

# Audit Committee Report



### Audit Committee Meeting Attendance

Andrew Cripps (5/5)	Louise Fowler (1/1) <sup>2</sup>
Mark Allen (2/5) <sup>1</sup>	Tiffany Hall (4/4) <sup>3</sup>
Karen Caddick (5/5)	Debbie White (5/5)
Geoff Drabble (5/5)	

1. Mark was unable to attend the February and April meetings due to his commitments at Dairy Crest and the November meeting due to health reasons. Mark received all of the meeting papers ahead of each meeting and was able to feedback his views to the Committee Chair.
2. Louise was appointed to the Board on 1 November 2019.
3. Tiffany retired from the Board on 17 September 2019.

### INTRODUCTION FROM THE COMMITTEE CHAIR

As stakeholders seek ever greater assurance over the robustness of controls and the integrity of financial reporting, so the importance of the Audit Committee has evolved such that it is a central pillar of the corporate governance framework of the organisation. It provides independent challenge and scrutiny of the Company's internal financial controls and risk management systems.

The Audit Committee is supported in providing assurance over the integrity of financial reports by our independent external auditor, Deloitte LLP ('Deloitte'). Deloitte provide an impartial evaluation of our financial statements and their report to members of the Company may be found on pages 161 to 168. We have committed to retendering the external audit and engaging a new external auditor no later than 2022 and will continue to monitor Deloitte's independence throughout the remainder of their appointment.

The Howdens internal audit function is also a key partner for the Audit Committee in ensuring that the internal controls of the Company are robust. The Internal Audit Plan is regularly reviewed by the Committee to ensure it's fully aligned to the strategy and the latest view of emerging and significant risks to the business. The Head of Internal Audit and Risk also has a standing invitation to Audit Committee meetings.

In 2019, the Audit Committee increased its scheduled meetings from three to five, which allowed more time for the Committee to focus on the Company's internal controls.

At the end of 2019, the Board undertook its triennial externally-facilitated effectiveness evaluation. Information about the evaluation outcomes for the Audit Committee may be found on page 115.

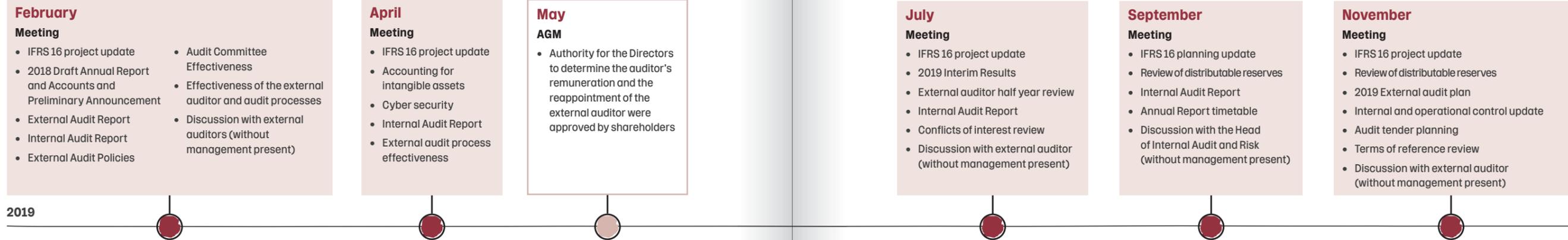
During 2020, the Committee will continue to monitor the integrity of financial statements and formal announcements relating to financial performance, review internal controls, review and monitor the effectiveness of the Internal Audit function, and the effectiveness and objectivity of the external auditor. It will also continue its plan for the re-tender of the external audit work in preparation for the change of auditor in 2022 (see 'Key activities in the year ahead' to the right).

### Andrew Cripps Audit Committee Chair

### Key activities in the year ahead

- Review of the Annual Report and Accounts and preliminary results announcement.
- Deloitte's reappointment as auditor to be recommended to shareholders at the AGM.
- Update to be given by the Audit Committee Chair to shareholders at the AGM.
- Planning for the retender of external audit services.
- Review of the 2020 interim results.
- Consideration of Internal Audit's findings.
- Review of key controls in the Supply and Trade business areas.
- Approval of the 2021 Audit Committee calendar.
- Review of the Committee's terms of reference.

### 2019 AUDIT COMMITTEE ACTIVITY



## Audit Committee Report continued

### FINANCIAL REPORTING

#### Results Review

The Audit Committee reviewed the Group's 2019 Annual Report and Accounts and the half-yearly financial report published in July 2019.

