

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

<https://www.evraz.com/en/company/governance/policies/#reference>

Dear shareholders,

I am pleased to present the Audit Committee Report for the financial year ended 31 December 2019.

As part of the Group's efforts to increase engagement across the business, the Audit Committee held one of its meetings at EVRAZ Pueblo during 2019 and we plan to meet at another operation during 2020. In addition, I visited the Group's steel mills at EVRAZ NTMK and the iron ore operations at Kachkanar.

Once again, I would like to extend the thanks of the Committee to the executive and financial management of the Group, 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 Board meetings 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's risk register and risk appetite proposed by management before they are considered by the Board.

The Committee reviewed and updated its terms of reference in November 2019.

I confirm on behalf of the Company its compliance, during the financial year commencing 1 January 2019, 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 Alexander Izosimov provides key strategic experience. Laurie Argo has extensive commercial and financial experience in the North American market. As disclosed in the Corporate Governance Report on page 114, Olga Pokrovskaya continues to attend Audit Committee meetings as an observer, providing additional technical expertise and valuable regional knowledge.

Senior members of the Group's finance function, the head of internal audit (who acts as secretary to the Audit Committee and 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 2019, these included the CEO and vice presidents of strategy, steel, HSE, IT, security, legal, compliance and personnel, the CEO and CFO of EVRAZ North America plc (ENA) and the director of investor relations. Other members of the management team and internal audit function were also invited to attend Committee meetings as appropriate.

The Audit Committee met ten times during 2019 and four times in early 2020 before the publication of this Annual Report. Two of the meetings in 2019 focused on the Group reorganisation as detailed on page 114. Most of the meetings are in person and attended by all the members of the Audit Committee.



Details of committee attendance are set out on page 114.

ACTIVITIES AND WORK OF THE COMMITTEE DURING 2019

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, and the Committee received regular updates from the Group's financial and operational management, internal audit, compliance officer and legal team, as well as the external auditors.

The IT security of the Group was monitored by the Committee on an ongoing basis during 2019, including the results of external audit reviews, mitigation plans and the level of attempted attacks. A new information security assessment of the Russian business was undertaken by EY in November 2019 to test the effectiveness of the updated procedures and risk mitigation actions that had been implemented following the 2017 attack, and concluded that information security has improved. The Committee reviewed the detailed mitigation plan developed by the North American business following the IT

risk assessment undertaken by EY in 2018 and will monitor progress in this area during 2020. Given the significance of IT security to the Group's risk profile and resilience, and the level of digital transformation across the business, this will remain an area of focus for the Audit Committee in 2020 and beyond.

The Audit Committee received regular updates from the vice-president of HSE on the development of the updated health and safety risk management methodology and significant findings from the industrial safety audit team. The new processes will be tested by internal audit in 2020 and the Committee will consider and monitor the mitigation of any findings.

At the request of the Board, the Committee reviewed the reorganisation the group undertook during 2019 to streamline the corporate structure and optimise the capital efficiency of the business Note 3 of separate financial statements on page 241.

In 2019, the Committee also received regular reports on a number of ongoing projects and monitored progress against objectives. These included the finance transformation project initiated in 2018, the procurement contract process and the plan to improve inventory and product shipment controls at one of the plants using innovative technology solutions. The repairs and maintenance transformation project developed by management in 2019 was also considered. These projects will remain an area of focus for the Committee in 2020.

The Committee updated its terms of reference, and undertook a self-assessment to consider its performance. The internal audit charter and the Group's financial reporting procedures (FRP) manual were also considered and updated. 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 requirements of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

At the request of the Board, the Audit Committee reviewed the proforma Viability Statement and supporting analysis

produced by management and reviewed by the Risk Management Group. The Audit Committee considered the scenarios being tested in the context of the updated risk register, the assumptions and mitigating actions underpinning each scenario and the capital required for the effective operation of the business. Capital projects and expenditure are now classified as a principal risk as the Group moves into a major investment cycle. Compliance with trade regulations and sanctions regimes remains a principal risk for the business. As in 2018, the Risk Management Group consider the risk of sanctions being imposed on EVRAZ to be remote and the potential implications difficult to predict in the current environment. The Audit Committee reviewed this position again and agreed with the Risk Management Group. As a result, this scenario has not been modelled as part of the viability analysis in 2019.

