Audit Committee Report

The Committee's Purpose and Function

Membership, Meetings and Attendance

The membership of the Audit Committee (the Committee), together with appointment dates and attendance at meetings is detailed on page 69 of the Corporate Governance Report.

In accordance with the Code, the Board considers that Julian Heslop has recent and relevant financial experience as a result of his financial background and qualification. In addition, its other two members, Dr Chris Richards and Ishbel Macpherson provide different but specific skills and experience which support the Committee in meeting its objectives as set out in its terms of reference. The biographies of all Committee members are detailed on pages 64 to 65. All members of the Committee are considered to be independent, in line with the Code.

The Company Secretary, Zoe Goulding, also attends each meeting and acts as its secretary. Zoe Goulding assists the Chairman in ensuring that all Committee papers are provided prior to each meeting in a timely manner and provides advice to the Committee on all governance related matters.

The Lead Audit Partner together with the Chief Executive Officer and Chief Financial Officer attend each meeting at the Committee's invitation. Other members of the Board also normally attend each meeting together with the Group Financial Controller.

The Committee has discussions at least twice a year with the external auditor without management being present including the meeting which reviews and endorses the annual results.

Neither the Company nor its Directors have any relationships that impair the external auditor's independence.

Role and Responsibilities

The main role and responsibilities of the Committee are set out in the written terms of reference which are available on the Company website at www.dechra.com. The Board reviewed the Committee's terms of reference during the year and amended them to reflect the updated Code and FRC Guidance on Audit Committees. Further details on the terms of reference are provided on page 72 of the Corporate Governance Report.

Major Activities of the Committee during the year

The Committee met four times since the last Annual Report was issued. The meetings are timed to coincide with the financial reporting timetable of the Company. The Chairman and the Company Secretary have developed an annual programme of business, in order to ensure that standing items are appropriately considered alongside any exceptional matters that may arise during the course of the year. The table below provides an overview of the main matters discussed at the meetings.

Meeting Date	Main Activities
6 December 2013	• Meeting with Deloitte LLP (Deloitte), in their capacity as the newly appointed advisers in respect of the internal risk management and assurance project • Discussion and review of the tax strategy project update including approval of a new tax policy
20 February 2014	• Review of the Group's half-yearly report • Consideration of the Audit Memorandum prepared by the external auditor • Review of the Committee's terms of reference • Review of non-audit fee spend (including actual and projected spend) • Consideration of the progress of the internal risk management and assurance project • Meeting with the external auditor without management present
1 May 2014	• Review of the audit strategy for the year ended 30 June 2014 (including timetable, scope and fees) • Discussion in relation to the Company expectations of the external auditor and audit process • Review of the Anti-Bribery Policy and Company's Whistleblowing Policy • Consideration of the progress of the internal risk management and assurance project • Review of a new treasury policy and recommendation to the Board of its approval • Discussion of the programme of business for 2014/2015

1 September 2014	• Review of the Group's preliminary statement and draft Annual Report (including the Audit Committee Report) for the year ended 30 June 2014
	• Consideration of the Audit Memorandum prepared by the external auditor, including:
	  • review of accounting treatment of non-underlying items
	  • assessment of intangible assets and goodwill
	  • commentary on the general control environment across the Group
	• Review and approval of going concern statement
	• Review of the external audit effectiveness, external auditor independence and level of non-audit fees
	• Meeting with the external auditor without management present
	• Discussion in relation to timetable and process for the external audit tender
	• Fair, balanced and understandable assessment of the Annual Report

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All significant matters under consideration were supported by the appropriate justification paper and fully discussed in order to ensure that due and appropriate consideration was given before any decision was approved or action proposed. Further details in relation to a number of the matters listed are provided below:

- **Financial Judgements**

The Committee reviewed the annual financial statements and, earlier in the year, the half-yearly financial statements. This process included an analysis by management of key judgements made in determining the results over matters such as the carrying value of intangible assets; the Committee reviewed this in detail and endorsed management's judgements.

In reviewing both the annual and half-yearly financial statements the Committee gave particular attention to significant matters where judgement was involved, or which were complex in nature or where adjusted numbers were provided to enhance investors' understanding of the underlying performance. These matters were well supported by briefing papers provided by management and were specifically reviewed and agreed by the external auditor, KPMG, in their reports to the Committee and in related discussions. The key matters so reviewed comprised:

Significant risk considered by the Committee in relation to the financial statements	Corresponding actions taken by the Committee to address the issues
Review of the carrying value of intangible assets and goodwill of £196.2 million which represents 96% of the Group net assets.	The Committee reviewed the analysis provided by management which supported the underlying carrying values. Special attention was paid to the assumptions relating to future growth rates in the context of current underlying performance including the impact and calculation of terminal values. The impact of sensitivity analysis was also considered where relevant. In addition, the Committee focused on the expected longevity of the intangible assets. It also reviewed the discount rates used.