As part of these reviews, the Committee received papers from management on changes in accounting policy, areas of significant judgement, the Group's key risks, going concern considerations and longer-term viability. The Committee also received reports from Deloitte on their audit of the Annual Report and Accounts and review of the half-yearly financial report.

The Committee considered whether the Annual Report and Accounts were fair, balanced and understandable and contained the information necessary for shareholders to assess the Company's position, performance, business model, and strategy.

#### Financial Controls

The Committee received a report from the Head of Internal Audit and Risk on the results of key control questionnaires prepared by Group and Divisional management. The effectiveness of the Group's internal financial controls (with specific reference to controls in place on a divisional basis) and the disclosures made in the Annual Report and Accounts on this matter were reviewed by the Audit Committee.

#### Areas of Significant Financial Judgement

The Committee exercises its judgement in deciding the areas of accounting that are significant to the Group's accounts. The external auditor reports detailed results of their procedures in relation to these significant areas to the Committee.

#### Areas of significant financial judgement

Inventory obsolescence provisioning

Validity of the actuarial assumptions

Management override of controls (presumed risk)

■ Area of significant financial judgement in 2019 and 2018

□ Presumed risk for the audit under ISA 240

The matters shown below have been discussed with the Deputy Chief Executive & Chief Financial Officer, Group Finance Director and the external auditor, and the Committee is satisfied that each of the matters have been fully and adequately addressed by the Executive Committee, appropriately tested and reviewed by the external auditor, and the disclosures made in the Annual Report and Accounts are appropriate.

#### Inventory obsolescence provisioning

The Group's in-stock model (further information about which may be found on page 6) and the scale of our product range necessitates tight management of inventory to ensure local availability of stock while at the same time minimising obsolescence and wastage.

The Committee reviewed the results of stock counts and the processes used to value each category of inventory, including the assumptions behind obsolescence provisions, with management.

The external auditor provided reports to the Committee which considered the appropriateness of provisions held against the carrying value of inventory, while also having regard to the age of discontinued lines and volumes of continuing lines relative to the expected usage and the levels of historical write-offs.

#### Validity of the actuarial assumptions

During 2019, the Group moved to a policy of updating CMI tables, a key element of the mortality assumptions, annually. The previous approach had been to update these every three years following completion of the triennial valuation. Given the more modest life expectancy improvement rate forecast in the 2018 CMI table and a deterioration of the discount rate, the pension deficit increased from £36m at the end of 2018 to £56.6m at this balance sheet date. The Committee remains aware that the valuation of assets and liabilities remain sensitive to changes in the actuarial assumptions, particularly the discount, inflation and mortality rates applied.

The Committee carefully considered:

- whether the actuarial assumptions, and in particular the discount, inflation and mortality assumptions, applied were appropriate; and
- the views of the external auditors.

The Committee also met with the Group's external actuaries during the year and considered their recommendations.

#### Distributable Reserves

The Committee requested that management analyse the revenue and other reserves of the parent company to ascertain the full extent to which these may be distributable. This information is now included on page 170.

### GOVERNANCE

#### Governance Updates

Updates on the latest governance practices for Audit Committees and changes in reporting requirements were provided by the external auditor. All members of the Audit Committee are also members of the Deloitte Academy, which provides updates on financial and reporting matters.

#### Committee Effectiveness

An effectiveness review was carried out on the Committee as part of the Board's triennial externally-facilitated evaluation process (further details about the process may be found on pages 90 and 91 of the Nominations Committee Report).

The evaluation of the Audit Committee focused on the following areas:

- Chairship
- Meetings and meeting agendas
- Evolution of responsibilities
- External audit
- Internal audit
- The internal Finance team

Feedback from the review was that the Audit Committee has evolved in a positive way in response to increased responsibilities and regulations and also to the increased size of the business. The feedback also showed that the Committee is "thorough and tenacious in its approach" and that the addition in 2019 of two further scheduled meetings a year allowed for more challenge and consideration of subjects in more detail.

#### Policies and Conflicts

The Committee reviewed its policies in relation to allocation of non-audit work (further detail on this policy may be found on page 118) and employment of ex-audit firm personnel. It also reviewed the Directors' conflicts of interest register. Further information about conflicts of interest may be found on page 119.

#### CMA Order Compliance

The Audit Committee confirms that the Company has complied with the provisions of the Competition and Markets Authority Order 2014 throughout its financial year ended 28 December 2019 and up to the date of this report.

