

Audit Committee Report

David Adams

Chair of the Audit Committee



The Audit Committee has continued its work of reviewing the effectiveness of Halfords' corporate governance framework with emphasis on the quality of financial reporting, internal control and risk management.



Chair's Letter

I am pleased to present the report of the Audit Committee for the financial year ended 29 March 2019.

Throughout the year, the Audit Committee has continued its work of reviewing the effectiveness of Halfords' corporate governance framework with particular emphasis on the quality of financial reporting, internal control, and risk management systems. The Committee monitors risk and internal control through engagement with the external Auditor, internal auditors and executive management. The latter regularly present management briefings to the Committee, explaining in detail how selected key areas of business risk are managed.

This report explains in detail how the Committee undertook its duties.

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3

Audit Committee meetings held

Committee Composition

During the year the Committee consisted of:

David Adams (Chair)

Helen Jones

Jill Caseberry (appointed 1 March 2019)

Claudia Arney (resigned 1 March 2019)

Three scheduled Committee meetings were held during the year and were attended by all relevant members at the time of the meeting. In addition, a further unscheduled meeting was held to discuss the audit tender process. After each Committee meeting the Audit Committee Chair, reported to the Board on the key issues discussed.

Membership and Remit of the Audit Committee

Membership

All the members of the Audit Committee are independent Non-Executive Directors. David Adams is considered by the Board to have recent and relevant financial experience to chair the Committee, having been the Deputy Chief Executive and Finance Director of House of Fraser Plc, and over the last few years has chaired six listed companies' Audit Committees, including one currently. Each of the other independent Non-Executive Directors has, through their other business activities, significant experience in financial matters. The Audit Committee as a whole is considered to have competence relevant to the sector in which the Company operates. The effectiveness of the Audit Committee is reviewed at least annually through discussions at the Board and Audit Committee.

2018/19 Key Achievements

- Considered and recommended to the Board the appointment of the new external Auditor in succession to KPMG
- Reviewed the year-end and half-year Chief Financial Officer's reports
- Reviewed the external Auditor's year-end and half-year reports
- Approved the non-audit fee policy
- Reviewed the statement of external Auditor's independence
- Reviewed the Internal Audit full-year report
- Reviewed and approved the Internal Audit Charter
- Reviewed the Internal Audit progress reports including regular updates on the Company's risk management and internal control systems
- Reviewed and recommended the Preliminary and Interim results announcements to the Board for approval
- Reviewed the anti-bribery and corruption risk assessment and reviewed and approved the Anti-Bribery and Corruption Policy
- Reviewed and approved the Committee's Terms of Reference
- Reviewed the update on a new Accounting Standard
- Reviewed and approved the external Auditor's annual strategy and fees
- Reviewed and approved the Whistleblowing Policy

The Chairman of the Company's Board, Executive Directors, senior managers and key advisors are invited to attend meetings as appropriate in order to ensure that the Committee maintains a current and well-informed view of events within the business, and to reinforce a strong risk management culture. The Audit Committee meets according to the requirements of the Company's financial calendar. The meetings of the Audit Committee also provide the opportunity for the independent Non-Executive Directors to meet without the Executive Directors present and to raise any issues of concern with the external Auditor. There have been three such meetings in the period ended 29 March 2019 and nothing of note was reported.

Remit

The Audit Committee's responsibilities include:

- making recommendations to the Board on the appointment of the external Auditor, including on effectiveness, independence, non-audit work undertaken (against a formal policy) and remuneration;
- reviewing the accounting principles, policies and practices adopted throughout the period;
- reviewing and approving external financial reporting for adoption by the Board;
- assisting the Board in achieving its obligations under the UK Corporate Governance Code in areas of risk management and internal control, focusing particularly on compliance with legal requirements, accounting standards and the Listing Rules;
- reviewing the Corporate Risk Register and regular Internal Audit reports on developments in the internal control framework to ensure that an effective system of internal financial and non-financial controls is maintained on an ongoing basis;
- approving a formal Whistleblowing Policy whereby colleagues may, in confidence, disclose issues of concern about possible malpractice or wrongdoings by any of the Group's businesses or any of its employees without fear of reprisal, including arrangements to investigate and respond to any issues raised;
- approving the Company's systems and controls for the prevention of bribery and corruption, including the receipt of any reports on non-compliance;
- listening to and reviewing presentations on key topics or salient risk areas, which in the last two years has included GDPR, cash-in-stores controls and tax strategy, supplier rebates and contributions, cyber security and global sourcing;
- approving the Group's Tax Policy and published tax strategy; and
- approving the Group's Treasury Policy, including foreign currency and interest rate exposure.

