

Audit Committee



Ian Brindle
Chairman of the Audit Committee

Dear Shareholder,

In this Audit Committee report, you will find details of the work of the Audit Committee (“the Committee”) during the year and in particular details of how it has discharged its responsibilities as set out in the UK Corporate Governance Code in respect of the following three principal areas of focus:

- how the significant accounting issues that the Committee has considered in relation to the financial statements for the year have been addressed;
- how the Committee has assessed the effectiveness of the external audit process and the approach that has been taken to the appointment of EY as external auditor; and
- how EY’s objectivity and independence has been safeguarded in relation to their provision of non-audit services.

In addition, during 2013, the Board and the Committee have been briefed on and considerable attention has been given to the recently introduced governance requirements for the Annual Report taken as a whole to be fair balanced and understandable. The Board and Committee understand that ‘fair’ should mean reasonable and impartial, ‘balanced’ should mean even handed in terms of being positive and negative and ‘understandable’ should mean simple, clear and free from jargon or unnecessary clutter.

The Board and Committee consider that the Annual Report for 2013, taken as a whole, is fair, balanced and understandable, with appropriate signposting being made throughout the various sections to assist shareholders and others understand the information and disclosures contained within them.

The Committee’s focus areas for the rest of 2014 are:

- monitoring revenue recognition policy;
- challenging the corporate risk appetite as it moves into new business areas and testing the risk tolerance of the Company’s strategy; and
- assessing the Company’s response to the changing regulations relating to the tendering of the external audit.

Also in 2014, we are welcoming a new Chief Financial Officer, Rachel Whiting, to the Board. Rachel has worked in several roles at Spirent and has a deep-rooted understanding of the financial reporting structure throughout the Company and the Committee is confident that she will provide a robust approach to the high standards that it has come to expect from the Finance team.

A handwritten signature in black ink, appearing to read 'I. Brindle'. The signature is fluid and cursive.

Ian Brindle
Chairman of the Audit Committee
27 February 2014

Responsibilities

The Board has delegated to the Audit Committee responsibility for overseeing the financial reporting, internal risk management and control functions and for making recommendations to the Board in relation to the appointment of the Company's external auditors.

The full terms of reference of the Committee are available at http://corporate.spirent.com/Governance/Board_Committees or from the Company Secretary at the registered office.

Composition of the Committee

At the date of this Report, the Audit Committee comprises four independent non-executive directors, one of whom acts as Committee Chairman.

The Board considers that two members of the Committee, Ian Brindle (who acts as Committee Chairman) and Tom Maxwell, provide recent, significant and relevant financial experience.

Further biographical details of the Committee members can be found on pages 46 and 47.

Meetings and attendance

The Committee meets at least two times each year and at other times as necessary. During 2013, three meetings were held, with individual members' attendance as follows:

	Number of meetings held	Number of meetings attended
Ian Brindle (Chairman)	3	3
Duncan Lewis	3	3
Tom Maxwell	3	3
Sue Swenson	3	3

The Company's external auditor, the Chairman, Chief Executive Officer, Chief Financial Officer, Group Vice President, Finance, Head of Financial Reporting and Company Secretary, who is Secretary to the Committee, were in attendance at each meeting of the Committee.

In addition, the Committee meets regularly with the Company's external auditor and with the Group Vice President, Finance without management present.

Committee activity during the period

The Committee discharged its responsibilities to the Board and communicated with them on the following matters during the period under review:

- review of the full-year and half-year financial statements, key accounting policies and significant financial reporting judgements contained therein (with particular reference to the critical accounting assumptions and judgements as set out in Note 2 of the consolidated financial statements on pages 87 to 93) and recommendation of such financial statements to the Board for approval;
- review of whether the Annual Report taken as a whole is fair, balanced and understandable and forming an opinion thereon prior to recommending it to the Board;

- review and consideration of assumptions in relation to the going concern basis for preparation of financial statements;
- review of the external auditor's report on the interim review and year end audit and management's responses to the issues raised;
- review of the policy on the engagement of EY to supply non-audit services;
- review and recommendation to the Board of the re-appointment of EY as external auditor and approval of their fees, in particular in light of the UK Corporate Governance Code's recommendations regarding the tender of the external audit contract;
- review of recommendations on segmental reporting in accordance with IFRS 8 and the impact of IAS19 (revised);
- review and approval of restructuring of the Finance team in light of business unit reorganisation;
- monitoring and review of internal control and risk management systems;
- review and approval of the internal audit programme for 2013;
- review of risk assessment of cyber security;
- review of the Company's Whistleblowing Policy and anti-bribery and corruption procedures; and
- review of regular reports on taxation, treasury operations and health and safety.

