



Colin Rutherford Chairman of the Audit Committee

Introduction from the Audit Committee Chairman

I am delighted to present, on behalf of the Board, the report of its Audit Committee for the financial year ended 29 September 2018.

Over the past year we continued to have the benefit of spending valuable time with our Group Risk Director and those key individuals throughout the Group, who collectively provide an appreciation and rigorous insight into how our Group functions and reports. These interactions are extremely valuable and the Committee is grateful for the instruction they provide. These activities also significantly assist towards the promotion and efficient execution of the Committee's oversight role.

Engagement with auditors and third parties

The Committee continued to engage formally, regularly and at an appropriate level of detail with our external auditors, internal auditors (also externally resourced) and other third-party advisers as necessary. This has enabled the Committee to maintain an appropriate understanding of how our auditors and third-party advisers interact with our assurance and risk function. In turn this enabled these essential reporting authorities to provide comprehensive coverage over the whole audit process and has helped augment our Committee's confidence in their respective and collective fieldwork conclusions.

It is also important to note our Committee's role in overseeing the well-considered provision of adequate resources by the Group, towards ensuring that any additional non-audit services required over the year were obtained, where necessary, and in dealing with the increasing role of the Financial Reporting Council (FRC) and its evolving reporting requirements.

Effectiveness of internal controls and Group assurance and risk function

The above efforts provided the Committee with a clear and detailed understanding of the principal operations at all levels over the year. The Committee continued to focus on challenging the effectiveness of the Group's internal controls, the robustness of the Group Assurance and Risk Management processes and in assessing the importance of, and acting as required upon, all reported information received from our external and internal auditors and third-party advisers.

We remain committed to maintaining an open and constructive dialogue with our shareholders on audit matters. Therefore, if you have any comments or questions on any element of the report, please email myself, care of Adrian Brannan, Group Risk Director, at company.secretariat@mbplc.com

Membership and remit of the Audit Committee

The main purpose of the Audit Committee is to review and maintain oversight of Mitchells & Butlers' corporate governance, particularly with respect to financial reporting, internal control and risk management. The Audit Committee's responsibilities also include:

- reviewing the processes for detecting fraud, misconduct and internal control weaknesses;
- reviewing the effectiveness of the Group Assurance function; and
- overseeing the relationship with the external and internal auditors.

At the date of the Annual Report, the Audit Committee comprises four independent Non-Executive Directors: Colin Rutherford (Chair), Imelda Walsh, Stewart Gilliland and Dave Coplin, and two further Non-Executive Directors nominated by substantial shareholders, Ron Robson and Eddie Irwin. In accordance with Code provision C.3.1 the Board considers that Colin Rutherford has significant, recent and relevant financial experience. Biographies of all of the members of the Audit Committee, including a summary of their respective experience, appear on pages 48 and 49.

Following the appointment of three Independent Non-Executive Directors in April and May 2013, Committee members were appointed with effect from 11 July 2013, and revised terms of reference were established, in order to comply with Code requirements. Those terms of reference are reviewed by the Committee annually.

The Audit Committee continued to meet quarterly during FY 2018. In each case, appropriate papers were distributed to the Committee members and other invited attendees, including, where and to the extent appropriate, representatives of the external audit firm and the internal Group Assurance function.

When appropriate, the Audit Committee augments the skills and experience of its members with advice from internal and external audit professionals, for example, on matters such as developments in financial reporting. Audit Committee meetings are also attended, by invitation, by other members of the Board including the Chairman, the Chief Executive and the Finance Director, the Company Secretary and General Counsel, the Group Risk Director and representatives of the external auditor, Deloitte LLP. The Audit Committee also meets privately not less than twice a year, without any member of management present, in relation to audit matters, with the external auditor.

The remuneration of the members of the Audit Committee is set out in the Report on Directors' remuneration on page 80.

