Corporate Governance

Report of the Audit Committee

External review of Audit Committee effectiveness
An external evaluation of the effectiveness of the Audit Committee was carried out as part of the overall Board evaluation process in May 2017 and comprised interviews with the Board, members of Senior Management and the External Audit Partner. The findings of the evaluation confirmed that the Committee does fulfil its Terms of Reference effectively and therefore there were no specific recommendations on how it could improve its effectiveness.

External auditor tender process
BDO LLP has been the Group’s external auditors for 12 years since FY 2006 (following a formal tender). The Company recognises the importance of audit independence and, in consideration of the Code and the associated FRC transition guidelines, as well as to ensure compliance with the Competition & Markets Authority’s Statutory Audit Services for Large Companies Market Investigation Order 2014, put the audit out to tender in FY 2018.

Given the importance of the appointment, the Audit Committee, with assistance from the CFO and finance team, put in place a nine-month process during which to assess the most effective outcome for the business. Consideration of potential audit firms was therefore initiated by the Audit Committee in January 2017, with the scope of the tender set to extend across the entire Petra Group, wherein the participating external audit firms would be required to illustrate their capacity, competency and ability to add significant value in the jurisdictional areas of South Africa, Tanzania, the United Kingdom, Botswana, Belgium, Jersey and the Netherlands.

Further to the initial assessment period, a request for proposal (“RFP”) was sent to a shortlist of three external audit firms considered to have the most relevant expertise suited to Petra’s business. The tender process took place in September 2017, when presentations were made to the Committee by the participating audit firms.

Further to the presentation process, the Audit Committee took time for careful consideration of the proposals in order to assess the appropriate external auditors for Petra. Following this, the Committee recommended the re-appointment of BDO LLP to the Board on 6 October 2017, with BDO LLP deemed most appropriate to service the needs of the Group going forward. This process has coincided with the external partner rotation at BDO and therefore a new partner will be assigned to the Company for FY 2018 onwards.

Committee experience
In light of the publication of the 2016 edition of the UK Corporate Governance Code and the Financial Reporting Council (“FRC”) Guidance on Audit Committees, it is important to specifically address the Committee’s backgrounds and experience. The changes to the Code, which were applicable as at 1 January 2017, prompt me to highlight the significant level of experience present on the Committee as it relates to both audit and Petra’s specific sector of diamond mining – as set out on page 69.

Gordon Hamilton
Chairman of the Audit Committee
14 October 2017

Members of the Audit Committee
Gordon Hamilton (Chairman)
Pat Bartlett
Tony Lowrie
Octavia Matloa

The Audit Committee continued its important work to continually assess whether the Group’s reporting, controls and systems are robust and appropriate to the business.

Dear shareholder,
The Audit Committee (“the Committee”) plays a vital role at Petra by ensuring that the Group has effective and appropriate risk management and internal control systems, backed up by comprehensive financial, governance, internal audit and reporting functions. As Chairman of the Committee, I am pleased to have this opportunity to summarise some of the key developments during the Year, as well as our ongoing responsibilities and objectives.

Whistleblowing policy updates
In line with the Company’s commitment to ethical behaviour and its focus on ensuring compliance with our codes and policies, Petra’s whistleblowing procedure was reviewed by the Committee during the Year. The requirements for appropriate independence in the reporting process and for employees to be fully briefed on steps to be taken if they wish to report a matter or incident were both addressed and the system was accordingly updated. A new external whistleblowing and fraud hotline, which is monitored by the Committee, was activated on 1 March 2017 and employees were fully briefed. Details can be accessed in Petra’s Code of Ethical Conduct and on the Company’s website: www.petradiamonds.com/about-us/corporate-governance/business-ethics.
Committee experience and skill-set

The members of the Audit Committee are considered to possess the appropriate skills and experience to monitor and ensure the integrity of the Group’s financial reporting, internal audit, internal financial control and risk management systems and to support Petra’s governance.

Mr Hamilton, the Chairman of the Committee, fulfils the requirements of the Code with regards to recent and relevant financial experience, having spent more than 30 years as a partner at Deloitte LLP primarily responsible for multinational and FTSE 350-listed company audits in mining and for several South African companies. He is currently chairman of the audit committee for several other companies.

