

# Audit Committee report



**Deborah Gudgeon**

Independent Non-Executive Director,  
Chairman of Audit Committee



The role and responsibilities of the Audit Committee are delegated by the Board and set out in the written terms of reference <http://www.evraz.com/governance/directors/committees/>.

Dear shareholders,

I am pleased to present the Audit Committee Report for the financial year ended 31st December 2017.

Once again, I would like to extend the thanks of the Committee to the executive and financial management of the Company, the internal audit department and EY, our external auditor, for their continuing diligence and valued contributions to the work of the Committee.

## Role and Responsibilities of the Audit Committee

The Audit Committee minutes are tabled at the Board meeting for consideration, and the Chairman updates the Board orally on the Committee proceedings, making recommendations on areas covered by its terms of reference if appropriate.

The Audit Committee reviews the Group Risk Register and the Group Risk Appetite proposed by management before they are considered by the Board.

During the year, the Committee members undertook a self-assessment process facilitated by an external organisation, Lintstock LLP, to consider the performance and composition of the Committee, its duties and responsibilities, and access to management. The results of this assessment were judged satisfactory.

The terms of reference for both the Audit Committee and the Risk Management Group were reviewed by the Committee and considered



as appropriate and no changes were deemed necessary.

EVRAZ also confirms its compliance, during the financial year commencing 1 January 2017, with the provisions of the Competition and Markets Authority Order 2014 on mandatory tendering and audit committee responsibilities.

## Committee Members and Attendance

The Audit Committee members are all Independent Non-Executive Directors. The Committee members have a wide range of skills and experience: Deborah Gudgeon has recent and relevant financial experience, and Karl Gruber has extensive sector experience and knowledge. Alexander Izosimov has wide ranging corporate and executive experience. As disclosed in the Corporate Governance Report [page 115](#), Olga Pokrovskaya continues to attend Audit Committee meetings as an observer, providing additional technical expertise and valuable regional expertise.

Senior members of the Group's finance function, the head of Group Internal Audit (who acts as secretary to the Audit Committee and the Risk

Management Group), and the external auditors also attend Committee meetings.

Key members of the management team and Risk Management Group are also invited to attend Committee meetings when appropriate; in 2017, these included the CEO and VP's of Strategy, Steel, IT, Security, Legal, Compliance and Personnel, the CFO of Evraz North America plc (hereinafter "ENA") and the Director of Investor Relations. Other members of the EVRAZ management team and the Internal Audit Function were also invited to attend Committee meetings as appropriate.

The Audit Committee met 9 times during 2017 and 3 times in early 2018 before the publication of this annual report.

Details of committee attendance are set out [on page 115](#).

## Activities and Work of the Committee during 2017

During 2017, the Audit Committee has continued to focus on the integrity of the Group's financial reporting, the related internal control framework and risk management, including finance, operations, regulatory compliance and fraud. These areas were comprehensively reviewed on an ongoing basis and the Committee received regular updates from the Company's financial and operational management, Internal Audit, the Compliance Officer and legal team, as well as the external auditors.

The Committee monitors the IT security of the Group on an ongoing basis including the results of the external audit, mitigation plans and the level of attempted attacks. Following the virus attack in June 2017, the Committee reviewed the implications of and response to the attack, and considered the mitigation plan developed to enhance the resilience of IT security and business continuity across the Group. This will remain an area of focus for the Audit Committee in 2018.

During 2017, the Committee continued to monitor the progress of the financial transformation project and considered the implications for the quality, timeliness and continuity of financial reporting through the

ongoing transition. Following the successful implementation of the initial project, the scope of the Shared Service Centre at Novokutznetzk was extended during 2017 with the migration of transactional activities and procurement back office operations and a pilot project to assess the potential to employ Robotics. The Committee also reviewed the status of the procurement transformation project. Progress on both of these projects will be reviewed on an ongoing basis during 2018.

The Committee reviewed the updated information and disclosure required in support of the Payments to Government filing for 2017 as well as the new disclosures in 2017 in respect of the Modern Slavery Act and Tax Strategy before their approval by the Board.

The Committee continued to monitor the process for capturing, monitoring and approving related party transactions during 2017 together with the accuracy and completeness of the disclosures in the 2017 financial statements.

The Committee reviewed and updated its own terms of reference, the internal audit charter and the Group Financial Reporting Procedures Manual ("FRP"). The effectiveness and status of the anti-corruption policy and sanctions risk compliance controls were reviewed throughout the course of the year, together with progress to meet the governance requirements of the Financial Reporting Council ("FRC") Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. At the request of the Committee, Linklaters LLP have prepared an updated EVRAZ Compliance Manual and worked with management to develop an in-house training programme to ensure compliance with the EU Market Abuse Regulation.