Significant judgements considered by the Committee in relation to the financial statements	Corresponding actions taken by the Committee to address the issues
Reporting of the impact of the completion of the disposal of the Services Segment in August 2013.	The disposal of the Services Segment gave rise to a post-tax profit on disposal of £38.6 million. The Committee reviewed the basis supporting this calculation including tax clearances received from HMRC and supporting audit work carried out by KPMG.
Review of the corporate tax rate on underlying continuing operations for the year of 20.1% (2013: 24.1%) following the disposal of the Services Segment and a strategic review carried out by Deloitte.	The detailed review of the Group's tax position and strategy moving forward, which was undertaken by Deloitte, was reviewed. The Committee discussed the key recommendations and risks in respect of corporate tax and considered KPMG's audit work and conclusions.
In order to assist investors with a better understanding of the underlying performance of the business, management present within the financial statements figures for underlying profit and earnings. This is reconciled to the figures provided in the financial statements and excludes matters such as intangible amortisation, profit on business disposal and acquisition related restructuring costs.	The Committee reviewed the basis for calculating the underlying figures and its consistency with previous year's figures. It also sought confirmation from the external auditor that they were satisfied with the accuracy of these figures.

- **Going Concern**

The Committee reviewed management's forecasts for profit, cash flow and net debt and the committed financing facilities available to the Group. Based on this, it concluded that it was appropriate to use the going concern principle for Group reporting. Further detail in relation to this is provided on page 75 of the Corporate Governance Report.

- **Fair, Balanced and Understandable Assessment of the Annual Report**

At the request of the Board, the Committee considered whether the 2014 Annual Report was fair, balanced and understandable and whether it provided the necessary information for shareholders to assess Dechra's performance (pages 38 to 49), business model (page 14) and strategy (pages 20 to 22).

The Committee based its assessment on a review of the processes and controls put in place by management. This included the relevant senior management providing the information for their own sections and their confirmation that it was fair, balanced and understandable. In addition, the final draft document was reviewed by members of the Senior Executive Team (SET) which included the Chief Executive Officer and Chief Financial Officer who also concluded that it met the fair, balanced and understandable test.

An integral part of the process was the Committee's final review; other Board members and the external auditor were invited so that issues could be debated and a final assessment made. The external auditor also confirmed that in their opinion the Annual Report was fair, balanced and understandable.

This assessment was carried out by the Committee on 1 September 2014, following which the Committee reported to the Board that it was satisfied that, taken as a whole, the Annual Report is fair, balanced and understandable.

- **Review of Policies and Procedures**

During the year the Committee reviewed the following policies:

- Anti-Bribery and Whistleblowing:
  The Committee reviewed the current documentation, as circulated to all employees within the Group, and noted that no further changes were required. The Company Secretary has ensured that the Committee is updated on a regular basis in respect of the ongoing training and monitoring of the policies across the Group. In respect of the whistleblowing policy, the Committee reviewed the process in place to report issues and to follow up on them.

- Treasury:
  An updated policy was discussed by the Committee. The document establishes clear responsibilities for the treasury operations of Dechra. In particular the policy defines what matters are reserved for the Board.

- Tax:
  The Committee reviewed and approved the tax policy which sets out the standards the Board applies in respect of the management of taxes and the governance it employs to ensure those standards are embedded throughout the global business. In particular, the tax policy governs how significant decisions in respect of tax are made and the circumstances which require Board approval.

Internal Financial Controls

The Board retains overall responsibility for establishing the systems of internal control and monitoring their ongoing effectiveness and also for the identification and management of risk. The Committee monitors and reviews the effectiveness of the Group's internal financial control activities and the requirement for an internal audit function. Further details in respect of the internal controls are provided within the Corporate Governance Report on pages 76 to 77.

Following the acquisition of *Eurovet* in 2012, the Committee agreed that the Group was of sufficient size and complexity to warrant the appointment of an internal audit function. The Committee commenced discussions in relation to the role specification in August 2012. However, following the resignation of the then Group Finance Director it was agreed that the discussions and subsequent recruitment be placed on hold until the new Chief Financial Officer, Anne-Francoise Nesmes, had taken up her role with the Company. Following Anne-Francoise's appointment, the Committee revisited the necessity for an internal audit function and agreed that the best approach was to seek tender invitations from a number of accountancy firms (excluding the external auditor) for a review of Dechra's existing enterprise risk management and internal financial controls and for an assessment of the resourcing of the internal audit and risk assurance function.

Following a successful proposal and presentation, Deloitte were appointed to the role. The project commenced in January 2014:

(i) Assessment of the Risk Management Process:
Deloitte carried out preliminary interviews with the risk owners from each Operating Segment and Head Office with a view to gaining an insight into their perceptions of the key risks and the current risk management framework. Following these interviews a risk workshop was attended by the SET which resulted in the validation of the existing risks and the identification of a number of new risks. From within the SET, owners have been identified to take responsibility for each of these risks and the matter will remain as a standing agenda item for all SET meetings going forward. In addition, each SET member is scheduled to present to the Board, on a rolling annual basis, to discuss strategic progress and risk management within their function.

