

Audit Committee Report

‘The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors.’

The UK Corporate Governance Code, Principal C.3

MEETING ATTENDANCE

The Committee meets at least three times a year and at any other such time as the Chairman of the Committee requires. Only the attendance of members of this committee is shown in the table below, although other Directors, where appropriate, have often also attended at the invitation of the Committee Chair.

The Chairman of the Board, along with the Chief Executive Officer, Deputy Chief Executive and Chief Financial Officer, Group Finance Director, Head of Internal Audit and Risk, representatives from the Finance function and senior representatives of the external auditors, are regularly invited to attend all or part of our meetings as and when appropriate. The Audit Committee reserves the right to request any non-members to withdraw from any meeting.

	Attendance	No. of meetings
Andrew Cripps (Chairman)*	2	3
Mark Allen	3	3
Geoff Drabble	3	3
Tiffany Hall	3	3
Richard Pennycook**	1	1
Michael Wemms***	2	3

* Andrew Cripps was unable to attend the Committee meeting on 15 February 2016 due to ill health.

** Richard Pennycook ceased being a member of the Committee following his appointment as Chairman of the Board on 5 May 2016.

*** Michael Wemms was unable to attend the Committee meeting on 3 November 2016 due to a conflict with another commitment.

In compliance with the UK Corporate Governance Code and the Committee’s terms of reference, during the year the Audit Committee consisted wholly of independent Non-Executive Directors. Subject to successful annual re-election to the Board, appointments to the Audit Committee are for a period of three years, which may be extended by the Committee provided the Director remains independent.

INTRODUCTION BY THE COMMITTEE CHAIRMAN

The Audit Committee has a vital role in the financial probity of the business so that shareholder interests are properly protected. We do this primarily through a focus on financial controls and risk management, financial reporting and on the independent external audit of this Annual Report and Accounts.

The Committee are supported in their review of financial controls by a comprehensive internal audit team who examine and report on the adequacy of the Group’s procedures from a risk-based perspective. We debate and approve their annual plan, as well as changes thereto, and receive regular reports on their work. Where appropriate the Committee meets with relevant management to gain further assurance on implementation of key controls. This process has worked well during the year.

We review the Interim Report and this Annual Report and Accounts, focusing on key judgements as well as the completeness and overall balance of reporting to shareholders. In this we are supported by the independent external auditors, Deloitte. Continued independence necessitates change and with this audit our lead engagement partner completes his five year term. The Committee have approved his successor having considered a well-qualified shortlist and the handover process has commenced. Having reviewed the effectiveness of the audit, the Committee are pleased to recommend that shareholders reappoint Deloitte as external auditors at the AGM.

AUDIT COMMITTEE TERMS OF REFERENCE

www.howdenjoinerygroupplc.com/investors/governance/audit/index.asp

Audit Committee Report continued

ROLE OF THE AUDIT COMMITTEE

The Committee is responsible for ensuring that the Group's financial systems provide accurate and up-to-date information, that the Group's published financial statements represent a true and fair reflection of this position and for ensuring the effectiveness and rigorosity of the external audit on behalf of the Board.

It has primary responsibility for:

	Role	Considerations, actions and activities
Controls and internal audit	<p>Monitoring the Group's internal financial controls throughout the year;</p> <p>Reviewing the Group's risk management processes, systems and reports (although the Board as a whole remains responsible for overseeing the overall risk profile of the business); and</p> <p>Overseeing the Group's Internal Audit function effectiveness and ensuring that its findings are used effectively.</p>	<p>The Committee considered the controls in place to mitigate fraud risk;</p> <p>Senior management from the business were invited to discuss the controls in their business areas. During 2016, 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;</p> <p>The Committee assessed the coverage of independent assurance by reviewing the Group assurance map and reviewed the business continuity management provisions; and</p> <p>The Committee received a report on the activity reported under the Group's whistleblowing policy and considered this report against a wider peer group benchmark.</p>
Financial reporting	<p>Monitoring the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance, reviewing accounting policies and significant financial reporting judgements contained therein (although the Board as a whole remains responsible for determining whether the Annual Reports and Accounts as a whole are fair, balanced and understandable);</p> <p>Ensuring that information flows from the senior management and external auditor are such that the information received by the Committee is complete, accurate, timely and robust; and</p> <p>Reviewing the going concern report and the report on the longer-term viability of the business, prior to consideration by the Board.</p>	<p>The Committee reviewed the Group's Annual Report and Accounts and the half-yearly financial report published in July 2016. As part of this review, the Committee received a report from Deloitte on their audit of the Annual Report and Accounts and review of the half-yearly financial report which took into account the Group's key risks, going concern considerations and longer-term viability;</p> <p>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; and</p> <p>Consideration was given as to whether the Annual Report and Accounts were 'fair, balanced and understandable'.</p>
External audit	<p>Making recommendations to the Board in relation to the appointment of the external auditor and approving the remuneration and terms of engagement of the external auditor;</p> <p>Reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;</p> <p>Reviewing the external auditor's audit plans and Audit Committee reports; and</p> <p>Developing and implementing a policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm.</p>	<p>The proposed plan of work presented by the external auditor, including audit risks, materiality, terms of engagement and fees was considered prior to commencement of the 2016 audit;</p> <p>The reports from the external auditor on the conduct of their audit, their review of accounting policies, areas of judgement and their comments on risk and the effectiveness of internal controls were scrutinised;</p> <p>An assessment of the qualification, expertise, resources, and independence of the external auditor and the effectiveness of the audit process was undertaken. This included consideration of a report on the audit firm's own quality control procedures and the audit firm's annual transparency report; and</p> <p>The Committee discussed the risk of a possible withdrawal of the external auditors from the market.</p>
Governance	<p>Ensuring members of the Audit Committee are aware of changes to the technical, regulatory and governance environment applicable to the work of the Committee; and</p> <p>Reporting to the Board on how it has discharged its responsibilities.</p>	<p>The Committee received updates from the external auditor on latest governance practices for Audit Committees and changes in statutory reporting requirements;</p> <p>Members of the Committee and the Committee collectively was subject to an external effectiveness review as part of the Board's wider evaluation process and undertook an effectiveness self-assessment review. The external review concluded that the Committee was 'thorough and effective';</p> <p>The Committee updated its policies in relation to allocation of non-audit work, employment of ex-audit firm personnel and the Group Whistleblowing policy;</p> <p>An update on the changes in legislation in relation to audit tendering and compulsory auditor rotation was provided by the Company Secretary; and</p> <p>The Committee reviewed the Directors' conflicts of interest and the Committee's terms of reference.</p>

As a result of its work during the year, the Audit Committee has concluded that it has acted in accordance with its terms of reference during the period and has ensured the independence and objectivity of the external auditors.

Audit Committee Report continued

AREAS OF SIGNIFICANT FINANCIAL JUDGEMENT CONSIDERED BY THE AUDIT COMMITTEE DURING THE YEAR

The Committee recognises that some areas of accounting require judgement to be exercised. In relation to the Group's accounts this year, the principal areas of judgement relate to inventory obsolescence and actuarial assumptions.

Valuation of inventory

The Group's in stock model necessitates tight management of inventory to ensure comprehensive local availability while minimising obsolescence and wastage. The Committee reviewed the results of stock counts and processes to value inventory including the assumptions behind obsolescence provisions. They also received reports from the external auditor on inventory in considering the appropriateness of provisions held against the carrying value of inventory, having regard to the age of discontinued lines and volumes of continuing lines relative to the expected usage.

Actuarial assumptions

The net deficit of the Group's defined benefit pension scheme has increased substantially over the year reflecting the impact of market conditions on key valuation assumptions. The Committee considered carefully the appropriateness of these assumptions, the recommendations of external actuaries and the views of the external auditors.

In previous years, the Audit Committee considered recoverability of trade debtors to be an area of significant financial judgement. Whilst management's assumptions underlying the bad debt provision continues to be challenged as an area of audit focus, the Audit Committee no longer consider these assumptions to be significant to the overall results. This reflects the effectiveness of tight credit controls over many years and the consistent record of predicting recovery rates.

All of the matters considered above were discussed with the Deputy Chief Executive and Chief Financial Officer, Group Finance Director and the external auditor. The Committee is satisfied that each of the matters set out above 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.