#### Case Study

### IFRS 16

As we have been reporting in our Annual Report and Accounts since 2015, Howdens will report under IFRS 16 for first time in our financial year to December 2020.

IFRS 16 will bring all leases onto the Group balance sheet as right to use assets and associated financial liabilities, increasing both by a material amount. At the end of December 2018, Howdens had leases with committed repayments of c.£0.5bn. In recognition of the fact that IFRS 16 would bring this amount onto the balance sheet, albeit discounted to reflect the time value of money, the Committee agreed an implementation plan, progress against which was reported at each meeting during 2019.

A project team formed in 2017, made up of representatives from the Group divisional accounting teams and Information Services, has been working towards the implementation plan. The project team confirmed early in the process that an IT solution was required and a tender process was carried out. System penetration and interface testing was carried out on the selected solution. The uploading of templates to the system then commenced.

In April 2019, the Committee considered the basis of adoption and in July approved the modified retrospective basis, having also considered alternative permitted bases. The Committee concluded that the adopted method combined the simplicity of not needing to derive a large number of discount rates with most of the P&L benefits of a fully retrospective adoption.

In September 2019, the Committee discussed and approved the incremental borrowing rate methodology, one of the main judgemental inputs into the IFRS 16 calculation. The incremental borrowing rate being the discount rate used to give the present value of leases on the balance sheet. The key features of the methodology were considered prior to adoption.

In November, the Committee considered the draft disclosure for 2019, the final version of which can be found in Note 2 on pages 128 and 129.

The external auditor was engaged with the process throughout the implementation plan and provided input on the basis of adoption and the incremental borrowing rate methodology.



## Audit Committee Report continued

### Committee Membership

The Committee is composed entirely of independent Non-Executive Directors. Independence is critical for fair assessment of the management team and the external and internal audit functions.

### Committee Chair

Andrew Cripps was appointed Audit Committee Chair in May 2016. He is responsible for determining the Committee's agenda and for maintaining the key relationships between the Group's senior management, Head of Internal Audit and Risk, the Company Secretary and senior representatives of the external auditor.

Andrew is also responsible for ensuring that key audit issues are reported to the Board in an effective and timely manner and that they are reported to shareholders in the Annual Report.

From 2020, he will also present a summary of the work of the Audit Committee to shareholders at the Annual General Meeting.

### Recent and relevant financial experience

Andrew Cripps qualified as a Chartered Accountant with KPMG and has held executive director roles in the UK and Europe with Rothmans International, where he was Corporate Finance Director. More recently, Andrew has been Audit Committee Chair of a number of public companies.

### Competence relevant to the sector

The unique business model of Howdens means it does not naturally fit into one sector and therefore when the Committee undertook an assessment of its skills and experience it assessed them against a number of sectors relevant to the Company. These included building and construction, multi-site wholesale, manufacturing and logistics, and service to customers.

The Committee concluded that competence relevant to these sectors was well represented within the current membership and that the thorough inductions provided to the Committee members and the opportunities for them to meet with senior management and Executives further enhanced their working knowledge of the way the Company operates and the sectors it spans.

### EXTERNAL AUDITOR

External auditor	<b>Deloitte LLP ('Deloitte')</b>
External auditor tenure	<b>18 years</b>
Lead audit partner	<b>Claire Faulkner</b>
Lead audit partner tenure	<b>3 years (of a 5 year cycle)</b>
Latest that a new external auditor will be engaged*	<b>2022</b>
Total fees paid to auditor in the year	<b>£0.7m (Non-audit fees accounted for £0.1m of the total fee)</b>

\* The information above is correct as at 28 December 2019.

### External Audit Tender

As previously reported, the Audit Committee will engage a new external auditor no later than 2022 (following the conclusion of the current five-year lead audit partner cycle). The Committee will keep the need to re-tender the external audit under review until this time.

In coming to this decision, the Audit Committee considered the transitional arrangements published by the Department of Business, Energy & Industrial Strategy in 2015, which provide that the Company cannot renew Deloitte's appointment as external auditor beyond June 2023, given it has been the external auditor for over eleven years but less than twenty years.

The Committee also considered the UK Corporate Governance Code and the FRC's Guidance on Audit Committees, which provides that the external audit should be re-tendered at least every ten years and that this process should fit in with the lead audit partner five-year rotation.

