

Audit Committee report



Andrew Cripps Audit Committee Chair



Introduction from the Committee Chair

I am pleased to present this Report covering the work of the Audit Committee in 2020.

The Audit Committee has focused its attention on maintenance of business controls in the face of changing ways of working this year as well as ensuring effective external and internal audit verification whilst working remotely. We also looked more deeply into liquidity and sustainability management in considering the immediate and longer-term viability of the business.

We continued examining key control risks with particular attention on four areas:

- Enhanced governance arrangements consequent upon COVID-19 restrictions.
- Compliance with COVID-19 enhanced procedures at depots.
- Financial controls over supply operations, including those following establishment of separate commercial teams.
- Information and cyber security risks including those arising from increased remote working.

In each case the Committee noted the speed of response to changing conditions as well as adoption of recommendations from the internal audit team. The business adapted well to this combination of evolving governance processes reinforced by independent review from internal audit.

Howdens continues to evolve a more unified organisational structure which both preserves local autonomy of depots while broadening collaboration and expertise across supply and business support. This, coupled with increased public interest in internal control systems following the Kingman and Brydon Reviews, precipitated a project to review the network of internal controls in order to reappraise and document key controls consistent with responsibilities of the revised organisational structure. This project is sponsored by the CEO and CFO with scrutiny from the Committee. We have provided a case study on the key controls project on page 133.

We commenced the process of selecting a new external auditor in 2020. Whilst the Committee remains comfortable with the independent challenge currently provided by Deloitte, best practice requires a new auditor, and the fresh perspectives this will bring, from 2022.

2020 Audit Committee activity



Audit Committee meeting attendance

Andrew Cripps (5/5)	Louise Fowler (4/5) ¹
Karen Caddick (5/5)	Debbie White (5/5)
Geoff Drabble (5/5)	

¹ Louise was unable to attend the Committee meeting in September due to pre-existing commitments entered into prior to joining the Company. She received all of the meeting papers in advance of the meeting and was able to feedback her views to the Committee Chair.

A key element of this selection, which is the responsibility of the Audit Committee, is to identify within the most appropriate audit firm an engagement partner and senior team best equipped to understand and constructively challenge the business. We decided it would not be efficient to continue this in 2020 whilst the Company was adapting to new ways of working for COVID-19 and therefore plan to recommence the process following announcement of the annual results.

I look forward to reporting directly to shareholders at our AGM and responding to questions.

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.
- The tender of external audit services.
- Review of the 2021 interim results.
- Consideration of internal audit's annual plan, independence, resources and findings.
- Review of key controls.
- Approval of the 2022 Audit Committee calendar.

Audit Committee report continued

Financial reporting

Results review

The Audit Committee reviewed the Group's 2020 Annual Report and Accounts and the half-yearly financial report published in July 2020.

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 discussed 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.

The matters shown below have been discussed with the 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 2020 Annual Report and Accounts are appropriate.

Areas of significant financial judgement

Inventory obsolescence provisioning

Validity of the actuarial assumptions

■ Area of significant financial judgement in 2020 and 2019

Inventory obsolescence provisioning

The Group's in-stock model (further information about which may be found on page 18) 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. This was particularly true during 2020 where the dual supply chain risks of COVID-19 and Brexit resulted in the Group holding additional safety stock to safeguard the in-stock model at a time of transferring to a new national distribution centre.

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.

The Committee reviewed the processes used to value each category of inventory, including the assumptions behind obsolescence provisions, and were satisfied with the judgements made.

Validity of the actuarial assumptions

The Committee carefully reviewed the report of the Company's actuaries and concluded that:

- the actuarial assumptions applied to pension fund liabilities, and in particular the discount, inflation and mortality assumptions, were appropriate;
- the valuation of pension fund assets was consistent; and
- they concurred with the views of the external auditors.

IFRS 16, Leasing

This accounting standard, which took effect from the beginning of 2020, requires recognition in the balance sheet of 'right of use assets' of some £550 million and a corresponding lease liability, with relatively minor impact on profit before tax (note 28 on page 174). The Committee monitored implementation over the last year. Deloitte concur with the Committee's view that this change does not represent a matter of significant judgement nor estimation as the majority of the company's leases are straightforward property leases on similar terms and conditions.

Distributable reserves

As reported in the 2019 Audit Committee report, 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 included on page 188.

Governance

Governance updates

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

Committee effectiveness

An effectiveness review was carried out on the Committee and its members. The review concluded that the current mix of financial, commercial and relevant sector experience of the Audit Committee, and that of its advisors, was such that the Committee could effectively exercise its responsibilities to the Group in relation to risk and controls.

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 131) 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 133.