INTERNAL AUDIT

During the year, the Committee reviewed:

- Internal Audit's programme of work and resources;
- Results of key 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; and
- Staffing, reporting and effectiveness of divisional audits.

During the year, the Committee considered the effectiveness of the Internal Audit function and the Internal Audit plan. The Committee concluded that the function remained effective, well-led and had a well-defined remit. An independent review of the Internal Audit function was last undertaken by PwC in 2012. In line with the Committee's policy to perform an external review of the function every five years, an external review of the Internal Audit function will be undertaken during 2017.

WHISTLEBLOWING

The Group's whistleblowing policy contains arrangements for employees to have access to a confidential outsourced service, which allows calls and emails to be received in multiple languages, 24 hours a day. Complaints on accounting, risk issues, internal controls, auditing issues and related matters are reported to the Audit Committee as appropriate. The Whistleblowing policy and issues raised and investigated under this policy were formally reviewed during the year.

EXTERNAL AUDITOR

The Committee is responsible for the development, implementation and monitoring of the Group's policy on external audit in line with relevant legislation, ethical standards and guidance.

Auditor effectiveness

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

- The arrangements for ensuring the external auditor's independence and objectivity;
- The external auditor's fulfilment of the agreed audit plan and any variations from the plan;
- The perceptions of the auditor and audit process from key management personnel in the finance function;
- The robustness and perceptiveness of the auditor in their handling of the key accounting and audit judgements; and
- The content of the external auditor's report on internal control.

Auditor independence and fees

The Committee recognises that auditor independence is an essential part of the audit framework and the assurance it provides. To fulfil its responsibilities regarding the independence of the external auditor, the Committee undertook a comprehensive review during 2016 encompassing the following:

- 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;
- Consideration of the effectiveness of the external auditor through a review of their plan of work and the outputs arising from the audit;
- 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; and

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.

All relevant fees proposed by the external auditor must be reported to and approved by the Audit Committee. At the year end, the external auditor formally confirmed that their independence and objectivity had been maintained.

Policy for non-audit services

The main aims of this policy are to ensure the independence of the auditor in performing the statutory audit and to avoid any conflict of interest by clearly detailing the types of work that the auditor can and cannot undertake.

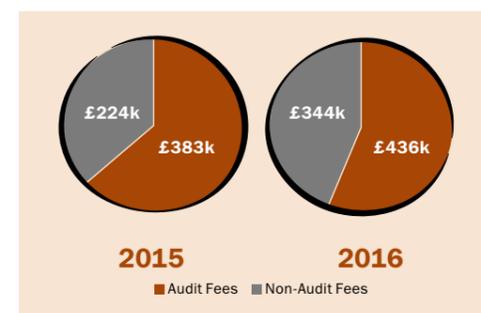
During the year, the Audit Committee reviewed and updated the policy for non-audit services to bring it into line with the amended FRC ethical standards and UK Corporate Governance Code (application from 25 December 2016). The regulation substantially curtails those non-audit services which can be provided by auditor. Key changes included:

- The introduction of a 70% cap of the value of the audit fee for all non-audit services calculated on a rolling three-year basis.
- The inclusion of tax calculation services as one of the category of services upon which is prohibited.
- The inclusion of actuarial valuation services in the category of services which are prohibited.

The policy specifies the type of non-audit work for which the auditor can be engaged without referral to the Audit Committee for which a case-by-case decision is necessary or from which the auditor is excluded.

The policy aims to ensure that in providing non-audit services 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.

Details of the total fees, including non-audit fees of £344,000, paid during the year to the external auditor, Deloitte LLP, are set out in the chart below and in Note 6 to the consolidated financial statements.



Non-audit services comprise the review of the Interim Report and tax compliance and tax advisory services for which Deloitte have been the most appropriate provider. Following regulatory changes, steps have been taken during the year for tax compliance to be conducted internally and an alternative supplier is being sought for tax advisory services.

The Audit Committee also has a policy in relation to the employment of former members of the external audit team.

Lead audit partner and audit tender

The external audit was last tendered in 2002 which resulted in a change to the Group's external auditor, with Deloitte LLP being appointed. In February 2016, following completion of the 2015 external audit, the Audit Committee considered whether it was in the best interests of the Company to re-tender the external audit at the end of the current lead audit partner rotation cycle. At that time, the current lead audit partner, Ed Hanson, had completed four years of a five year cycle.