Summary terms of reference

A copy of the Audit Committee's terms of reference is publicly available within the Investor section of the Company's website: www.mbplc.com/pdf/audit_committee_terms.pdf

The Audit Committee's terms of reference were approved by the Committee and adopted by the plc Board in 2013. Those terms of reference specifically provide that they will be reviewed annually. They have been reviewed and updated as appropriate each year since and no changes were felt to be needed in FY 2018. At the time of re-adoption of the Company's Corporate Governance Compliance Statement in July 2016, as updated to reflect changes required to give effect to the introduction of the Market Abuse Regulation (MAR), any changes to the Company's governance arrangements to reflect the requirements of MAR were introduced. Other than those MAR-related amendments, which related to consequential changes to regulatory references (e.g. the UKLA's Disclosure and Transparency Rules are now known as the Disclosure Guidance and Transparency Rules), there have been no material changes to these Terms of Reference since the last review in 2015. Accordingly, in FY 2018 no material changes were made to the terms of reference of the Audit Committee, and the work of the Audit Committee is kept under review with the expectation that any such matters which come to light are included in the review scheduled for FY 2019.

The Audit Committee is authorised by the Board to review any activity within the business. It is authorised to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to co-operate with any request made by the Audit Committee.

The Audit Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice and secure the attendance of outsiders with relevant experience and expertise, if it considers this necessary.

The Chair of the Audit Committee reports to the subsequent Board meeting on the Committee's work and the Board receives a copy of the minutes of each meeting.

The role and responsibilities of the Audit Committee are to:

- review the Company's public statements on internal control, risk management and corporate governance compliance;
- review the Company's processes for detecting fraud, misconduct and control weaknesses and to consider the Company's response to any such occurrence;
- review management's evaluation of any change in internal controls over financial reporting;
- review with management and the auditor, Company financial statements required under UK legislation before submission to the Board;
- establish, review and maintain the role and effectiveness of the internal audit function, known as Group Assurance, whose objective is to provide independent assurance over the Group's significant processes and controls, including those in respect of the Group's key risks;
- assume direct responsibility for the appointment, compensation, resignation, dismissal and the overseeing of the auditor, including review of the external audit, its cost and effectiveness;
- pre-approve non-audit work to be carried out by the external auditor and the fees to be paid for that work together with the monitoring of the external auditor's independence;

- oversee the process for dealing with complaints received by the Group regarding accounting, internal accounting controls or auditing matters and any confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters; and
- adopt and oversee a specific Code of Ethics for all corporate employees which is consistent with the Company's overall statement of business ethics.

Key activities of the Audit Committee

Audit matters are reviewed at quarterly Audit Committee meetings throughout the year at which detailed reports are presented for review. The Audit Committee commissions reports from external advisers, the Group Risk Director or Company management, either after consideration of the Company's major risks or in response to developing issues. During the year, in order to fulfil the roles and responsibilities of the Audit Committee, the following matters were considered:

- the suitability of the Group's accounting policies and practices;
- half year and full year financial results;
- the scope and cost of the external audit;
- the auditor's half year and full year reports;
- reappointment and evaluation of the performance of the auditor, including recommendations to the Board, for approval by shareholders, on the reappointment of the Company's auditor and on the approval of fees and terms of engagement;
- non-audit work carried out by the auditor and trends in the non-audit fees in accordance with the Committee's policy to ensure the safeguarding of audit independence;
- the co-ordination of the activities and the work programmes of the internal and external audit functions;
- the arrangements in respect of Group Assurance including its resourcing, external support, the scope of the annual internal audit plan for FY 2018 regarding the level of achievement and the scope of the annual internal audit plan for FY 2019;
- periodic internal control and assurance reports from Group Assurance;
- the Group's risk management framework for the identification and control of major risks, its risk and assurance mitigation plan and the annual assessment of effectiveness of controls;
- compliance with the Company's Code of Ethics;
- corporate governance developments;
- the status of material litigation involving the Group; and
- reports on allegations made via the Group's whistleblowing procedures and the effectiveness of these procedures including a summary of reports received during FY 2018.

Disclosure of significant issues considered

The Audit Committee has reviewed the key judgements applied in the preparation of the consolidated financial statements, which are described in the relevant accounting policies and detailed notes to the financial statements on pages 92 to 147.