At the request of the Board, the Audit Committee also considered the proforma Viability Statement and supporting analysis produced by management and reviewed by the Risk Management Group.

FRC reviewed EVRAZ's judgements and estimates disclosures in the 2016 financial statements as part of its 2017 thematic review. The review covered only the specific disclosures relating to the thematic review and considered compliance with reporting requirements. The FRC requested clarification in respect of the specific assumptions used to determine certain judgements and estimates, and the sensitivity of some estimates to the assumptions made. As a result of the review, the FRC used certain disclosures from the EVRAZ 2016 financial statements as examples of better practice in the Thematic Review Judgements and Estimates published on 9 November 2017 and certain disclosures including those in respect of PP&E and mineral reserves have been refined in the 2017 financial statements.

## Significant Financial Reporting Issues considered by the Audit Committee in 2017

The primary objective of the Audit Committee is to support the Board in ensuring the integrity of the Company's financial statements and annual report including review of:

- compliance with financial reporting standards and governance requirements;
- the material financial areas in which significant accounting judgements have been made;
- the critical accounting policies and substance, consistency and fairness of management estimates;
- the clarity of disclosures; and
- whether the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's performance, business model, strategy, principal risks and uncertainties.

### Financial reporting standards and governance requirements

The full financial statements can be found on pages 142-263.

The Audit Committee considered a number of financial reporting issues in relation to the Interim Results for H1 2017 and the financial statements for 2017. These included the appropriateness of accounting policies adopted, disclosures and of management's estimates and judgements. The Committee considered papers produced by management on the key financial reporting judgements and reviewed reports by the external auditor on the full year and half year results which highlight any significant risks and areas of focus with respect to the audit work.

The financial statements continue to be impacted by fluctuations in the key functional currencies of the business (primarily the Russian rouble and, to a lesser extent, the Ukrainian hryvnia) against the US dollar, the presentation currency of the financial statements, as set out in Note 2. As a result, challenging the consistency and comparability of balances in the financial statements remains difficult but management separate out where appropriate the forex impact on areas of significant judgements and estimates.

The following financial reporting issues are considered significant.

### Going concern (Note 2) and the viability statement

EVRAZ is exposed to a wide range of risks and inherent uncertainties as set out on pages 38-40, many of which are outside the control of the Company. During 2017, growing global demand and supply optimization in China supported positive steel and raw material price growth but markets remain volatile. The Audit Committee reviewed management's going concern analysis which included both a base case and a flexed downside scenario which is based upon forward pricing close to the bottom of the range of current investment analyst forecasts, and a reduced level of budgeted capital expenditure. The Committee carefully considered the projected Use and Sources of Funds for the period to June 2019 which includes scheduled loan repayments, new committed funding, free cash flow after capital expenditure and payments arising from the revised dividend policy. Given the volatility of the current global supply/demand environment in which EVRAZ operates, the Committee again focused on the pessimistic downside case and the implications on free cash flow and compliance with financial covenants.

Following these detailed considerations, the Audit Committee resolved to recommend the going concern basis of preparation for the Financial Statements as at 31 December 2017 to the Board.

The Committee reviewed the analysis supporting the viability statement before it was considered by the Board. The Committee also reviewed the scenarios that might challenge viability, the key assumptions in each scenario and the proposed disclosures in the viability statement.

### Areas of significant accounting judgement and management estimates

Impairment of goodwill and tangible assets (Notes 5 and 6). The Committee considered management's impairment recommendations in the context of the current and future trading environment and the mineral reserves valuation undertaken by IMC during 2017. Testing was undertaken as at 30 September 2017 and reassessed at 31 December 2017 when no further impairment triggers were identified. The continued weakness of the rouble means that the carrying values of Russian cash generating units remain low in US dollar terms and are largely not challenged by the value in use comparisons used to determine impairment, even in a negative pricing environment.

As a result of changes to coal, iron ore and steel price expectations, revised production volumes and improvements to net working capital, there

is an impairment reversal of US\$12 million recorded in the financial statements in 2017. This includes a net charge of US\$19 million in respect of the intangibles and property, plant and equipment of ENA and a specific impairment charge of US\$9 million at Yuzhkuzbassugol to reflect increased site restoration provisions. These charges are offset by a reversal of US\$20 million of the impairment recognised on the idling of Palini e Bertoli, which was restarted in 2016, to reflect a significant improvement to net working capital assumptions and sales mix changes and net reversals of US\$9 million at Rospadskaya and US\$8 million at Evrazruda to reflect updated mine plans. The Audit Committee considered these reversals and concluded that they were appropriate.