SIGNIFICANT FINANCIAL REPORTING ISSUES CONSIDERED BY THE AUDIT COMMITTEE IN 2019

The Audit Committee's primary objective is to support the Board in ensuring the integrity of the Group'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 Group's performance, business model, strategy, principal risks and uncertainties

Financial reporting standards and governance requirements



The full financial statements can be found on pages 156-247.

The Audit Committee considered several financial reporting issues in relation to the interim results for H1 2019 and the financial statements for 2019. These included the appropriateness of accounting policies adopted, disclosures and 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 issues 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) against the US dollar, the presentation currency of the financial statements, as set out in Note 2. As a result, the analysis of balance movements in the financial statements between reporting periods can be difficult although management although management separately reports the forex impact for key movements.

Going concern (Note 2)

EVRAZ is exposed to a wide range of risks and inherent uncertainties as set out on pages 34-39, many of which are outside the control of the Group. Market conditions were challenging in 2019 as steel margins narrowed and global metallurgical and vanadium supply/demand dynamics stabilised but there was a positive trend in pricing and demand in the Group's key markets in the final quarter of the year. The Audit Committee reviewed management's going concern analysis, which included both a base case and a flexed downside scenario based on forward pricing close to the bottom of the range of current investment analyst forecasts, as well as a reduction in the level of budgeted capital expenditure. The current

impact of the COVID – 19 virus outbreak on steel and raw material supply and demand was considered together with the potential longer term implications for the Group's market. The Committee carefully considered the projected use and sources of funds for the period to June 2021, which includes scheduled loan repayments, new committed funding, free cash flow after committed capital expenditure and the dividend policy. Given the volatility of the global supply and demand environment in which EVRAZ operates, the Committee again focused on the pessimistic downside case and the implications for 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 2019 to the Board.

Areas of significant accounting judgement and management estimates

Impairment of goodwill and non-current assets (Notes 5 and 6)

The Committee considered management's impairment assessment in the context of the current and future trading environment for the Group, including assumptions as to the continuation of tariffs and duties in North America and their impact on the recoverable amount of the affected assets. Testing was undertaken as at 30 September 2019 and reassessed at 31 December 2019 when no further impairment triggers were identified. With the exception of large diameter pipes, the recoverable amounts for all cash generating units in 2019 were determined on the basis of their value-in-use. The recoverable amount for large diameter pipes was determined on the basis of fair value less cost of disposal (see below). 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 if the pricing outlook were to deteriorate.

An impairment charge of US\$442 million is recorded in the financial statements for 2019. This primarily relates to the large diameter pipe business in Canada where a goodwill impairment charge of \$300 million has been recorded. This goodwill arose on the acquisition of the business in 2008. The Committee considered the continuing implications of trade barriers and the long term outlook for this business segment, as well as the growth achieved in 2019 and the strong order pipeline for 2020. Given the existence of a recent relevant market transaction, the Committee accepted management's assumption that the value of the large diameter pipeline business be determined on the basis of fair value less cost of disposal and an impairment recognised. During 2019, management decided to postpone the reopening of the MUK-96 mine at Raspadskaya. Given the future uncertainty, the value of the mining assets relating to this mine was re-assessed and a fully impaired, with a charge of \$84 million.