In terms of the Committee members and in line with updated FRC Guidance, Dr Bartlett, as an experienced diamond geologist, possesses a wealth of sector-specific experience relevant to the nature of Petra’s business, Mr Lowrie brings many years of business experience across international banking and financial sectors, and Ms Matloa is a qualified Chartered Accountant who brings highly relevant business and audit experience as she is currently a member of the audit committee for other organisations in South Africa.

New members to the Audit Committee receive the required induction to ensure they are properly equipped to discharge their duties; this includes the standard Board induction process (as set out on page 62), as well as information specific to the Committee such as its Terms of Reference, Internal Audit Charter, previous internal and external auditor reports and Committee meeting minutes. The Committee members receive appropriate ongoing training and development as well as regular updates from the Group’s external auditors on relevant financial reporting, governance and regulatory developments.

The Committee may, if considered necessary, take independent advice at the expense of the Company. Other than BDO LLP, as the external auditors, no other external consultants assisted the Committee during FY 2017.

Committee meetings

Five meetings were held in FY 2017 and the Committee invited the Group Chairman, the Executive Directors and the Group Internal Audit Manager to attend these meetings as appropriate. In addition, the Chairman of the Committee met separately with the BDO LLP Audit Partner on several occasions to discuss significant audit and accounting matters, together with relevant financial reporting and governance developments. The full Committee also met with the Audit Partner without the Executive Directors present during the Year.

The Committee recognises the importance of allocating significant time to fulfil its duties effectively. In advance of each Committee meeting, a formal agenda and information pack is circulated allowing each member time to review the information and prepare for the Committee meetings. During the formal meetings, the members then engage in robust and open debate and assessment of relevant matters.

Mr Hamilton, as Chairman of the Committee, allocates a significant amount of time to this role. In addition to chairing formal meetings of the Committee and attending sessions with the external auditors, Mr Hamilton travelled regularly to Johannesburg during FY 2017 where he was able to meet with the CFO and team, as well as the Group Internal Audit Manager, in order to discuss and monitor the financial controls and audit activities of the Group on a timely basis.

In addition, site visits were arranged for Committee members during the Year to the Group’s various operations, enabling the Chairman and the Committee to uphold a comprehensive understanding of corporate and finance developments and activities, any associated risks, as well as the controls in place at Petra. A site visit was undertaken by Mr Hamilton and Dr Bartlett to all of the South African operations during October 2016 and in August 2017 and Mr Hamilton also accompanied the investor/analyst site visit to Cullinan in February 2017. A site visit by the Full Committee to all of the South African operations took place in October 2017.
## Committee role and activities

The principal functions of the Audit Committee are listed below, along with the corresponding activity and performance in FY 2017.