Competition and Markets Authority (CMA) Order compliance

The Audit Committee confirms that the Company has complied with the provisions of the Order throughout its financial year ended 26 December 2020 and up to the date of this report.

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 2021, 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 FTSE250 and other 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.

Audit Committee report continued

External auditor

External auditor	Deloitte LLP (Deloitte)
External auditor tenure	19 years
Lead audit partner	Claire Faulkner
Lead audit partner tenure	4 years (of a 5 year cycle)
Latest that a new external auditor will be engaged*	2022
Total fees paid to auditor in the year	£0.7m (Non-audit fees accounted for £0.1m of the total fee)

* The information above is correct as at 26 December 2020.

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). As such, the Committee will undertake an external audit tender during 2021 in order to appoint a new external auditor in 2022.

In coming to this decision, the Audit Committee considered the continuing robust performance of the incumbent auditor, 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 for the financial year 2021 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 6 May 2021 (details of the AGM may be found on page 194).

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 2020, which included:

- A review of the independence of the external auditor and the arrangements which they have in place to restrict, 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 2020 audit.
- The external auditor's fulfilment of the agreed audit plan and any variations from the plan.
- Evaluation from key management personnel and members of the Committee of the external auditor's exercise of professional scepticism and challenge.
- 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.

External auditor fees

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

The only non-audit services provided by Deloitte in the year was their review of the half-yearly financial report. No advisory work has been requested from the auditor during the previous three years.

Details of the fees paid during the year to Deloitte may be found in the table above and in note 5 to the consolidated financial statements (page 149).

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 took 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 minimis 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.

The only non-audit services provided by Deloitte in the year was their review of the half-yearly financial report. No advisory work has been requested from the auditor during the previous three years.

Performance expectations for the external auditor

Specific auditor responsibilities

- Discuss the audit plan, materiality, 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.

Audit Committee report continued

Controls and internal audit

Internal control framework

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

- The Board approves the Group's strategy and annual budgets; the Executive Committee are accountable for performance within these.
- 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). 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.

A case study on the review of key controls may be found on page 133.

Internal audit

The internal audit team has increased its capabilities during the year, both through implementation of a new audit management tool and enhanced technical expertise. It has communicated an updated Internal Audit Charter to management and thereby refreshed understanding of responsibilities for internal controls and their verification, based on the three lines of defence model.

The Committee reviewed:

- Internal Audit's programme of work and resources and approved its annual plan.
- The level and nature of assurance activity performed by Internal Audit.
- Results of audits and other significant findings including the adequacy and timeliness of management's response.
- 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 Finance for the Supply Chain and Head of Compliance of the Trade division gave presentations on the key risks and control environments in their areas. An update on cyber and information security was also presented by the Chief Information Officer and Head of Information Systems Security.

COVID-19 crisis governance

In April, in addition to the updates received by the Board, the Chief Governance Officer presented the governance and control arrangements put in place to respond to the COVID-19 crisis to the Committee. This included presentation of the governance principles adopted by the Executive Committee, in particular its 'people first' approach. The Committee noted how the Internal Audit team had worked alongside management to provide assurance to the Committee over key controls, both pre-existing and those which had been introduced as a result of the crisis. In particular, the underlying Health & Safety framework had been utilised to introduce new controls and ways of working to incorporate social distancing measures. Control, safety and risk implications of increased remote working as well as internal audit's confirmation of the effectiveness of these controls continued to be reviewed at each subsequent meeting.

More information on the Board's governance response to the COVID-19 crisis can be found on pages 80 and 81.

Independent assurance

The Committee assessed the coverage of independent assurance by reviewing the annual internal audit plan against the Group's key controls.

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 74 and 75).

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

24 February 2021

Case study Key controls

During 2020 we have worked to clarify our key controls across the business to focus and further strengthen our overall control framework. Sponsored by the CEO and CFO, and reporting regularly to the Audit Committee, this project is improving our capability to identify operational, IT and financial controls which mitigate our key and principal risks. Phase 1 of this project was delivered in 2020, with further phases starting in H1 2021.

Our project streams will reinforce key responsibilities across the business and their verification, assist new systems design, and enable us to address regulatory consequences of the Brydon and Kingman reviews when these are known. The immediate results include:

- A sustainable approach for cataloguing, monitoring and ownership of key controls.
- Embedding of operational ownership to measure effectiveness.
- An even stronger attestation process.

We see this exercise as both a necessity and an opportunity to further strengthen our control framework whilst protecting the essential Howdens locally empowered culture.

Working alongside the project, the Internal Audit team has embedded a new industry standard software solution that integrates enterprise risk assessments with independent control and audit activity. This solution has enabled further development of risk-based assurance and reporting capabilities, giving the Audit Committee, Board and Executive Committee a clearer view of control effectiveness.