### Other matters

There were a number of disposals during 2017 and the Committee reviewed the accounting treatment for each of these, in particular:

- the sale of Evraz Nakhodka Trade Sea Port (“NMTP”) to Lanebrook Limited, the ultimate controlling shareholder of the Group, for a cash consideration of US\$340 million in June 2017. Coterminal with the sale, the Group entered into a five year agreement with NMTP to transship specified volumes of the Group’s coal and metals. US\$8 million of the consideration was recognized as relating to the terms of the transshipment agreement and has been treated as deferred income in the financial statements and is being amortized over the five year agreement, reducing shipping costs; and
- the sale of Evraz Yuzhkoks completed on 19th December 2017 with consolidation of this entity ceasing from that date. A loss of US\$91 million was recognized on the sale, including US\$132 million of cumulative exchange losses reclassified from other comprehensive income to statement of operations.

The Committee considered the implications of the US Tax Reform Bill (Tax Cuts and Jobs Act) passed in December 2017 for ENA, including whether historic deferred tax assets and intra-group interest would be tax deductible. Management’s treatment and disclosure were reviewed and agreed.

## Fair, balanced and understandable

In considering whether the annual report is fair, balanced and understandable, the Committee reviewed the information it had received, discussions held with management throughout the year and the preparation process adopted. Management agreed the key overall messages of the annual report at an early stage to ensure

a consistent message in both the narrative and financial reporting. Regular meetings were held to review the draft annual report and for management and Committee members to provide comments, and detailed review of the appropriate draft sections were undertaken by the relevant Directors and external advisers. The Committee particularly considered whether the description of the business, principal risks and uncertainties, strategy and objectives was consistent with the understanding of the Board, and whether the controls over the consistency and accuracy of the information presented in the annual report are robust.

Taking into account the disclosure implications of the issues discussed in this report, the Committee recommended to the Board that, taken as a whole, it considers the annual report to be fair, balanced and understandable. The Audit Committee recommended approval of the Group’s 2017 Consolidated Financial Statements by the Board. Both recommendations were accepted by the Board.

## Other Matters

### UK Bribery Act (“UKBA”)

The Committee continues to monitor the status of the procedures, controls and data collection of the Group’s anti-corruption policy and Code of Conduct, including the regulation of interaction with state authorities introduced by the Company in November 2014, and progress in respect of the areas for improvement and implementation identified by the external audit in 2014. A comprehensive framework for annually monitoring compliance with EVRAZ’ anti-corruption policies and identifying risk was developed during 2016 by the compliance, legal and internal audit teams. Using this framework, compliance was tested in late 2017 and the results reported to the Committee in February 2018 indicating further progress in reducing risk. Anti-corruption training continued during 2017 with a further 3,000 managers across the business completing the programme developed by Thomson Reuters. The programme will be continued and extended in 2018. Internal audit also tested the procedure and completeness for maintaining registers of entertainment costs, business gifts, and charitable and sponsorship expenditure at a number of key entities during the year. Based upon the output, the mitigation plan and training programmes will be updated to reflect the increasing maturity of these processes.

### Sanctions Compliance Controls

The Committee receives regular updates from the Group’s external legal advisers and the Compliance Officer on any extension or change to the evolving sanctions framework

and the control processes, procedures and reporting framework are updated regularly to incorporate the latest guidance. These were tested by Internal Audit during the year, along with progress against the recommendations of the Group’s external legal advisers, and found to be satisfactory. There is a process of continuing education of compliance personnel and executive management in relation to sanctions.

## Risk Management and Internal Control

This should be read in conjunction with the Risk Management and Internal Control section on pages 117–119.

EVRAZ has an integrated approach to risk management to ensure that the review and consideration of risks inform the management of the business at all levels, the design of internal controls and internal audit process. The Group’s financial reporting procedures, internal controls, risk management systems and activities are documented in a comprehensive Financial Reporting Procedures Manual (FRP). The manual was updated and reviewed by the Audit Committee in December 2017.

The Risk Management Group attended the Audit Committee in October 2017 and presented the updated Risk Register and their recommendation on the level of Risk Appetite. These were reviewed by the Audit Committee, along with the draft Statement of Principal Risks and Uncertainties to be included in the annual report, prior to the Board’s consideration.

Internal Audit findings on control issues that exceed the Group’s risk appetite are reported to the Board by the Audit Committee and followed up by the Group’s Management Committee and the progress on resolving issues is monitored regularly.

The Audit Committee continues to receive bi-annual updates on whistleblowing reports together with a security report on the progress of follow-up investigations and resulting actions in relation to fraud and theft. Any significant whistleblowing report is reported to the Committee on an ad hoc basis when it arises.

### Assessment of the Group’s risk profile and control environment

Internal Audit reviews the Group’s risk and control environment bi-annually and this is considered by the Risk Management Group and the Audit Committee. In particular, the

Audit Committee considered whether the financial and procurement transformation projects had implications for the risk and control environment.