The Committee Chairman reports any significant findings or identified weaknesses to the Board.

Financial reporting and significant financial issues

Following discussions with management with regard to their own review of accounting policies and internal controls, the Audit Committee concluded that there were two significant financial issues arising from the financial statements which would require particular consideration during the year:

- Revenue recognition
Having discussed the impact that complex commercial arrangements entered into by the Group could have on the recognition of revenue and associated balances, the Committee noted that a review of current procedures in the light of current trading should be undertaken. As part of their audit procedures EY would examine the allocation of revenue and review specific large and complex transactions to ensure that revenue has been recognised appropriately.
- Tax accounting
The Committee recognises that the complexity associated with the Group operating in a number of tax jurisdictions may lead to an incorrect tax charge being recognised in the income statement for the period and deferred tax assets being inappropriately recognised. The Committee noted that EY would be performing a detailed review of the deferred tax recognised and tax provisions to ensure the appropriateness of tax disclosures in the Group accounts as part of their audit review.

The Committee noted that EY had included these areas of significant risk in the Auditor's Report on pages 80 to 81 of this Annual Report and was satisfied with the results of the procedures followed.

Audit Committee continued

The Group Vice President, Finance is responsible for ensuring that the finance department employs a level of management and specialists appropriate for maintaining financial records and processes that provide financial information that is relevant, reliable, complies with the applicable laws and regulations, and is distributed both internally and externally in a timely manner. A review of the consolidation and financial statements is undertaken by senior management to ensure that the financial position and results of the Group are appropriately reflected. All financial information published by the Group is subject to the approval of the Audit Committee prior to it being approved by the Board.

Internal control

The Board has overall responsibility for the Group's system of internal control and risk management and for reviewing its effectiveness. The Board, assisted by the Audit Committee, has reviewed the effectiveness of this system and this review did not reveal any significant issues or weaknesses. The Board confirms that this system of internal control and risk management was in place throughout the year under review and up to the date of approval of this Report.

The primary aim of the Group's internal controls is to operate a system which is appropriate to the business and which can support the Group in delivering its strategic objectives, safeguard the Group's assets and, over time, enhance shareholder value. The system is designed to identify, evaluate and manage the significant risks faced by the Group rather than to eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Group consists of a limited number of entities and the Board and Audit Committee continue to consider that currently there is no need for a dedicated internal control and risk management department.

As disclosed in the "Our principal risks and uncertainties" section on pages 20 to 25, the Group risk review committee reviews the key risks facing the business. Membership of the Group risk review committee, which includes representation from each of the key business areas, is currently:

- Chief Executive Officer;
- Chief Financial Officer;
- Executive Vice President, Networks, Applications and Infrastructure;
- Executive Vice President, Wireless and Service Experience; and
- Group Vice President, Finance

Members of the Group risk review committee meet with each business unit periodically to challenge and debate the assessment of risk within each business unit, who then submit local risk registers for the committee to analyse and rank together with company-wide risks to form a robust corporate risk register. This corporate risk register is then presented to the Audit Committee at each of its meetings. Actions arising from the Audit Committee's review of the corporate risk register can then be fed back to the business units for their management.

Day-to-day responsibility for effective internal control and risk management and monitoring rests with senior management at business unit level. The Group Vice President, Finance attends all Audit Committee meetings to report on internal control and risk management and to apprise the Committee of any control weaknesses, control failings and risks, their impact and the actions taken to deal with the issues. The Group Vice President, Finance, is independent of any business unit and is therefore able to provide an objective view and continual assessment of the effectiveness of internal control and risk management throughout the Group. Detailed updates on specific areas, such as cyber security or business continuity, are provided by the Group Vice President, Finance at the Committee's request.

