

# AUDIT COMMITTEE REPORT



**In a year of increased focus internally and externally on culture, values and judgements made to support strategic growth, I am pleased to report good progress in improving the quality of people, processes and systems that underpin all these elements**

Neil Warner, Chairman of the Audit Committee

## Dear Shareholder,

I am pleased to present the Audit Committee (“the Committee”) report for the year ended 31 March 2017, which has been prepared by the Committee and approved by the Board.

As a Committee, we have focused on the integrity, completeness and clarity of financial reporting, the areas where judgements and estimates are required in the financial statements and the quality and effectiveness of audit processes to complement the other risk management activities.

The Board and Committee have also focused on the recently introduced governance requirements regarding the Annual Report and consider that, taken as a whole, the 2017 Annual Report is fair, balanced and understandable with appropriate references being made throughout the various sections, which I hope you will find helpful in understanding the information and disclosures contained within them.

The Committee meetings are held to coincide with key dates within the financial reporting and audit cycle and I also meet with management on an ad-hoc basis. I would like to thank the Committee members, the executive management team and our external auditor, KPMG LLP (‘KPMG’) for the open discussions that take place at our meetings and the importance they all attach to its work.

On behalf of the Audit Committee

**Neil Warner**

Chairman of the Audit Committee  
12 June 2017

## Committee membership and attendance

In accordance with the Code, the Audit Committee consists entirely of the Independent Non-Executive Directors and met three times in the year

	<b>Attendance in 2016/17</b>
Neil Warner (Chairman)	3
Jonathan Shearman	3
Scott Mac Meekin	3

The external auditor KPMG, the Non-Executive Chairman, the Chief Executive, the Chief Financial Officer and the Company Secretary are also invited to attend meetings, although it is only the Committee Chairman and its members who are entitled to be at a meeting of the Committee.

The Board are satisfied that the members of the Committee have the breadth of knowledge, experience and financial dynamics to effectively fulfil their responsibilities. The Chairman, Neil Warner, has significant, recent and relevant financial experience as a former CFO of a FTSE 250 company and through his other Non-Executive appointments. The Director’s summary biographies can be found on pages 54 to 56 of this Report.

## Role and responsibilities

The Committee operates within its terms of reference, which are reviewed on an annual basis and are available on the Company’s website or on request to the Company Secretary.

The role of the Committee is to assist the Board in fulfilling its oversight responsibilities by reviewing and monitoring:

- the integrity and compliance of the financial information provided to shareholders including the strategic report, financial results, announcements and financial statements
- the appropriateness of accounting policies and the supporting key judgements and estimates
- whether the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable
- the Company’s system of internal controls and risk management including the identification of principal risks and their mitigation and the requirement for a formal internal audit function (see pages 51 to 53 for Risk Management)

- the external audit process and external auditors, making recommendations to the Board on appointment, remuneration, performance, expertise, independence and objectivity, along with the effectiveness of its scope, of the external auditor
- the processes for compliance with laws, regulations and ethical codes of practice including procedures for detecting, monitoring and managing the risk of fraud and the adequacy and security for its employees in relation to whistleblowing

#### Key matters considered and activities during the year

During the year, the Committee met to agree the audit strategy for the full year audit, reviewed the results of the external audit for the financial year and reviewed the external auditor's half year review and the half year results. It also considered the results of the internal review process ('health checks') carried out as part of the cycle (more details of this process are given in the section 'internal audit' below) and finally it reviewed the Annual Report and the financial statements contained within it.

The Committee reports to the Board on how it has discharged its responsibilities on a regular basis.

The Committee's prime areas of focus have been:

- the integrity, completeness and consistency of financial reporting and disclosures
- the areas where significant judgements (during the year, at and post the balance sheet date) and estimates are required in the financial statements
- the materiality level to apply to the audit
- whether the going concern basis of accounting should continue to apply in the preparation of the annual financial statements; and
- the appropriateness of the bases of disclosure in the company's viability statement
- the appropriateness of transactions separately identified and disclosed as one-off in order to highlight the underlying performance for the periods presented in the financial statements
- the appropriateness of transactions presented in Alternative Performance Measures (APM's) in order to compare relevant results for the periods presented in the financial statements

- the key assumptions, judgements and estimates as detailed in note 31 to the financial statements
- to review the Group's cyber risk strategy to ensure controls and testing are in place to mitigate the Group's exposure to this growing risk

#### Financial reporting and significant financial risks

The Committee concluded that there were two significant financial risks arising from the financial statements which would require particular consideration during the year:

- **Valuation of customer-specific specialised inventory (recurring)**  
The Group has significant inventory holdings which are specific to individual customer requirements. The Board recognises that as the business continues to grow the Group is required to carry additional inventory to meet its transactional and OEM business. This carries with it an increased exposure to recoverability of these balances. The Committee is satisfied that sufficient focus is given to this whole area and, in particular, the adequacy of provisions made for customer specific, slow moving and obsolete inventory.
- **Valuation of goodwill and other intangible assets (recurring)**  
The determination of whether or not goodwill has been impaired requires a review of the value in use of the asset. The main judgements in relation to the review were considered to be the achievability of the long term business plan and the impact upon the plan of macroeconomic and regulatory issues. In addition, the Committee reviewed the discount rates used in projecting future cash flows to ensure they were within an acceptable range. The calculation of the value in use was undertaken and the Committee reviewed the conclusion, including sensitivity calculations. The Committee also held discussions with KPMG. The Committee concurred with management's conclusion that goodwill is not impaired.