The Audit Committee has reviewed its Terms of Reference and its composition during the year and believes that both are appropriate.

Copies of the full Terms of Reference are available on the Company's website or on request from the Company Secretary.



The Terms of Reference for the Committees are available at www.halfordscompany.com/investors/governance

Significant Issues in Relation to the Financial Statements

In order to discharge its responsibility to consider accounting integrity, the Committee carefully considers key judgements applied in the preparation of the consolidated financial statements which are set out on pages 120 to 125. The Committee's review included consideration of the following key accounting judgements:

Impairment of Goodwill associated with Autocentres (Car Servicing):

- following the acquisition of Nationwide Autocentres in 2010, the Group holds significant goodwill in the Halfords Autocentres business. There are a number of factors that could impact on the future profitability of the business (e.g. loss of key customers, change in

market behaviour) and therefore, there is a risk that the business may not meet the growth projections necessary to support the carrying value of the intangible asset (see Note 10 on page 143 of the Financial Statements); and

- the Audit Committee has received detailed reports from Halfords' finance team and reports from the external Auditor addressing this issue. The finance team has undertaken detailed work to consider the impairment of goodwill associated with Autocentres. Consideration has been given to ensuring that cash flow models, discount rates, sensitivity analysis and centre profitability are all reasonable. It was concluded that no impairment is required. The Committee concluded that it is satisfied with the accounting treatment of impairment of goodwill.



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Valuation of inventory within the Retail division:

- with the business holding a wide range of stock, it is likely that changing consumer demands will mean that some lines cannot be sold or will be sold at below the carrying value. Provisions are made to reflect this. Given the difficulties in forecasting market trends, there is a risk that inventory provisions made will be inappropriate or incomplete (see Note 13 on page 146 of the Financial Statements). Management have fully reviewed the inventory provision in the current year and believe the level of provisioning is appropriate. Range reviews are regularly undertaken to ensure that all discontinued inventory is identified; and
- the Audit Committee has received detailed reports from Halfords' finance team and reports from the external Auditor addressing this issue. The finance team has undertaken detailed work around the valuation of inventory within the Retail division. After consideration of the accuracy of the provisioning model, the completeness and accuracy of range reviews, and the reflection of these reviews within the provisions, the Committee concluded that it is satisfied with the accounting treatment of the valuation of inventory.

External Auditor

Effectiveness of External Audit

The effectiveness of the External Audit is considered throughout the year through, amongst other factors: assessment of the degree of the audit firm's challenge of key estimates and judgements made by the business; feedback from any external or internal quality reviews on the audit; and the wider quality of communication with the Committee.

In addition, at its meeting in March 2019, the Committee performed a specific evaluation of the performance of the external Auditor considering the areas set out above and feedback from management. Following this, the Committee concluded that:

- the overall audit approach, materiality, threshold, and areas of audit focus were appropriate to the business; and
- the audit team possessed the necessary quality, expertise and experience to provide an independent and objective audit.

Approach to Appointment or Reappointment

KPMG LLP (formerly KPMG Audit plc) was appointed as external Auditor to the Group in 2009 following a formal tender process. Since that time, KPMG LLP has complied with the partner rotation requirement set out in Ethical Standards for Auditors. The most recent rotation took place last year with Michael Froom becoming Halfords' audit partner.

During FY19, the Committee decided to hold a competitive audit tender process for rotation of the audit firm in respect of FY20. The tender process was overseen by the Audit Committee and the management of the process was delegated to the Chair of the Committee and the Chief Financial Officer. The Company announced, on 6 February 2019 that BDO LLP had been successful in the audit tender process and will therefore be appointed, subject to approval by shareholders at the AGM in July 2019, as its new external Auditor with effect from the year commencing 30 March 2019. BDO LLP have therefore been shadowing KPMG during the FY19 year end audit process and have attended Committee meetings prior to their appointment. The Committee would like to record its thanks to KPMG and its partners and staff for its many years of service to the shareholders of Halfords.