Deloitte has expressed their willingness to continue in office as auditor and the Committee has unanimously recommended to the Board that a proposal to reappoint them as the auditor and to authorise the Directors to fix their remuneration is put to the shareholders at the Annual General Meeting on 7 May 2020 (details of the AGM may be found on page 176).

### External Auditor Independence

Auditor independence is an essential part of the audit framework and the assurance it provides. The Committee therefore undertook a comprehensive review of auditor independence during 2019, which included:

- A review of the independence of the external auditor and the arrangements which they have in place to identify, report and manage conflicts of interest.

- A review of the changes in key external audit staff for the current year and the arrangements for the day-to-day management of the audit relationship.
- Consideration of the overall extent of non-audit services provided by the external auditor, in addition to case-by-case approval of the provision of non-audit services as appropriate.
- Deliberation of the likelihood of a withdrawal of the auditor from the market and note taken of the fact that there are no contractual obligations to restrict the choice of external auditor.

At the year-end, the external auditor formally confirmed that they had complied with the requirements of the FRC Ethical Standard as well as internal requirements and their independence and objectivity had been maintained. The Audit Committee also has a policy in relation to the employment of former members of the external audit team.

### External Auditor Effectiveness

To assess the effectiveness of the external auditor, the Committee reviewed:

- The proposed plan of work presented by the external auditor, including audit risks, materiality, terms of engagement and fees prior to commencement of the 2019 audit.
- The external auditor's fulfilment of the agreed audit plan and any variations from the plan.
- Perceptions and professional scepticism of the external auditor and audit process from key management personnel in the finance function.
- Robustness and perceptiveness of the auditor in their handling of the key accounting and audit judgements.
- Internal control and risk content of the external auditor's report.
- Independence of thought and potential for conflict.

The only non-audit services provided by Deloitte in the year was their review of the half-yearly financial report. No advisory work was requested from the auditor this year or last.

### External Auditor Fees

All relevant fees proposed by the external auditor must be reported to and approved by the Audit Committee.

Details of the total fees, including non-audit fees, paid during the year to Deloitte may be found on the opposite page and in Note 6 to the consolidated financial statements (page 136).



## Performance Expectations for the External Auditor

### Specific auditor responsibilities

- Discuss audit approach and areas of focus in advance.
- Report issues at all levels within the Company in a timely fashion.
- Ensure clarity of roles and responsibilities between local Deloitte and Howdens' Finance teams.
- Respond to any issues raised by management on a timely basis.
- Meet agreed deadlines.
- Provide continuity and succession planning of key staff members of Deloitte.
- Provide sufficient time for management to consider draft auditor's reports and respond to requests and queries.
- Ensure consistent communication between local and central audit teams.

### Wider responsibilities

- Provide timely up-to-date knowledge of technical and governance issues.
- Serve as an industry resource, communicating best practice trends in reporting.
- Adhere to all independence policies.
- Deliver a focused and consistent audit approach for the Group that reflects local risks and materiality.
- Liaise with the Howdens Internal Audit and Risk team to avoid duplication of work.
- Provide consistency in advice at all levels.
- Ultimately, provide a high quality service to the Board, be scrupulous in their scrutiny of the Group and act with utmost integrity.

### Independence

The Committee reviews the independence of the external auditor bi-annually. This includes consideration of the potential for conflicts of interest as well as the auditor's internal procedures to ensure independence of its staff.

The Committee noted that the only non-audit services provided by Deloitte in the year was their review of the half-yearly financial report. No advisory work was requested from the auditor this year or last.

## Audit Committee Report continued

### Policy for Non-Audit Services Provided by the External Auditor

The main aims of this policy are to:

- Ensure the independence of the auditor in performing the statutory audit; and
- Avoid any conflict of interest by clearly detailing the types of work that the auditor can and cannot undertake.

The Audit Committee has reviewed and updated the policy for non-audit services to ensure that it is in line with the FRC's Revised Ethical Standards 2019 (which will take effect from 15 March 2020) and the FRC's Audit Quality Practice Aid 2019.

The policy, in line with regulation, substantially limits the non-audit services which can be provided by the external auditor. The policy provides:

- A 70% cap of the value of the audit fee for all non-audit services calculated on a rolling three-year basis.
- Categories of service that are prohibited from being carried out by the auditor.

The policy specifies a de minimus limit as well as the type of non-audit work that the auditor may be engaged in without the matter first being referred to the Audit Committee, which considers each referral on a case-by-case basis.