#### Internal audit

A formalised internal review process called a 'health check' has been in operation for some years and all business units are the subject of a health check on a rotational basis. The reviews, covering both operational and financial controls, are carried out by senior Group finance personnel, from Head Office, who are separated from the day to day activities within the entity which is the subject of the review. All health checks are presented by the Chief Financial Officer to the Audit Committee and remedial actions agreed. Whilst the Board recognises that this process does not constitute a fully independent internal audit function, it believes that due to the size of the Group, this provides appropriate comfort as to the operational and financial controls in place.

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## Internal control

The Board is ultimately responsible for the system of internal control and for reviewing its effectiveness. The system of internal control is designed to manage rather than eliminate the risk of failure to achieve strategic business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Corporate Governance Code requires that the Board reviews the effectiveness of the system of internal controls, in accordance with section C.2, including those of an operational and compliance nature, as well as internal financial controls. Having done so, the Committee is of the view that there is an appropriate ongoing process for identifying, evaluating and managing significant risks. Operating policies and controls are in place and have been in place throughout the year under review, and cover a wide range of issues including financial reporting, capital expenditure, information technology, business continuity and management of employees. Detailed policies ensure the accuracy and reliability of financial reporting and the preparation of Financial Statements including the consolidation process.

The key elements of the Group's ongoing processes are:

- a full detailed review of the business risks undertaken as part of the ongoing day-to-day procedure of the business
- an organisational structure with clearly defined lines of responsibility and delegation of authority
- that Group policies for financial reporting, accounting, financial risk management, information security, capital expenditure appraisal and Corporate Governance are well documented
- that detailed annual budgets and rolling forecasts are prepared for all operating units and reviewed and approved by the Board
- that performance is monitored closely against budget and material variances reported to the Board
- that the Committee is to deal with any significant control issues raised by the auditor
- that a formal schedule of matters specifically reserved for decisions by the Board is maintained
- that capital expenditure is controlled by the budgetary process with authorisation levels in place. Any single item of capital expenditure over £50,000 goes to the Board for approval with detailed written proposals and financial analysis of expected returns

There were no significant control deficiencies identified during the year.

## External auditor

The external audit is a continuous process. At the start of the audit cycle, KPMG present their audit strategy identifying their assessment of the key risks for the purposes of the audit and the scope of their work. For 2017 these risks were: the calculation of customer-specific inventory and valuation of goodwill. More detail is set out in KPMG's report on pages 91 to 94.

During the year the FRC's Audit Quality Review team reviewed our external auditor's (KPMG) audit of our 2016 financial statements. We have discussed the report with KPMG and the Audit Quality Review team. The review identified three areas for improvement in the audit which KPMG have addressed for the audit of our 2017 financial statements. Overall, the results of the review raised no issues which cast doubt on the fundamental quality of our audit or raised issues about our financial reporting.

KPMG reports to the Committee at both the half and full year, setting out their assessment of the Group's judgements and estimates in respect of key risks and the adequacy of the reporting. The Chairman of the Committee speaks to the lead audit director before each meeting and the whole Committee meets with KPMG in private at least once a year without executive management present. The Committee reviews the external auditor's performance and ongoing independence and concluded that the external audit process is operating effectively and KPMG continues to prove effective in its role as external auditor.

## Non-audit services provided by KPMG

In order to ensure the independence and objectivity of the external auditor, the Committee has a policy which provides clear definitions of services that the external auditor can and cannot provide. Tax compliance and advisory services are currently provided by another professional services firm PricewaterhouseCoopers LLP ('PwC'). The policy also establishes a formal authorisation process, including either the tendering for non-audit services or pre-approval by the Committee for allowable non-audit work.

The fees in relation to non-audit services are found in note 5 of the Annual Report. These relate to tax compliance services for PSEP and TR Formac in Malaysia.

## Reappointment of external auditor

Following the completion of the audit, the Committee reviews the effectiveness and performance of KPMG with feedback from Committee members, senior executive management and finance personnel, covering overall quality, independence and objectivity, business understanding, technical knowledge, responsiveness and cost effectiveness.

The Committee acknowledges the new EU rules with regard to auditor rotation and the requirement for companies to put audit services contracts out to tender at least every ten years (outside of transitional rules). KPMG has been our auditor for over 20 years. The current lead audit director at KPMG was appointed in September 2016 and will be required to stand down no later than the Annual General Meeting in 2020. Accordingly, and in line with the arrangements set out by the EU, the Committee continues to recommend to the Board that the tendering of the external contract should be either at the next rotation of audit lead director or earlier, if appropriate circumstances arise. There are no contractual obligations which restrict the Audit Committee's choice of external auditor. The Committee and the Board have concluded that KPMG provides an effective audit and have recommended their reappointment at the 2017 AGM.