<table>
<thead>
<tr>
<th>ROLE</th>
<th>ACTIVITIES IN FY 2017</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>To monitor the integrity of the interim and preliminary full year results announcements, as well as the Annual Report and Accounts published by the Company, reviewing significant financial reporting judgements contained therein.</td>
<td>The Committee formally considered the Group's interim results, preliminary full year results and Annual Report and Accounts and considers that they present a fair, balanced and understandable assessment of the Group’s performance and prospects. The Committee, on behalf of the Board, has a specific process of review that enables it to make this assessment, which included a detailed appraisal by each member. The Committee then met with the Executive Directors to discuss any questions and comments.</td>
<td>In accordance with the Code, the Directors consider that the Annual Report and Accounts taken as a whole are fair, balanced and understandable and provides information necessary for shareholders to assess the Company’s performance, business model and strategy.</td>
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<tr>
<td>To review and challenge, where necessary, accounting policies and practices, decisions requiring a major element of judgement, the clarity of disclosures, compliance with accounting standards, and compliance with regulatory and legal requirements.</td>
<td>As part of its work to approve the Group’s Financial Statements, the Committee reviewed the key financial reporting judgements and accounting policies therein. These judgements were assessed through discussions with the Group’s auditors and presentations by Management in which the Committee, where appropriate, challenged the basis for such judgements and estimates. Details of the significant matters considered by the Committee in respect of the FY 2017 Annual Report are set out on page 72.</td>
<td>The Committee considers that the accounting policies used, reporting disclosures, compliance with accounting standards and other requirements are appropriate to the Group in all regards, taking account of the specialised nature of its business.</td>
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<td>To ensure that Petra's risk management systems, internal financial controls and other internal controls are effective.</td>
<td>The Committee assesses the Company’s risk management systems, internal controls and internal financial controls on an ongoing basis. Part of this, the Committee invites the Group Chairman, the Executive Directors and the Group Internal Audit Manager to attend the meetings as appropriate. During these meetings, the Committee was provided with updates on the Group’s activities and the members considered the risk and control implications on an ongoing basis. Additionally, the Board as a whole received presentations and reports by Management on operational and financial performance each quarter that allowed for assessment of risk and internal controls. The Committee meetings during FY 2017 included presentations by BDO LLP regarding the results of the FY 2016 audit, the interim review for H1 FY 2017 and the FY 2017 Audit Committee Planning Report, with a presentation by BDO LLP of the results of the FY 2017 audit subsequent to the Year end. These presentations included the auditors’ observations and recommendations in respect of internal controls that the Committee incorporated into its overall assessment of the effectiveness of risk management and controls.</td>
<td>The Committee considers that Petra’s internal controls, including its financial internal controls, continue to be robust and defensible. The Committee will continue to review and assess the development of risk management and internal control systems, assisted by the work of the Internal Audit team.</td>
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<td>To ensure the Internal Audit function is adequately resourced and effective and is supported by the Committee in its role.</td>
<td>The Internal Audit Charter was reviewed, updated and approved by the Committee in FY 2017. The Committee continued to assess the effectiveness of the Internal Audit team during the Year and to review and develop the Internal Audit Plan as required.</td>
<td>The Group Internal Audit Manager, and supporting team, will continue to work with the Committee to ensure the integrity and effectiveness of the Group’s internal control procedures and risk management systems.</td>
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### Committee role and activities

**ROLE**

To consider the appointment, re-appointment or removal of the external auditors, to recommend the remuneration and terms of engagement of the external auditors and to assess the external auditors' independence and objectivity.

To review the engagement of the external auditors to ensure the provision of non-audit services by the external audit firm does not impair their independence or objectivity.

To give due consideration to relevant laws and regulations, the provisions of the Code and the requirements of the UK Listing Rules.

To review the adequacy of the Company's whistleblowing system, its fraud detection procedures and the systems and controls in place for bribery prevention.

**ACTIVITIES IN FY 2017**

The Committee proposed the re-appointment of BDO LLP to act as auditors for FY 2017, having considered the independence, objectivity, tenure and effectiveness of BDO LLP and the audit process.

In advance of the FY 2017 audit, the Committee reviewed and approved the external auditors' audit planning presentation and assessed the appropriateness of the audit strategy, scoping, materiality and audit risks.

The Committee approved the audit fees as part of the audit planning process. The Committee also reviewed audit related fees in relation to the interim review and comfort letters in relation to the US$650 million loan notes issued during the Year, having considered the FRC's Ethical Standard. The services represented audit related services, which are not considered to create independence threats under the FRC's Ethical Standard.

Details of the Committee's assessment of the auditors' independence and its assessment of their effectiveness are provided on page 73.

The Committee received adequate timely information, briefings and training on all relevant regulatory updates and developments. The Committee as a whole and, on occasion, the Chairman of the Committee met separately with the BDO LLP Audit Partner to discuss significant audit, accounting and governance developments during the Year.

The Committee continues to consider the adequacy of the various policies and systems in place across the Group that cover the whistleblowing system, its fraud detection procedures and the systems and controls in place for bribery prevention.

The Group's whistleblowing procedure was reviewed and updated during the Year, with a new external whistleblowing and fraud hotline being activated in March 2017, and communicated to all employees.

During FY 2017, there were three reported incidents involving fraud that were reported, two of which could not be substantiated. The other matter is currently under investigation, but the amount involved is not considered material to the Company. Further to the outcome of the investigation, the Company will consider whether changes to its system of internal controls are required to limit such events taking place in the future.