The Audit Committee's review included consideration of the following key accounting judgements:

- Property, plant and equipment valuation – the assumptions used by management to value the long leasehold and freehold estate including estimated fair maintainable trading levels, brand multiples and use of spot valuations to ensure a consistent valuation methodology is in place. Short leasehold buildings, unlicensed land and buildings and fixtures, fittings and equipment are held at cost less depreciation and impairment. The revaluation methodology is determined by using management judgement, with advice taken from third-party valuers;
- Valuation of onerous lease provisions – determination of whether a loss is unavoidable requires areas of judgement which include consideration of potential future investment decisions, local conditions which may be impacting on current performance and the opportunity to surrender a lease back to the landlord;
- Pension deficit – the pension liability is sensitive to the actuarial assumptions applied in measuring future cash outflows. The use of assumptions such as the discount rate and inflation which have an impact on the valuation of the defined benefit pension scheme has been assessed by the Audit Committee. The most significant criteria considered for the selection of bonds include the rating of the bonds and the currency and estimated term of the retirement benefit liabilities. Management have used judgement to determine the applicable rate of inflation to apply to pension increases in calculating the defined benefit obligation;
- Covenants – the headroom on the covenants within the securitised estate, together with an evaluation of the mitigating options available to management (to ensure there is reasonable assurance that should a covenant be close to being breached, management have further actions that could be undertaken to prevent such a breach occurring), have been reviewed in detail by management and assessed by the Audit Committee; and
- Separately disclosed items – judgement is used to determine those items which should be separately disclosed to allow a better understanding of the adjusted trading performance of the Group. This judgement includes assessment of whether an item is of sufficient size or of a nature that is not consistent with normal trading activities.

Effectiveness of internal audit

The Audit Committee is responsible for monitoring and reviewing the effectiveness of the Company's internal audit function. The Audit Committee meets regularly with management and with the Group Risk Director and the internal auditor, to review the effectiveness of internal controls and risk management and receives reports from the Group Risk Director on a quarterly basis.

The annual internal audit plan is approved by the Audit Committee and kept under review on a monthly basis, by the Group Risk Director, in order to reflect the changing business needs and to ensure new and emerging risks are considered. The Audit Committee is informed of any amendments made to the audit plan on a quarterly basis. The FY 2018 internal audit plan was developed through a review of formal risk assessments (in conjunction with the Risk Committee and the Group's Executive Committee) together with consideration of the Group's key business processes and functions that could be subject to audit. A similar approach has been employed in relation to the FY 2019 internal audit plan.

The principal objectives of the internal audit plan for FY 2018 were, and remain for FY 2019:

- to provide confidence that existing and emerging key risks are being managed effectively;
- to confirm that controls over core business functions and processes are operating as intended ('core assurance'); and
- to confirm that major projects and significant business change programmes are being adequately controlled.

During FY 2018, 17 audit reports were issued by the Group Assurance function and reviewed by the Board or the Audit Committee. Internal audit recommendations are closely monitored through to closure via a web-based recommendation tracking system, introduced in FY 2013 and updated in FY 2018, which has significantly improved the overall monitoring of internal audit recommendations to ensure these are successfully implemented in a timely manner. A summary of the status of the implementation of internal audit recommendations is made monthly to the Executive Committee and quarterly to the Audit Committee.

In FY 2018, a comprehensive tender process was undertaken regarding the co-sourced Group Assurance function. PwC were successfully re-appointed based upon overall merit and quality of the team, to provide Group Assurance audit services to M&B for a further two-years.

Risk management framework

As disclosed in the 'Risk and uncertainties' section on pages 38 to 42 the Risk Committee continues to meet on a quarterly basis to review the key risks facing the business. Membership of the Risk Committee, which includes representation from each of the key business functions, is detailed below:

- Company Secretary and General Counsel (Chairman)
- Group Finance Director
- Commercial and Marketing Director
- Divisional Director (Operations)
- Group HR Director
- Director of Business Change & Technology
- Group Risk Director
- Head of Legal

Key risks identified are reviewed and assessed on a quarterly basis in terms of their likelihood and impact, within the Group's 'Key Risk Heat Map', in conjunction with associated risk mitigation plans. In addition, the Risk Committee review includes an assessment of the material relevance of emerging risks and the continued relevance of previously identified risks. During FY 2018, Risk Committee meetings continued to include a cross-functional, detailed review of the Group's key risks. This process, which was introduced in FY 2016, continues to prove to be effective and adds value to the continued development and progression of the Group's approach to evaluating new and existing risks, supported by robust mitigation plans.

