

# Audit and Risk Committee report



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## INTRODUCTION

The Audit and Risk Committee has pleasure in submitting its report for the year ended 31 December 2017 in compliance with section 94(7) of the Companies Act.

The Audit and Risk Committee acts for the Company and all its subsidiaries, and is an independent entity accountable to the Board. It operates within a documented charter and complies with all relevant legislation, regulation and governance codes and executes its duties in terms of the requirements of King IV.

The committee's terms of reference were approved by the Board and are reviewed annually.

## COMPOSITION

The Audit and Risk Committee comprises three non-executive directors, all of whom are independent. Tim Ross is the Chairman and Neo Dongwana and Andrew Thompson are the current members. The CEO, the CFO, the Head of ICT, the Group Risk and Sustainability Manager, a representative of KPMG, the independent Internal Auditor, and a representative of Deloitte & Touche, the independent External Auditor, and other senior managers all attend meetings by invitation.

The committee members are appointed annually by the shareholders at the Annual General Meeting.

## MEETINGS

The Audit and Risk Committee held four meetings during the year. Members attended all meetings of the committee during the year.

## COMMITTEE ACTIVITIES

The Audit and Risk Committee attended to the following during the year:

### External auditors

The committee reviewed the independence of Deloitte & Touche as the Group's external auditor with MH Holme as the independent individual registered auditor who undertook the Group's audit for the current year. The committee considered all information as required by the JSE Listings Requirements in assessing Deloitte & Touche's re-appointment and the registered auditor's appointment.

After considering the below factors and the auditor's tenure, the committee is satisfied that Deloitte & Touche is independent of the Group.

The committee proposes the re-appointment of Deloitte & Touche as External Auditor. Following the mandatory rotation of MH Holme, the committee has proposed SJ Nelson as the new individual registered auditor and shareholders of the Group are requested to vote at the Annual General Meeting.

### Independence of external auditors

This assessment was made after considering the following:

- Confirmation from the external auditors that they, or their immediate family, do not hold any significant direct or indirect financial interest or have any material business relationship with Mpact. The external auditors also confirmed that they have internal monitoring procedures to ensure their independence.
- The auditors do not, other than in their capacity as external auditors or rendering permitted non-audit services, receive any remuneration or other benefits from Mpact.

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- The auditor's independence was not impaired by the non-audit work performed having regard to the quantum of audit fees relative to the total fee base and the nature of the non-audit work undertaken.
- The auditor's independence was not prejudiced as a result of any previous appointment as auditor. In addition, an audit partner rotation process is in place in accordance with the relevant legal and regulatory requirements.
- The criteria specified for independence by the Independent Regulatory Board for Auditors.
- The audit firm and the designated auditor are accredited with the JSE.

The committee confirms that the external auditor has functioned in accordance with its terms of reference for the 2017 financial year.

### External auditor's fees

The committee:

- approved, in consultation with management, the audit fee and engagement terms for the external auditors for the 2017 financial year;
- reviewed and approved the non-audit services fees for the year under review and ensured that the fees were within limit and in line with the non-audit service policy; and
- determined the nature and extent of allowable non-audit services and approved the contract terms for the provision of non-audit services.

### External auditor's performance

The committee:

- reviewed and approved the external audit plan, ensuring that material risk areas were included and that coverage of the significant business processes was acceptable;
- monitored the effectiveness of the external auditors in terms of audit quality and expertise; and
- reviewed the external audit reports and management's response, considered their effect on the financial statements and internal financial control.

### Financial statements

The committee reviewed the interim results and year-end financial statements, including the public announcements of the Group's financial results, and made recommendations to the Board for their approval. In the course of its review, the committee:

- took appropriate steps to ensure that the financial statements were prepared in accordance with IFRS;
- considered the appropriateness of accounting policies and disclosures made;
- in accordance with the JSE Listings Requirements approved the Group financial reporting procedure; and
- completed a detailed review of the going concern assumption, confirming that it was appropriate in the preparation of the financial statements.

The committee was not required to deal with any complaints relating to accounting practices or internal audit, nor to the content or audit of the financial statements, nor internal financial controls and related matters.

### Key audit matters

The figures disclosed in the annual financial statements in certain circumstances are arrived at using judgement. These are explained in detail in the accounting policies. The committee has considered the qualitative and quantitative aspects of the information presented in the statement of financial position and other items that require significant judgement and noted the following:

### Recognition of section 12I allowance on property, plant and equipment

Mpact Operations Proprietary Limited, a major subsidiary of the Group, applied for S12I incentives for its Felixton project. In the prior financial year, management deferred the recognition of the allowance in respect of phase 1 of the project. In the current financial year, the full tax benefit of the S12I incentive allowance has been recognised. The impact on tax amounts to R114.2 million. The committee is satisfied with the work done by the external auditors in assessing the qualifying criteria. This, together with discussions with management, concludes that the qualifying criteria will be met.

### Impairment of Polymers

The Mpact Polymers plant has continued to make losses during the year, with throughput being constrained and targeted production volumes not achieved. The continuation of losses is an indicator of possible impairment of the Mpact Polymers plant. Taking the above into account, the directors have performed an impairment test on the plant as at 31 December 2017. The recoverable amount was determined by calculating the net present value of forecast operating cash flows (discounted cash flows).

In determining the discounted cash flows, a weighted average cost of capital range of between 15.8% and 16.5% was used. The result of the impairment testing reflects no impairment on the Mpack Polymers plant, however, the testing was sensitive to the following variables:

- Growth rate used in the discounted cash flows; and
- Production volumes.