Risk management

The Board and Audit Committee consider that having the following key elements in place are critical to underpinning the overall internal control environment:

Operating Structure and Controls	An organisational structure with clear operating procedures, defined lines of responsibility and delegated levels of authority
Financial Control Structure	A comprehensive strategic planning, financial control and budgeting system which is properly documented and regularly reviewed
Ethics Policy	A policy that sets standards of professionalism and integrity for all employees and operations
Anti-Bribery Policy	A policy to ensure that all of Spirent's systems, controls and training comply with the anti-bribery and corruption legislation in all the countries where we operate and that a culture of prevention and detection of all forms of bribery and corruption is in place
Whistleblowing Policy	A whistleblowing procedure whereby employees may report, in confidence, suspected wrongdoings
Acquisitions and Divestments	A disciplined due diligence process and post-acquisition integration programme

External audit

The Committee places great importance on ensuring that high standards of quality and effectiveness are maintained within the external audit process. It considers a number of areas in relation to the external auditors: their performance in discharging the audit and interim review of financial statements, their independence and objectivity, and their reappointment and remuneration.

Consideration of the effectiveness of the external auditors also forms part of the Audit Committee's performance evaluation questionnaire and is discussed regularly with management to enable prompt feedback to be given.

The Company's external auditors, Ernst & Young LLP ("EY"), provided the Committee with their plan for undertaking the year end audit at the Committee meeting in November 2013. This highlighted the proposed approach and scope of the audit for the year and identified the areas of significant risk and other financial statement risk, including the audit approach for these areas in some detail. The areas of significant risk were primarily identified as issues of judgement and complexity and included revenue recognition and tax accounting. The Committee reviewed and appropriately challenged the basis for these before agreeing the proposed approach and scope of the external audit identified.

EY prepared a detailed report of their audit findings, which was presented to the Committee at its meeting in February 2014. The findings were reviewed and discussed in detail by the Committee, in particular in relation to the areas that had been highlighted at the planning stage. As part of the review, the external auditor was questioned and challenged by the Committee about the work undertaken, its findings and what key assumptions had been made during the audit, especially with regard to the key areas of audit risk identified.

Prior to recommending their re-appointment as external auditors, the Committee considers EY's independence and objectivity in the light of relevant UK professional and regulatory requirements, specifically in the light of the Competition Commission's investigation into the market for statutory audit services for large companies and also the EU's review of the audit services market. EY have been the Company's external auditors for more than 25 years and the audit has not been tendered during that time, although it was noted that as a result of EY's policy on rotating audit partners there had been a new Audit Partner in 2011. The Committee determined that given the developing nature of the regulations relating to audit tendering provisions from the Competition Commission and the EU, and that there are no contractual obligations that restrict the Company's current choice of external auditor, it would not be appropriate to instigate a tender process at the present time.

Policy on non-audit services

The Committee's responsibility to monitor and review the objectivity and independence of the external auditor is supported by a policy in relation to the provision of non-audit services by the external auditor. Taking into account relevant ethical guidance this policy precludes a number of non-audit services including services relating to the accounting records and financial statements, internal audit, IT consulting, legal and investment services and other services deemed by regulators to be precluded. The policy is reviewed and financial limits for the provision of non-audit services, including audit-related fees, tax-related fees and other fees, are set on an annual basis (2013 \$0.6 million (2012 \$0.6 million)). Any amounts in excess of this limit must be approved in advance by the Audit Committee.

Requests for approval of any permitted non-audit service are reviewed and, if necessary challenged by the Company Secretary, who reports to the Committee all non-audit services undertaken at each Committee meeting so that it can monitor the types of services being provided and the fees incurred. Details of the fees paid to the external auditor for non-audit services can be found in Note 5 to the consolidated financial statements. The Committee considers that notwithstanding the non-audit services provided during the year totalling \$0.2 million (2012 \$0.4 million), EY's objectivity as external auditor was not impaired.



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27 February 2014