In addition, since the inception of the new external whistleblowing hotline on 1 March 2017, Petra received 37 calls and, of these, four reports involving alleged irregularities relating mostly to procurement and illegal substance abuse were considered necessary to investigate. Two of these matters could not be substantiated and investigation into the other two matters is ongoing, but they are not of a material nature.

**OUTCOMES**

The Committee has taken appropriate steps to assess the independence of its auditor recognising the importance of audit independence to the audit process.

The Committee has reviewed and gained a thorough understanding of the external auditors' strategy and has satisfied itself that it is robust and that the auditors remain independent.

The Committee is satisfied that Petra continues to act in accordance with the Code and all relevant laws, regulations and the UK Listing Rules.

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In addition, since the inception of the new external whistleblowing hotline on 1 March 2017, Petra received 37 calls and, of these, four reports involving alleged irregularities relating mostly to procurement and illegal substance abuse were considered necessary to investigate. Two of these matters could not be substantiated and investigation into the other two matters is ongoing, but they are not of a material nature.

### Committee Terms of Reference

The Committee's Terms of Reference were reviewed by the Committee post Year end, and subsequently considered and approved by the Board. They can be accessed at: [www.petradiamonds.com/about-us/corporate-governance/board-committees](http://www.petradiamonds.com/about-us/corporate-governance/board-committees).
### Significant issues considered by the Committee in FY 2017

The following are considered by the Committee to be the significant issues considered by the Committee in respect of the Group's Financial Statements, based upon its interaction with both Management and the external auditors during the Year. These issues align with those disclosed in the Independent Auditors’ Report on pages 105 to 109.