The policy ensures that the auditor does not audit its own work or make management decisions for the Company or any of its subsidiaries. The policy also clarifies responsibilities for the agreement of fees payable for non-audit work.

### CONTROLS AND INTERNAL AUDIT

#### Internal Control Framework

The Group has an established framework of internal controls, which includes the following key elements:

- The Board reviews Group strategy, and the Executive Committee are accountable for performance within the agreed strategy.
- The Group and its subsidiaries operate control procedures designed to ensure complete and accurate accounting of financial transactions and to limit exposure to loss of assets or fraud.
- The Audit Committee meets regularly and its responsibilities are set out in the Audit Committee Terms of Reference (which may be found on the Company's website at [www.howdenjoinerygroupplc.com/governance/corporate-governance-report/terms-of-reference-of-the-audit-committee](http://www.howdenjoinerygroupplc.com/governance/corporate-governance-report/terms-of-reference-of-the-audit-committee)). It receives reports from the Internal Audit function on the results of work carried out under an annually agreed audit programme. Operational and compliance controls are considered when the Committee reviews the annual Internal Audit programme. The Audit Committee has full and unfettered access to the internal and external auditors.
- Operating entities provide certified statements of compliance with specified key financial controls. These controls are then cyclically tested by Internal Audit to ensure they remain effective, and are being consistently applied.
- The Audit Committee annually assesses the effectiveness of the assurance provided by the internal and external auditors. Every five years an external assessment is also undertaken with regard to the assurance provided by the Internal Audit department. An external assessment was undertaken by Grant Thornton in 2017.

#### Internal Audit

During the year, the Committee reviewed:

- Internal Audit's programme of work and resources and approved its annual plan.
- Results of audits and other significant findings including the adequacy and timeliness of management's response.
- The level and nature of assurance activity performed by Internal Audit.
- Staffing, reporting and effectiveness of divisional audit.

The Committee considered that the Internal Audit function remained effective and provided a comprehensive level of assurance through its programme of work.

### Fraud Risk

The Committee considered the controls in place to mitigate fraud risk and received a report from Internal Audit which confirmed the effectiveness of those controls.

### Divisional Controls

Senior management from the business were invited to discuss the controls in their business areas. The Director of Commercial Finance and Head of Compliance of the Trade division gave presentations on the control environments in their area. An update on the IT control environment was also presented by the Chief Information Officer. Updates on cyber and information security were also provided by the Head of Information Systems Security.

### Independent Assurance

The Committee assessed the coverage of independent assurance by reviewing the annual internal audit plan against the Group assurance map. In addition, the Committee reviewed reports on preparedness to manage crises, business continuity and product recall. It also received reports on the scope of preparations for the UK's exit from the EU.

### Whistleblowing

Complaints on accounting, risk issues, internal controls, auditing issues and related matters are reported to the Audit Committee as appropriate. Oversight of the Company's whistleblowing policy is a matter considered by the Board. The Board receives biannual updates on whistleblowing statistics and trends (see pages 77 and 80).

### Conflicts of Interest

The Companies Act 2006 places a duty upon Directors to ensure that they do not, without the Company's prior consent, place themselves in a position where there is a conflict, or possible conflict, between the duties they owe the Company and either their personal interests or other duties they owe to a third party.

If any Director becomes aware that they, or any party connected to them, have an interest in an existing or proposed transaction with the Company, they must notify the Board as soon as practicable. The Board has the authority to authorise a conflict if it is determined that to do so would be in the best interests of the Company. The Audit Committee reviews the output of this process annually to ensure it is appropriately monitored.

By order of the Board

**Andrew Cripps**  
Audit Committee Chair

26 February 2020



### Case Study

## Intangible Assets

Intangible assets considered for capitalisation in the Group balance sheet principally comprise the directly attributable costs of developing computer software and ongoing costs of software licences. In view of the significant increase in expenditure on the Group's digital framework, the Committee reviewed:

- how software costs are accounted for
- the controls applied
- the disclosures made

The Committee noted that judgement is carefully applied as to whether expenditure produces demonstrable future economic benefit which justifies recognition as an asset in the Group's balance sheet, subject to annual amortisation. All other software costs are expensed as incurred. As a result of this review, the Committee were satisfied with the accounting policies for intangible assets and their application, including disclosure in the Annual Accounts. Further details of intangible assets are set out in Notes 2 and 12 to the consolidated financial statements.