and a review of the Group's financial control framework with a view to simplifying it to cover key essential controls to ensure that these are met, along with training programmes and up-skilling capabilities.

The committee also considered the plans being implemented by management to reduce reliance on manual controls, through the gradual implementation and integration of new financial systems.

Further details on internal controls are set out on page 51. The Audit Committee confirmed to the board that it is satisfied that the Group's risk management and internal control processes and procedures are appropriate and effective.

Internal audit

During 2016, the internal audit function spent a significant amount of time reviewing the operational effectiveness and providing training and advice to business units on minimum financial controls in order to prevent recurrence of previous control failures. This included the roll-out of an updated financial controls framework, the completion by business units of self-assessments against these controls based on their local control environment, with review and oversight of progress provided through the Regional Audit Committees. This enabled the identification of areas for improvement and where further training would be useful. Additional follow-up reviews of businesses and areas where improvement was considered to be necessary were carried out.

In 2017 the internal audit team will focus on assessing the effectiveness of a broader set of mandated controls with the goal of focusing local management on the most material control issues specific to their local environment, again with the support of the Regional Audit Committees to assist in driving improvements where appropriate.

External auditor

Following an audit tender process during 2014 PricewaterhouseCoopers LLP (PwC) was appointed the Group's new external auditor for the 2015 financial year. PwC was subsequently re-appointed at the 2016 AGM to hold office until the next AGM. Richard Hughes has been lead audit partner since the beginning of 2015.

During the year, the committee reviewed PwC's Group audit plan and the scope to be undertaken, reviewed their reports on external audit findings with particular focus on the areas set out above, had private sessions with the external auditor both during the year and at the Audit Committee, and approved the fee for the external audit. The committee also considered and approved the representation letter to be issued to the auditor.

Non-audit services

To ensure that the independence of the audit is not compromised, the committee has put 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 outsourcing 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 would require prior approval by the committee. Every year, the Audit Committee reviews its policy on the provision of non-audit services by the external auditor.

During 2016, amendments were made to the non-audit services policy to take account of the FRC's revised Ethical Standard issued in June, which prohibited certain services previously permitted (including the majority of tax services) and limited the pre-approval of other services at a level of fees which would be clearly trivial with effect from 1 January 2017. The auditor, PwC, has written to the Audit Committee confirming that, in its opinion, it was independent for the period through to 28 March 2017.

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.

Effectiveness of the external auditor

A combination of formal and informal processes is used in the assessment of the effectiveness of the external audit process. A formal questionnaire is completed at the end of the audit by members of the Audit Committee, by the group finance department and by the finance directors of significant operations across the Group, and the results of those questionnaires are reviewed by the Audit Committee. The assessment of the external audit for 2016 concluded that it remained effective and that the external auditor is independent.

Regulator's review of our external audit

During the year, the Audit Quality Review (AQR) team from the FRC reviewed the quality of the 2015 audit performed by PwC. The committee discussed the results of that review, which were satisfactory, corroborating the results of the committee's own independent evaluation of PwC which concluded that the external auditor was effective. The committee received a report from PwC detailing how the 2016 audit would address the one finding identified by the AQR team and was satisfied with PwC's planned response.

CMA Order Compliance

The G4S Group audit was put out to tender in 2014, following which PwC were appointed with effect from 2015. The committee thereby confirms that the company has complied with the Audit Services for Large Companies (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2004.

Committee performance

The assessment of the committee's performance, conducted with assistance from Lintstock, concluded that the committee remained effective, in particular in reviewing the quality of the Group's financial reporting. In 2017, we will review the committee's annual cycle of work to ensure appropriate alignment with the board's agenda and the board's induction for new members. We will also review management's plans to sustainably embed controls across the business.