The Chairman of the Audit Committee tables the Internal Audit report judgement on the risk and control environment to the Board.

Following the cyber-attack in June 2017, the Group extended and accelerated the IT Security Risk Mitigation plan, including a comprehensive timeline of critical measures to be implemented in 2017 and 2018. This mitigation plan is regularly recalibrated to reflect progress already made and new threats identified.

## Internal Audit

The Audit Committee reviewed the internal audit plans for 2018 and recommended certain revisions in view of the macroeconomic environment, risk profile of the business and resources available. The plan was revised to reflect the updated risk analysis and to prioritise key business cycles and controls from a risk perspective. Overall, the Committee considers the current Internal Audit resource to be adequate for the internal control and risk management assurance requirements.

The Audit Committee reviewed and updated the Internal Audit Charter and Key Performance Indicators of the Internal Audit function in early 2018. An annual assessment of the effectiveness, independence and quality of the Internal Audit function was undertaken by way of a questionnaire to Committee members, management and the external auditors. The conclusion was again very satisfactory. An external assessment of the Internal Audit function in the Russian Federation, CIS and Europe was undertaken during 2015 and confirmed that it conformed to the International Standards for the Professional Practice of Internal Auditing, Code of Ethics and Definition of Internal Audit of the Institute of Internal Auditors. An external assessment of the Internal Audit function at ENA will be undertaken during 2018.

The Head of Internal Audit is secretary to both the Audit Committee and Risk Management Group and prepares the minutes.

## External Audit

The Audit Committee is responsible for monitoring the ongoing effectiveness and independence of the external auditor, and making recommendations to the Board with respect to the re-appointment of the auditor.

## Effectiveness and Independence

The Audit Committee has an established framework through which it monitors the effectiveness, independence, objectivity and compliance of the external auditor with ethical, professional and regulatory requirements. These include:

- review and approval of the external audit plan for the interim review and year-end audit, including consideration of the audit scope, key audit risks and audit materiality measures, and compliance with best practice;
- review and approval of the external auditor's engagement letter;
- review of the FRC's Quality Inspection Report June 2017 and EY's response;
- consideration of the external auditor's report on the Interim Review and annual report and Representation Letters; and
- review of the external auditor's management letter on the 2016 audit with management, consideration of management's response and proposed actions, and directing that Internal Audit undertake a follow-up audit of key areas.

Although the 2017 financial reporting timetable was not accelerated compared to 2016, the Audit Committee again considered the implications of the early hard close, acceleration of substantive procedures and year-end roll forward procedures for the external audit process, together with the SAP BCS upgrade at the end of 2017.

Management and members of the Audit Committee also completed a questionnaire to assess the effectiveness and independence of the external audit process in 2016, which was found to be satisfactory.

The Audit Committee holds regular meetings with the external auditor at which management are not present to consider the appropriateness of the Company's accounting policies and audit process. During 2017, the external auditor confirmed that these policies and processes were appropriate. The Committee Chairman also meets the Senior Statutory Auditor regularly outside of Audit Committee meetings.

Engagement of the external auditor for non-audit services is managed in accordance with the Group's policy which can be found on the Company's website: [www.evraz.com](http://www.evraz.com). This policy identifies a range of non-audit services which are prohibited on the basis that they might compromise the independence of the external auditor, and establishes threshold limits for the level of non-audit fees relative to audit fees and authorisation processes for the approval of all audit and non-audit fees. During 2017, non-audit fees totalled US\$272,000 (2016 US\$612,000) and were primarily in relation to capital market transactions, quality assurance reviews and

training related to the finance transformation project. Non-audit fees were 7.5% of the 2017 audit fee of US\$3.6 million compared to 14.7% of the 2016 audit fee. Irrespective of prior approval of the CFO and Audit Committee Chairman, all fees are reported to the Audit Committee for noting and comment. The policy on non-audit services was updated in January 2018 to reflect the latest guidance <http://www.evraz.com/governance/documents/>.

## Re-appointment of the external auditor

Following a tender process undertaken during 2016, the Committee recommended the re-appointment of Ernst & Young LLP ("EY") as external auditor for the years ending 31 December 2017 and 2018. EY was appointed as external auditor of EVRAZ plc in 2011, and the current audit engagement partner, Steven Dobson, assumed the role for the 2016 year end and will continue up to and including the 2020 financial year's audit. The Audit Committee continues to consider EY to be effective and independent in their role as auditor and has provided the Board with its recommendation to the shareholders that EY be re-appointed as external auditor for the year ending 31st December 2018.

The Committee considered the UK Governance Code guidance on re-appointment of the external auditor and the EU legislation on audit regulation together with the performance of EY and recommended that, subject to the agreement of appropriate terms, a further tender to appoint an external auditor be deferred from 2018 to 2019 and potentially to 2021.