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(ii) Review of Internal Financial Controls:
To date, Deloitte have carried out a review of the existing internal financial controls of each Operating Segment. This has comprised site visits to each of the finance functions including Head Office. Deloitte interviewed all relevant members of the finance teams in order to ascertain the key judgemental and complex areas within the accounts and identify the main areas of risk. Deloitte documented the existing controls and recommended specific actions to improve the control environment. The results of these reviews have been presented to the Committee throughout the process. Management are now working to embed these recommendations across the Group. The Committee is reviewing progress on a regular basis.

Finally the Committee reviewed the overall assessment of the Group's internal financial controls at its meeting on 1 September 2014. It concluded that there was reasonable assurance that internal financial controls operated effectively as referred to on pages 76 to 77 of the Corporate Governance Report. The Committee also reviewed at that meeting the proposal on how to resource the internal audit and risk assurance function going forward. Further detail will be provided in next year's Committee Report.

External Auditor

Audit Plan

KPMG agreed their audit plan with the Committee which included their audit scope, key audit risk areas and materiality. The Committee discussed the audit plan with KPMG and approved it together with the fees proposed.

Independence, effectiveness and objectivity of the audit process

The Committee reviews the independence, effectiveness and objectivity of KPMG each year based on:

- its own assessment of the quality of the audit plan, the rigour of the audit findings and conclusions and the extent to which the Lead Audit Partner understands and constructively challenges management;
- the results of a specific questionnaire on external auditor effectiveness and efficiency (further detail on which is provided below);
- a report prepared by KPMG setting out its processes to ensure independence and its confirmation of compliance with them;
- the level of non-audit fees as a percentage of the audit and half-yearly review fees paid to the external auditor, which were 52.4% (2013: 127.6%).

As stated above, a specific questionnaire has been formulated for completion by all finance directors across the Group who provided information and assistance to the external auditor. The questionnaire covered a number of areas, including:

- Quality of the audit team;
- Knowledge and understanding of the Group;
- Appropriateness of the areas of audit focus;
- Interaction with audit specialists; and
- Timeliness and adequacy of communication by the external auditor.

The results of the questionnaire were reported to the Committee at the meeting on 1 September 2014.

Based on the review set out above the Committee remains satisfied of the external auditor's independence, effectiveness and objectivity.

Re-appointment of External Auditor

At the forthcoming Annual General Meeting a resolution to appoint KPMG LLP as the external auditor and to authorise the Directors to set their remuneration will be proposed.

There are no contractual obligations that restrict the Committee's capacity to recommend a particular firm as external auditor and Dechra does not provide an indemnity to the external auditor.

External Audit Engagement Director Rotation

In line with the ethical standards of the Audit Practices Board the Lead Audit Partner is rotated every five years. The current Lead Audit Partner was appointed during the 2011 financial year and consequently will stand down following the completion of the audit of the 2015 financial results.

External Audit Firm Tendering

KPMG (as KPMG Audit Plc and latterly as KPMG LLP) has been appointed as the external auditor since the Company's formation in 1997 and their performance has been reviewed annually by the Committee since that time. The Committee has remained consistently satisfied with the level of independence of the external auditor and the integrity of the external audit process. However, the Committee is aware of the recommendations in the Code in relation to the expectation that the external audit is put out to tender every ten years. Therefore, as reported in the 2013 Annual Report, the Committee will undertake a tender process over the next nine months in line with the rotation of the Lead Audit Partner. This timing will allow the successful audit firm (not disallowing for the fact that this could be the incumbent firm) to take up its appointment when the current Lead Audit Partner stands down.

Non-Audit Assignments

With respect to non-audit assignments undertaken by the external auditor, the Company has a policy of ensuring that the provision of such services does not impair their independence or objectivity.

Prior approval of the Committee is required before the external auditor is appointed to carry out non-audit work and the rationale for doing so is provided to the Committee, which assess the qualification, expertise, independence and objectivity of the external auditor prior to granting approval. As such, non-audit fee expenditure is a standing item on the agenda for every Committee meeting.

The Committee firmly believes that there are certain non-audit services where it is appropriate for the Group to engage the external auditor. During the year, the external auditor was commissioned to carry out due diligence work in respect of the acquisition and assets of PSPC Inc. The external auditor was considered the most cost effective and appropriate firm to perform this work given their detailed knowledge of Dechra's business. In such cases safeguards are in place to ensure continued external auditor independence including the use of separate teams to undertake the non-audit work separately from the audit work. The Committee did not consider that the performance of this non-audit work would affect or impair the external auditor's integrity. This is consistent with the ethical standard published by the Accounting Practices Board.

The result of this policy is that:

(i) Deloitte was appointed in 2012 to undertake global tax compliance work in substitution for the external auditor and has subsequently been appointed during the year to undertake (a) a strategic tax review for the Group and (b) an enterprise risk management and internal financial controls project;

(ii) KPMG were prohibited from tendering for both the enterprise risk management and internal controls project and the global tax compliance work; and

(iii) during the course of the year Deloitte and PwC have been appointed to provide advice on employment and related tax advice.

A summary of audit and non-audit fees in relation to the year is provided in note 6 to the Group's financial statements. This shows that non-audit work represented 52.4% (2013: 127.6%) of the annual audit and half-yearly review fee, and reflects the policy set out above.