<table>
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<tr>
<th>SIGNIFICANT MATTERS CONSIDERED</th>
<th>OUR RESPONSE TO THESE MATTERS</th>
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<tr>
<td><strong>Going concern and debt facility covenants</strong></td>
<td>The Committee reviewed the covenant waiver received post Year end from the Group’s lenders for the 30 June 2017 covenants and confirmed that the 31 December 2017 covenants were reset in line with the revised covenant ratios.</td>
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<td>During April 2017, the Group issued US$650 million 7.25% loan notes due 2022 as part of a refining of its existing US$300 million loan notes due 2020 and made amendments to its banking facilities. During April 2017, the Group restructured its banking facility covenants for the three covenant measurement periods from June 2017.</td>
<td>The Committee members critically reviewed the forecast cashflow and banking covenant models against forecast Group liquidity requirements and covenants in relation to the banking facilities, particularly considering diamond pricing, exchange rate, project commissioning and production assumptions. The forecasts demonstrated that the Group retained sufficient liquidity; however, the forecasts indicated a likely breach of the banking covenants. Further details are provided in note 11.</td>
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<td>Going concern and covenant compliance remained a risk and area of focus given the delays in the commissioning of the Cullinan plant, the cumulative production issues at the mining operations and the forecast of a covenant breach for the reporting period ending 30 June 2017, in addition to the inherent risks surrounding diamond pricing and foreign exchange rates.</td>
<td>Management presented a sensitivity analysis on liquidity and covenant ratios with due consideration given to potential risk areas (diamond pricing, production, project commissioning and exchange rates), as well as the Group’s capacity to defer capital expenditure.</td>
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<td>Subsequent to the Year end, the Group obtained a covenant waiver for the two EBTDIA covenant tests for the 12-month measurement period to, and as at, 30 June 2017 and reset the two EBTDIA covenant tests for the 12-month measurement period to, and as at, 31 December 2017. However, following the impact of lower production than expected in H2 FY 2017, the impact of Year end labour disruption, and the uncertainties associated with the outlook for the Williamson mine, Management forecasts as at the date of this report indicate that the Group will likely breach the two EBTDIA covenant tests for the 31 December 2017 measurement period – as detailed in note 11.</td>
<td>Management further presented sensitivity analysis on liquidity and covenant ratios for a scenario in which the Group was unable to resume exports and diamond sales receipts at Williamson, including the parcel currently blocked for export – refer to ‘Liquidity and covenants’ in the Financial Review on page 30 for post Year end developments.</td>
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<td>The assumptions in the Group’s financial forecasts and the status of forecast future covenant compliance, mitigating actions available to the Group and appropriateness of the going concern assumption and related disclosures therefore represented an area of significant focus for the Committee.</td>
<td>Having considered the models, risks and sensitivity analysis, the Committee was satisfied that Management’s judgements and forecasts were appropriate.</td>
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<td><strong>Carrying value of mining assets</strong></td>
<td>Given that the Group is forecasting a likely covenant breach of the two EBTDIA covenant tests for the 31 December 2017 measurement period, the Group will likely need to obtain a waiver or reset of covenant ratios before the covenant test date in March 2018. The Committee considered the judgement that the Group would be able to engage with its lender group and obtain such a waiver or reset and retain access to its facilities in the event of such a breach and concluded that the judgement was appropriate having carefully considered all relevant facts and circumstances, including the historical track record in this regard.</td>
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<td>The carrying value of the Williamson and Koffiefontein mining assets were a key focus area for the Committee in FY 2017. At Williamson additional risks arising from recent legislative changes, political uncertainties, the post Year end parliamentary committee review into the Tanzanian diamond industry and the post Year end blocking of a parcel of diamonds due for export placed additional emphasis on the carrying value of the Williamson mining assets. The Year end impairment test showed that headroom at Williamson decreased to 2% using a discount factor of 9.0% (30 June 2016: 81% headroom using a discount rate of 10.0%).</td>
<td>The Committee assessed the disclosures in the Annual Report and Financial Statements with respect of going concern and covenant compliance and concluded that they were appropriate. Refer to note 11 on pages 115 to 116 for further details.</td>
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<td>At Koffiefontein, the headroom has decreased to 10% (30 June 2016: 94%) and additional emphasis was placed on the Group’s ability to meet its Life of Mine plan, given underperformance against budget.</td>
<td></td>
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<td>The impairment tests include significant estimates and judgements and therefore represented a key focus for the Committee, as covered in note 8 on pages 120 to 121.</td>
<td>The Committee reviewed, for all the operations, the sensitivity analysis performed by Management on key parameters and the effect on headroom or potential impairments under various scenarios.</td>
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<tr>
<td>The impairment tests include significant estimates and judgements and therefore represented a key focus for the Committee, as covered in note 8 on pages 120 to 121.</td>
<td>In relation to Williamson, the Committee reviewed post Year end legislative changes, reviewed associated commentary from legal bodies and discussed with Management and the Company’s legal counsel the potential impact of the legislative changes on the Williamson Life of Mine plan and impairment test. This included specific consideration of the impact on costs and the selection of an appropriate discount rate at 30 June 2017 including consideration of the extent to which developments in Tanzania post Year end represented non-adjusting subsequent events. In addition, the Committee confirmed with Management that if a copy of the parliamentary committee report on the Tanzanian diamond industry is received, such copy will be made available to the Committee.</td>
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<td>Each of these areas also represented significant audit risk areas for BDO LLP and, accordingly, the Committee was provided with detailed written and oral presentations by the engagement team on each of these matters. On the basis of their work, BDO LLP reported to the Committee no inconsistencies or misstatements that were material in the context of the Financial Statements as a whole.</td>
<td>At Koffiefontein, the key area considered was the delay in the commissioning and ramp-up of the SLC, which delayed the mining of the new orebody. Extensive consultation with Management was held, focusing on the forecast expenditure for the block cave and challenging the timing and costs thereof. In addition, the Committee reviewed independent diamond pricing estimates and actual production data (FY 2018: July to September 2017) to assess the assumptions used in the FY 2018 budget.</td>
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External auditors

During the Year, the Committee fully considered the effectiveness, objectivity, skills, capacity and independence of BDO LLP as part of their re-appointment, considering all current ethical guidelines, and was satisfied that all these criteria were met. The auditors’ fees were approved as part of this process.

The effectiveness of the external auditors was deliberated, giving consideration to recent FRC guidance on assessing audit quality. The Committee places considerable importance on the following attributes: African mining sector experience (given the specialised nature of the industry), service levels, audit quality, sound auditor judgement, the willingness and ability to challenge Management and provision of value for money.