Improvements to the front end of the plant are planned for the current financial year which are expected to significantly increase production volumes. The operating cash flows used in the impairment testing were based on production volumes which represented an achievable capacity utilisation forecast.

The cash flows beyond the five-year forecast were based on production volumes of 21,000 tons which management expects to achieve. The projected cash flows based on the production volumes resulted in the recoverable amount exceeding the cost of PPE.

In assessing the impairment of the plant, the benefit of the unrecognised tax losses were not taken into account. Based on the above, the directors are of the opinion that it is not necessary to impair the plant at Mpack Polymers.

## Goodwill

Goodwill is assessed annually for impairment. Key assumptions used are operating and capital expenditure cash flow projections, growth rates and discount rates. The cash flow projections are approved by senior management. The discount rate is calculated using market information, taking into account the geographic and other risk factors relating to a particular cash-generating unit being assessed. The committee considered the impairment test noting the assumptions used, its sensitivities and the resultant headroom. It is the Committee's opinion that the carrying value of the goodwill is fairly stated. Refer to note 7 of the consolidated annual financial statements.

## Internal audit

The committee:

- Reviewed and approved the existing internal audit charter, which ensures that the Group's internal audit function is independent and has the necessary resources, standing and authority within the organisation to enable it to discharge its duties.
- Satisfied itself of the credibility, independence and objectivity of the internal audit function.
- Ensured that internal audit had direct access to the committee, primarily through the committee's Chairman.
- Reviewed and approved the annual internal audit plan, ensuring that material risk areas were included and that the coverage of significant business processes was acceptable.
- Reviewed the quarterly internal audit reports, covering the effectiveness of internal control, material fraud incidents and material non-compliance with Mpack's policies and procedures. The committee is advised of all internal control developments and advised of any material losses, with none being reported during the year.
- Considered and reviewed with management and internal auditors, any significant findings and management responses thereto in relation to reliable financial reporting, corporate governance and effective internal control to ensure appropriate action is taken.
- The internal audit function provided a written assessment of the effectiveness of the Company's system of internal controls and confirmed that based on the results of work undertaken, they provided reasonable assurance regarding adequacy and effectiveness of systems of internal control.

The committee has reviewed the independence of KPMG and the audit executive of internal audit as the Group's internal auditor and is satisfied with their independence.

## Internal financial control and compliance

The committee:

- Reviewed and approved the existing treasury policy and reviewed the quarterly treasury reports prepared by management.
- Reviewed the quarterly legal and regulatory reports setting out the latest legislative and regulatory developments impacting the Group.
- Reviewed the quarterly report on taxation.
- Reviewed IT reports.
- Considered and, where appropriate, made recommendations on internal financial control.
- Monitored the outsourced internal audit service provided by KPMG internal audit, risk and compliance services.

KPMG performed the internal audit for the year ended 31 December 2017 and provided a written assessment of the effectiveness of Mpack's system of internal controls. A combined assurance model and risk management processes are work in progress. Risk management will be assessed as the function matures.

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## Risk management

Management is regularly developing and enhancing the Group's risk and control procedures to improve the mechanisms for identifying, assessing and monitoring risks given that effective risk management is integral to the Group's objective of consistently adding value to the business. The Board approves strategies and budgets and monitors progress against the budget. It also considers the identified business risks.

Risk management is addressed in the areas of physical and operational risks, human resource risks, technology risks, business continuity and disaster recovery risks, credit and market risks and compliance risks.

The Group has implemented several policies and procedures to manage its governance, operations and information systems with regard to the:

- reliability and integrity of financial and operational information;
- effectiveness and efficiency of operations;
- safeguarding of assets; and
- compliance with laws, regulations and contracts.

The committee assessed the effectiveness of the controls and determined how well management perceived the identified controls. The Likelihood rating tables and Potential Loss Impact Rating were reviewed and approved.

The Risk Management review is available on the website, [www.mpact.co.za](http://www.mpact.co.za). 

## Combined assurance

A combined assurance map was developed by management in collaboration with internal audit and external audit. The mapping was compiled to help understand the level of coverage achieved by each assurance provider in terms of the third level of defence in the Combined Assurance Model. Although the committee approved the Integrated Risk Assurance Framework it is noted that further improvements will be incorporated in the combined assurance map.

## INTEGRATED REPORT

The committee fulfils an oversight role regarding the report and the reporting process. Accordingly, it has:

- considered the Integrated Report and has assessed the consistency with operational, financial and other information known to the Audit and Risk Committee members, and for consistency with the annual financial statements. The committee is satisfied that the Integrated Report is materially accurate, complete and reliable and consistent with the annual financial statements; and
- the committee has, at its meeting held on 1 March 2018, recommended the Integrated Report for the year ended 31 December 2017 to the Board for approval.

## GOVERNANCE

The Board has assigned oversight of the risk management function to the committee, which has an oversight role with respect to financial reporting risks arising from internal financial controls, fraud and IT risks.

In line with the terms of the JSE Listings Requirements, the committee is satisfied that Brett Clark CA(SA) has the appropriate expertise and experience to meet the responsibilities of his appointed position as CFO as required by the JSE.

The committee is satisfied:

- that the resources within the finance function are adequate to provide the necessary support to the CFO; and
- with the expertise and experience of the Group Financial Manager.

In making these assessments, the committee has obtained feedback from the external and internal auditors.

Based on the processes and assurances obtained, the committee believes that the accounting practices are effective.

## ASSURANCE

The Audit and Risk Committee confirmed that they were prudent in exercising their duties of care and skill and they have taken reasonable steps to ensure that they performed their duties in accordance with the mandate.

On behalf of the Audit and Risk Committee

**Tim Ross**

*Audit and Risk Committee Chairman*

6 March 2018