Other matters

The Committee reviewed, challenged and ultimately agreed with the accounting treatment and disclosure of several transactions during 2019, including:

- the sale of property, plant and equipment and inventory of the Yartsevo rolling mill. The Group provided loans to Yartsevo in 2012 ahead of the privatisation of the mill. Due to the continuing bankruptcy proceedings at the mill, an impairment of \$56 million was recognised in the 2019 interim financial statements to reduce the carrying value of this asset to the likely recoverable value from the liquidation. In November 2019, Evraz acquired the property, plant and equipment and inventory of Yartsevo for \$22 million in the bankruptcy auction, the proceeds of which were used to partially repay the creditors of the mill, including Evraz. Upon acquisition, the Yartsevo mill was classified as an asset held for sale. The assets of the Yartsevo mill were subsequently sold to a third party for \$66 million and a gain of \$40 million was recognised upon the disposal. At the moment of the acquisition, the Group did not have any arrangement for the sale of the Yartsevo mill so the purchase and sale arrangements are not treated as linked in the financial statements;

- the new trading agreement for the supply of slab between EVRAZ North America and an independent supplier. Historically, the Group has been the major supplier of slab to the North American business; but to ensure the most competitive pricing and logistic and operational efficiency, management have been purchasing more actively in the market and have entered into an agreement with an independent supplier. This supplier contracts with both the Group as a supplier and ENA as a customer. There is no tri-partite agreement, put or call option which would require consideration of the supply and purchase as one transaction and the supplier carries the full inventory risk with each contract priced separately. On this basis, the contracts for the supply and purchase have been considered separately and no unrealised profit has been recognised by the Group on ENA stock of slab even if some of that slab was produced by other parts of the Group;
- the sales of Stratcor Inc, Evraztrans Ukraine and Palini e Bertoli and the respective gains and losses on disposal as disclosed in Note 12;
- the contract with Xcel Energy Inc for the construction of a solar power plant for the long term supply of electricity to EVRAZ Pueblo on a take-or-pay basis. The solar power plant will be owned and operated by a third party. The contract does not give the Group the right to use or operate the assets and the output will also be sold to unconnected third parties. On this basis, management concluded that this contract does not constitute a lease as defined by IFRS16 (Note 30); and
- the contracts with Air Liquide and Praxair for the long-term supply of oxygen and other gases to the Group's steel operations. As the Group does not control or manage the air separation plant and output will also be sold to unconnected third parties, management has concluded that neither of these contracts constitute a lease (Note 30).

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 on 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 was 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 were 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 should conclude that the Annual Report is fair, balanced and understandable. The Audit Committee recommended approval of the Group's 2019 Consolidated Financial Statements by the Board. Both also recommended were accepted by the Board.

OTHER MATTERS

UK Bribery Act

The Group's Code of Conduct and Anti-Corruption Policy was updated during 2019 as set out on page 103. This was reviewed by the Audit Committee and approved by the Board in December 2019. The existing framework for monitoring compliance with EVRAZ anti-corruption policies and identifying risk was updated early in 2019 by the compliance, legal and internal audit teams to reflect the latest best practice. Using this framework, compliance was tested in late 2019 and the results reported

to the Audit Committee in January 2020. Although the testing indicated further progress in reducing risk, the Committee asked the compliance team to provide further analysis of one specific risk area. Additional anti-corruption policies will be updated in 2020 to reflect best practice and the evolving compliance system.

Anti-corruption training continued during 2019. Further 2,000 managers across the business completed the anti-corruption training programme developed by Thomson Reuters, bringing the total number of those trained to 13,000. The training will be extended to additional staff in 2020 and refresher training will continue. In addition, specific training modules will be developed in-house by management to supplement the Thomson Reuters programme during 2020.

Sanctions compliance controls

Compliance with the extended sanctions regime remained a key focus for the Committee throughout 2019. The Committee received regular updates from the Group's external legal advisers and compliance officer on any extension or change to the evolving sanctions framework. The control processes, procedures and reporting framework are updated regularly to incorporate the latest guidance. There is a process of continuing education for 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 116–117.

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 FRP manual. The manual was updated and reviewed by the Audit Committee in November 2019.

The Risk Management Group and the Audit Committee reviewed the Group's risk profile in November 2019 and finalised the assessment in January 2020. The assessment includes the Risk Management Group's recommendation on the level of risk appetite of the Group and how that appetite is applied to strategic and operational business decisions. This was 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. Progress on the timely and effective resolution of issues is monitored regularly by the Committee.