In forming its assessment of the effectiveness of the audit, prior to the audit the Committee considered the FRC’s Audit Quality Review report on BDO LLP and received formal presentations regarding the proposed audit strategy and the Chairman met separately with the Audit Partner to discuss the audit strategy in detail. These forums enabled the Committee to assess the extent to which the audit strategy was considered to be appropriate for the Group’s activities and addressed the risks the business faces, including factors such as: independence, materiality, the auditors’ risk assessment versus the Committee’s own risk assessment; the extent of the Group auditors’ participation in the subsidiary component audits and the planned audit procedures to mitigate risks.

Following the audit, BDO LLP presented their findings to the Committee and met separately with the Committee Chairman to discuss key audit judgements and estimates. This provided an opportunity to assess the audit work performed, understand how Management’s assessments had been challenged and assess the quality of conclusions drawn.

The Committee also made enquiries of Senior Management to obtain their feedback on the audit process and considered this feedback in its assessment.

Each of the key attributes for audit effectiveness was considered to be appropriately met by the Group’s auditors.

<table>
<thead>
<tr>
<th>Auditors’ remuneration</th>
<th>FY 2017</th>
<th>FY 2016</th>
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<tbody>
<tr>
<td>Audit services¹</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td>Audit related assurance services²</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>1.3</td>
<td>1.0</td>
</tr>
</tbody>
</table>

¹. Audit services are in respect of audit fees for the Group.
². Audit related services are in respect of the interim review (US$0.1 million) plus services in respect of the issue of comfort letters in respect of the issue of the US$650 million loan notes, which were capitalised under non-current loans and borrowings (US$0.3 million).

Non-audit services

The Committee requires that any non-audit services to be performed by BDO LLP are formally approved by the Committee. Audit related services do not require pre-approval and encompass actions necessary to perform an audit, including areas such as internal control testing procedures, providing comfort letters to management and/or underwriters; and performing regulatory audits. BDO LLP provided audit-related services in the Year as set out to the left.

The provision of any non-audit service requires Committee pre-approval and is subject to careful consideration, focused on the extent to which provision of such non-audit service may impact the independence or perceived independence of the auditors. The auditors are required to provide details of their assessment of the independence considerations, as well as measures available to guard against independence threats and to safeguard the audit independence. No non-audit services were provided by BDO LLP during the Year, nor during the prior Year.

Internal controls (including the system of internal financial controls) and risk management

The Board, with assistance from the Committee, is responsible for the Group’s system of internal control and for reviewing its effectiveness. Such a system can only provide reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate those risks that may affect the Company in achieving its business objectives. The Code requires that the effectiveness of the system of internal control be reviewed by the Directors, at least annually, including financial, operational and risk management.

The Group’s Internal Audit function

The Group’s Internal Audit function is staffed by the Group’s Internal Audit Manager, supported by two Senior Internal Audit Managers. The Internal Audit function reports directly to the Committee.

The three-year Internal Audit strategy, approved in FY 2016, and the ‘Findings Register’ are in place to keep track of the periodic Internal Audit follow-up process pertaining to unresolved audit findings. As part of the scope agreed with the Committee, the Internal Audit work plan continues to focus on procurement and payroll-related controls. Any key unresolved findings, where applicable, now also form part of the formal quarterly Internal Audit submission to the Audit Committee. In addition, the FY 2017 Internal Audit Plan was approved by the Committee.

System of internal control

The Committee regularly reviews the adequacy and effectiveness of the Group’s internal control procedures and risk management systems through regular reports from the Group’s Internal Audit, Finance, Operations and Corporate teams, and through consideration of the external auditors’ Audit Committee reports and face to face discussion between the Audit Partner and the Audit Committee Chairman and Committee members.

For FY 2017, the Group Internal Audit Manager and the Committee remained satisfied that no material weaknesses in internal control systems were identified. Whilst being satisfied that controls and risk management remain appropriate for the Group’s activities, the Committee continues to undertake a thorough review and to challenge internal controls, risk management procedures, Internal Audit resourcing and strategy to ensure that its practices develop and remain appropriate. When internal control reviews identified necessary or beneficial improvements, appropriate steps have been taken to ensure the control environment is effective. This includes systems to track Management’s responses to the areas for improvement and subsequent Internal Audit visits to test the implementation.