Actions arising from Risk Committee meetings are followed up by the Group Risk Director. The Audit Committee reviews the Risk Committee minutes, in addition to undertaking a quarterly review of the Group's 'Key Risk Heat Map'.

Confidential reporting

The Group's whistleblowing policy enables staff, in confidence, to raise concerns about possible improprieties in financial and other matters and to do so without fear of reprisal. Details of the policy are set out in the Company's Code of Ethics. The Audit Committee receives quarterly reports on whistleblowing incidents and remains satisfied that the procedures in place are satisfactory to enable independent investigation and follow up action of all matters reported. No major issues have been reported in FY 2018 (major issues being defined for this purpose as matters having a financial impact of greater than £100k).

External auditor appointment

Deloitte LLP was appointed as the auditor in 2011, following a formal tender process. The Audit Committee has considered the guidance in relation to rotation including the proposed transition rules which will be considered when recommending the appointment of the auditor in future years. The most recent audit partner rotation took place in 2016 whereby John Charlton became the lead Audit Partner. The Company has complied throughout the reporting year 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. Under the terms of that Order, the Committee expects to carry out a competitive audit tender by no later than 2020 in respect of the financial year ending in 2021 to ensure the continued objectivity, independence and value for money of the statutory audit. It may choose to do so at an earlier time.

The Audit Committee considers that the relationship with the auditor is working well and is satisfied with its effectiveness and has not considered it necessary to require Deloitte LLP to re-tender for the external audit work. There are no contractual obligations restricting the Company's choice of auditor.

External auditor's independence

The external auditor should not provide non-audit services where it might impair their independence or objectivity to do so. The Audit Committee has established a policy to safeguard the independence and objectivity of the Group's auditor as set out below. That policy has been reviewed in FY 2018 and a copy of it is appended to the Audit Committee's terms of reference and is available on the Company's website. Pursuant to that policy the following services have been pre-approved by the Audit Committee provided that the fees for such services do not exceed in any year more than 70% of the average audit fee paid to that audit firm over the past three years:

- audit services, including work related to the annual Group financial statements, and statutory accounts; and
- certain specified tax services, including tax compliance, tax planning and tax advice.

Acquisition and vendor due-diligence may only be provided if it is specifically approved by the Committee on a case by case basis in advance of the engagement commencing. Any other work for which management wishes to utilise the external auditor must be approved as follows:

- services with fees less than £50,000 may be approved by the Finance Director; and
- engagements with fees over £50,000 fall to be approved by the Audit Committee or its Chair.

The Audit Committee remains confident that the objectivity and independence of the auditor are not in any way impaired by reason of the non-audit services which they provide to the Group.

That policy also includes an extensive list of services which the audit firm may not provide or may only provide in very limited circumstances where the Company and the audit firm agree that there would be no impact on the impartiality of the audit firm. Details of the remuneration paid to the auditor, and the split between audit and non-audit services, are set out in note 2.3 of the financial statements on page 112.

External audit annual assessment

The Audit Committee assesses annually the qualification, expertise, resources and independence of the Group's auditor and the overall effectiveness of the audit process. The Finance Director, Company Secretary and General Counsel, Audit Committee Chairman and Group Risk Director meet with the auditor to discuss the audit, significant risks and any key issues included on the Audit Committee's agenda during the year.

Fair, balanced and understandable statement

One of the key governance requirements of the Group's financial statements is for the report and accounts to be fair, balanced and understandable. Therefore, upon review of the financial statements, the Audit Committee and the Board have confirmed that they are satisfied with the overall fairness, balance and clarity of the Annual Report, which is underpinned by the following:

- formal minutes of the year end working group comprised of relevant internal functional representatives and appropriate external advisers;
- clear guidance being issued to all contributors to ensure a consistent approach; and
- formal review processes at all levels to ensure the Annual Report is factually correct.

Colin Rutherford Chairman of the Audit Committee

21 November 2018

 **The Going Concern and Long-Term Viability Statements** can be found on pages 105 and 42 respectively.