The Committee is satisfied that BDO LLP is independent and is best placed to conduct the Company's audit for FY20 and therefore recommends that BDO LLP be appointed as the Company's Auditor.

Approach to Safeguarding Objectivity and Independence if Non-Audit Services are Provided

The Audit Committee has established a policy to ensure that any non-audit services delivered by the external Auditor will not jeopardise objectivity and independence. The policy is consistent with the Ethical Standards for Auditors.

The policy specifies:

"The external Auditor can be used to provide non-audit services subject to any non-audit engagement proposal provided by the external Auditor being formally approved by the Audit Committee before contractual arrangements are entered into, except for activities set out in a list of prohibited activities. Other than for these, for each separate service proposed to be provided by the external Auditor, the Group Chief Financial Officer will prepare a note either to be tabled and minuted at an Audit Committee meeting or to be circulated via email to the Audit Committee members and the Chief Executive Officer giving a description of the work to be undertaken, the reasons why the external Auditor is involved in the proposal and how objectivity and independence has, and is seen to be, safeguarded.

In addition, the fees for any proposal for non-audit services will not exceed 70% of the three-year average statutory audit fees when taken into consideration with total fees for non-audit services already committed in the financial year.

Consent is required from the Audit Committee Chair on behalf of the Audit Committee before the external Auditor can be engaged for non-audit services."

In addition, the external Auditor follows its own ethical guidelines and continually reviews its audit team to ensure that its independence is not compromised.

An analysis of the fees earned by the external Auditor is disclosed in Note 3 on page 139 to the Financial Statements.

Role and Effectiveness of Internal Audit

The Company has a dedicated in-house Internal Audit team, with recourse to external specialists where necessary. An annual programme of audits that addresses the effectiveness of the control environment is based on an assessment of the risks to the business. The Audit Committee reviews the annual audit programme for coverage and may revise according to changing business circumstances and requirements. The Audit Committee also ensures that there are sufficient resources to undertake the audit programme.

The Internal Audit programme features reviews covering financial and commercial processes, governance issues and key risk safeguards. The executive summaries of all internal audit reports are circulated to Audit Committee members and discussed at meetings where appropriate.

The Audit Committee is satisfied that the Internal Audit team has the quality, experience and expertise appropriate for the business.

Internal Audit reports to the Chief Financial Officer but has a direct line of communication to the Audit Committee Chair. The findings of the independent audits are reported initially to executive management and any necessary corrective actions are agreed. Summaries of these reports are presented to, and discussed with, the Audit Committee along with details of progress against action plans as appropriate. The internal audit reports are distributed to the external Auditor as and when they are completed during the year.

Whistleblowing

A Whistleblowing Policy and procedure (the "Policy") enables colleagues to report concerns on matters affecting the Group or their employment, without fear of recrimination. Posters publicising whistleblowing channels are distributed to all stores, Autocentres, Distribution Centres and the Support Centre.

The Policy was reviewed and approved by the Audit Committee and was subject to an Internal Audit review during the year. The Company Secretary provides the Audit Committee with a regular summary of whistleblowing contacts and resolutions.

Anti-Bribery and Corruption Policy

The Group's Anti-Bribery and Corruption Policy statement reinforces that the Halfords Board is committed to conducting its business affairs so as to ensure that it does not engage in or facilitate any form of corruption. It is Halfords' policy to prohibit all forms of corruption amongst its colleagues, suppliers and any associated parties acting on its behalf. The Group has a detailed Anti-Bribery and Corruption Policy and maintains Gifts and Hospitality Registers. Anti-bribery expectations are set out in standard purchasing terms and conditions. Face-to-face and online training has been provided to colleagues to raise awareness of anti-bribery and corruption legislation.

The Audit Committee has requested that anti-bribery and corruption safeguards are periodically reviewed by Internal Audit.

Internal Control and Risk Management

Details of the Group's internal control and risk management framework are set out on pages 50 to 58.

David Adams

Chair of the Audit Committee

21 May 2019