The Audit Committee continues to receive quarterly updates on whistleblowing reports together with a bi-annual 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 evaluates the overall effectiveness of the Group's governance, risk and control environment annually and this is considered by the Risk Management Group and the Audit Committee. The chairman of the Audit Committee tables the internal audit report assessment of the governance, risk and control environment with the Board.

The Audit Committee monitors the internal control environment throughout the year and engages with management to ensure the resolution of any deficiencies identified by internal audit.

A particular area of focus during 2019 was the mitigation of health and safety risks across the business. The Committee reviewed reports from both internal audit and the industrial safety team on deficiencies and mitigation plans, as well as receiving regular updates from management. The Audit Committee continued to review the information security risks across the business by way of updated annual assessments and consideration of initiatives to mitigate the evolving risk environment. Progress on GDPR compliance, the process to standardise procurement contract documentation and the finance function development plan were also considered. Other areas reviewed were the repairs and maintenance transformation project across the Russian assets and the ongoing project to optimise product inventory and shipment control at one of the plants. The Audit Committee considered whether any of these matters had implications for the risk and control environment of the Group.

INTERNAL AUDIT

The Audit Committee receives quarterly internal audit reports detailing significant findings, progress on the timely and effective resolution of outstanding findings, the status of ad hoc projects and any revisions to the current year audit plan. The internal audit plan for 2020 was reviewed by the Audit Committee and certain revisions were recommended to reflect the updated risk profile of the business 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 January 2020. 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, and was again found to be very satisfactory. A scheduled external assessment of the internal audit function in Russia, the CIS and Europe will be undertaken in 2020.

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, as well as for making recommendations to the Board on 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 July 2019 and EY's response
- Consideration of the external auditor's report on the interim review, annual report and representation letters and
- Review of the external auditor's management letter on the 2018 audit with management, consideration of management's response and proposed actions.

The Audit Committee has monitored the enquiries into the independence of audit firms and effectiveness of the audit process during 2019 and noted the recommendations. The Revised Ethical Standard 2019 issued by the Financial Reporting Council in December 2019 has also been considered. There has been a constructive engagement with the external auditor to determine the implications of these recommendations on the EVRAZ audit process both in current and future years. The Audit Committee will review the process for monitoring the independence and effectiveness

of the external auditor to ensure it reflects the Revised Ethical Standard and finalised guidance from the other reviews.

Management and members of the Audit Committee completed a questionnaire to assess the effectiveness and independence of the 2018 external audit process during 2019, which was found to be satisfactory.

The Audit Committee holds regular meetings with the external auditor at which management is not present to consider the appropriateness of the Group's accounting policies and audit process. During 2019, 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 currently managed in accordance with the Group's policy, which can be found on the website: 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. This policy was updated in January 2019 to reflect the latest guidance and will be further updated in the first quarter of 2020 to reflect the FRC Revised Ethical Standard 2019. During 2019, non-audit fees totalled \$1,178,000 and included \$543,000 in respect of the interim review (2018 \$1,202,000 including \$459,000 in respect of the interim review). The balance in 2019 related to the Eurobond issue in March 2019 (\$330,000) together with a number of assurance projects, ISO 27001 GAP analysis and penetration testing and vendor due diligence services in connection with the sale of Palini e Bertoli Srl. Non-audit fees were 40% of the 2019 audit fee of \$3.0 million, compared with 41% of the 2018 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.

Re-appointment of the external auditor

Following a tender process in 2016, the Committee recommended the re-appointment of Ernst & Young LLP (EY) as external auditor for the years ended 31 December 2017 and 2018. After consideration of the UK Corporate Governance Code, EU legislation on audit regulation and the performance of EY, the Committee recommended in 2017 that, subject to the agreement of appropriate terms, a further tender to appoint an external auditor be deferred to 2021. The Committee has considered the latest regulatory guidance together with the terms agreed with EY in respect of the financial year ended 31 December 2020, as well as the performance of EY, and continues to recommend the deferral of the tender process.

EY was appointed as external auditor of EVRAZ plc in 2011. The current audit engagement partner, Steven Dobson, assumed the role for the year ended 31st December 2016 and will continue up to and including the audit for the year ended 31 December 2020.

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 31 December 2020.