As reported in last year's Annual Report, the Audit Committee determined that the Company would re-tender the external audit and change auditor no later than the conclusion of the subsequent five-year lead audit partner cycle in 2021. However, the Committee agreed to keep the need to re-tender and change auditor under review during this cycle and this remains its recommendation.

In reaching its conclusion, the Committee considered the transitional arrangements for mandatory audit tendering and auditor rotation published by the Department for Business, Innovation and Skills in March 2015 which provided that the Company could not enter into or renew its engagement for audit services with Deloitte LLP beyond June 2023, having been engaged as external auditor for over eleven but for less than twenty years. The Committee was also mindful of the provisions relating to audit tendering in the UK Corporate Governance Code and the FRC's Guidance on Audit Committees to put the external audit contract out to tender at least every ten years and that audit tendering should normally fit the five-year cycle of lead audit partner rotation.

The Committee considered a shortlist to succeed Ed Hanson as lead audit partner on completion of his five year cycle with the 2016 audit and are pleased to recommend Claire Faulkner to this role. Claire has substantial relevant experience as lead audit partner of premium listed companies and has been shadowing Ed through the 2016 year end audit.

The Committee has therefore unanimously recommended to the Board that a proposal be put to the shareholders at the Annual General Meeting that Deloitte LLP be reappointed as external auditor in 2017 and that the Directors be authorised to fix their remuneration.

Audit Committee Report continued

COMMITTEE MEMBERSHIP

Committee Chairman

The Chairman of the Audit Committee is responsible for determining the Committee's agenda and for maintaining the key relationships between the Group's senior management, Head of Risk and Internal Audit, the Company Secretary and senior representatives of the external auditor. To that end, he 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 via this report.

Richard Pennycook was Chairman of the Audit Committee until 5 May 2016. Following Richard's appointment as Chairman of the Board, Andrew Cripps was appointed Audit Committee Chairman. Andrew 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 Chairman of a number of public companies, including Booker Group plc. As such, the Board considers that he has the requisite recent and relevant financial experience to satisfy Provision C.3.1 of the UK Corporate Governance Code.

Committee Effectiveness

Committee membership and effectiveness is reviewed as part of the annual review of Board effectiveness. In addition, the Committee reviewed its own effectiveness by completing an Audit Committee effectiveness tool. The review encompassed a mix of qualitative and regulatory considerations as well as reviewing Committee structure, responsibilities and reporting. Both reviews concluded that the current mix of financial, commercial and relevant sector experience of the Audit Committee, and that of its advisors, is such that the Committee can effectively exercise its responsibilities to the Group in relation to risk and controls.

All members of the Committee are members of the Deloitte Academy which provides in-depth updates on financial and reporting matters.

The Committee is permitted by its terms of reference to obtain independent external advice at the Group's expense.

THE AUDIT COMMITTEE IN 2017

The Audit Committee is scheduled to meet at least three times during 2017 in conjunction with the annual reporting cycle. It will continue to consider all of the matters set out above for which it has primary responsibility in relation to financial statements, reporting and controls, the work of the external auditor and the Internal Audit function. It will continue to consider the Company's governance arrangements and review the Committee's terms of reference.

The Audit Committee confirms that the Company has complied with the provisions of the Competition and Markets Authority Order throughout its financial year ended 24 December 2016 and up to the date of this report.

By order of the Board

Andrew Cripps
Audit Committee Chairman

22 February 2017

Case Study: Cyber Security

Like all companies, Howdens is acutely aware of the risk associated with a cyber security incident or a serious data breach. Such events are considered by the Board to be a principal risk to the Company.

Whilst the Board is satisfied that the current mitigating security measures are sufficient, a recommendation in the 2015 external auditor management letter prompted the Audit Committee to request a deep dive in relation to the adequacy of password management controls across all user accounts. Similarly, an internal audit recommendation caused the Audit Committee to review cyber security awareness across the Group. At the July 2016 Audit Committee the Chief Information Officer presented updates against both recommendations and provided subsequent updates in writing at the November meeting.

The Audit Committee will continue to actively review the controls put in place by management in relation to cyber security as this risk matures.