

AUDIT COMMITTEE REPORT



Adapting to a changing environment and new ways of working to ensure financial integrity and robust and effective internal controls.”



Anne Thorburn
Chair of the
Audit Committee

Dear Shareholder

The Audit Committee assists the Board in discharging its responsibilities with regard to monitoring the integrity of Group financial reporting, external and internal audits and controls, including advising on the reappointment and independence of external auditors and assessing the quality of their services; and reviewing the effectiveness and appropriateness of the Company's internal audit activities, internal controls and management systems.

During the year ended 30 September 2021, the Committee has ensured that it has had oversight of all these areas while also focusing on diverse changes in the external environment, both regulatory and political, including the impact of the Covid-19 pandemic, which have had a range of implications on the risk management activities of the Company. The Committee continues to monitor the uncertainties arising from these changes and consider the management and mitigation of these risks. The Committee formulated a response to BEIS on their audit and governance reforms white paper "Restoring trust in audit and corporate governance" focusing upon the potential implications for the Group and the importance of proportionate approaches.

In addition, the Committee has received reports on internal audits for the Group's businesses, as well as updates on the steps being taken to address internal audit findings, controls issues and investigations. All members of the Committee participated in the externally facilitated performance evaluation carried out during the year, which felt that the Committee is a good and balanced forum, with plenty of relevant experience. Further details of the evaluation, its recommendations and actions can be found on pages 65 to 66.

As Audit Chair, I have regular conversations with the Chief Financial Officer, Group Internal Audit Director, Group Financial Controller, Group Company Secretary and also the audit partner at PricewaterhouseCoopers LLP ("PwC"), our external auditor.

PwC has now completed its fourth full annual cycle, and we value the rigour and challenge of its approach. I am pleased to report that again there have been no significant control deficiencies or accounting irregularities reported to the Committee this year. I am confident that the Audit Committee has carried out its duties during the year effectively and to a high standard, providing independent oversight with the support of management and assurance from the external auditors.

I look forward to meeting shareholders at the AGM on 19 January 2022 and will be happy to respond to any questions relating to the activities of the Audit Committee.

Anne Thorburn
22 November 2021

Audit Committee

The Committee is chaired by Anne Thorburn and comprises four independent non-Executive Directors. The Committee acts independently of the Executive Directors and management. Our members have a range of skills and the Committee as a whole has experience relevant to the Sectors in which the Group operates. Anne has recent and relevant financial experience, as required by the Code.

The Group Company Secretary acts as Secretary to the Committee. The Executive Directors also attend Committee meetings and subject matter experts are invited to present on specific topics as and when required. The Committee met with the external auditor during the year, without the Executive Directors being present.

The Audit Committee confirms that the Company has complied with the provisions of the Competition & Markets Authority Order throughout its financial year ended 30 September 2021 and up to the date of this report.

Financial reporting and significant financial judgements and estimates

The Committee considered and assessed:

- the full year and half year results, and quarterly trading updates for recommendation to the Board;
- the quality and appropriateness of accounting policies and practices, as well as critical accounting estimates and key judgements; and
- whether the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

The Committee considered the matters set out below as being significant in the context of the consolidated financial statements for the year ended 30 September 2021. These were discussed and reviewed with management and the external auditor and the Committee challenged judgements and sought clarification where necessary.

The Committee considered the judgements made in evaluating the financial statements, including the accounting for acquisitions and associated valuation of intangible assets, the impact on provisions for excess and slow-moving inventory, the appropriateness of the Going Concern assumption and the impairment of goodwill.

Accounting for acquisitions and disposals

The Committee reviewed the accounting for acquisitions completed during the year, in particular the acquisition of WCW and S&W for a combined consideration of £383m. The acquisitions were material for the FY 2021 audit and, in accordance with IFRS 3 (Business Combinations), management has performed a full fair value exercise for these two acquisitions in this year's financial statements. As part of their audit of the Group, the external auditor has performed work on: a) the Purchase Price Allocation ("PPA"); b) substantive detailed testing of the opening balance sheet as at the acquisition date; c) audit of any material fair value adjustments arising on the acquisition balance sheet; and d) testing procedures over the closing balance sheet. The Committee reviewed and challenged management's assessment, which also included consideration of the external audit findings. The Committee concluded that the accounting for these two acquisitions and the other eight smaller acquisitions was appropriate. The Group completed one disposal and committed to another, resulting in an impairment charge of £7.3m to state the company's net assets at their fair value.

Provisions for excess and slow-moving inventory

The Committee reviewed the report of the Chief Financial Officer ("CFO") that set out the gross balances, together with any related provision against the carrying value. The Committee reviewed the bases used to value inventory held across the Group; they also considered the appropriateness of provisions held against the carrying value of inventory, having regard to the age and volumes of inventory relative to expected usage and considering any continued impact of the Covid-19 pandemic and any actions taken in response to potential disruptions to supply chains.

Following their review, which also included consideration of the external audit findings, the Committee concluded that the provision for excess and slow-moving inventory is appropriate.

Impairment of goodwill

The Committee considered the carrying value of goodwill and the assumptions underlying the impairment review. The judgements in relation to goodwill impairment largely relate to the assumptions underlying the calculations of the value in use of the cash-generating units ("CGUs") being tested for impairment. These judgements are primarily the calculation of the discount rates, the achievability of management's forecasts in the short to medium term against the backdrop of the Covid-19 pandemic and the use of the long-term growth rate. Following the review, which also included consideration of the external audit findings, the Committee concurred with the conclusion that the carrying value of the goodwill recorded is appropriate.

Other audit matters

The external auditor also reported to the Committee on other less material matters including the recoverability of trade receivables and the valuation of the Group's defined benefit pension schemes.

In addition to the above, the Committee also seeks comments from the auditor that the Group's businesses follow appropriate policies to recognise material streams of revenue and their audit work carried out more generally has assessed whether there is any evidence of management override of key internal controls designed to guard against fraud or material misstatement.

As part of its monitoring of the integrity of the financial statements, the Committee reviews whether suitable accounting policies have been adopted and whether management has made appropriate estimates and judgements, and seeks support from the external auditor to assess them.

Going Concern and Viability

The Going Concern and Viability assessment was undertaken against the continued backdrop of Covid-19. In preparing the assessment, management considered two scenarios – the base case and downside case. The base case reflects actual recent trading and takes account of any further anticipated impact of Covid-19. The downside case reflects a more significant decline in trading, adverse movements in working capital and lower than forecast operating margin, and is considered by management to be a severe but plausible scenario. The Group has significant liquidity headroom and covenant headroom in both scenarios for both Going Concern and Viability Statement purposes. The Audit Committee reviewed the assumptions underpinning each scenario and is satisfied with management's assessment and conclusions in respect of Going Concern and Viability. Further detail on the assessment of Viability and the Viability Statement are set out on page 33. Further details on Going Concern can be found on page 113.

Engagement of the external auditor

The external auditor is engaged to express an opinion on the financial statements of the Group and of the Company. The audit includes the consideration of the systems of internal financial control and the data contained in the financial statements, to the extent necessary for expressing an audit opinion on the truth and fairness of the financial statements.

The Group's Annual Report & Accounts has been audited by PwC, led by Christopher Burns, Audit Partner. In its fourth year as auditor, PwC has met with the Audit Chair and has agreed its audit strategy and audit fees with the Audit Committee. As part of its audit, PwC will continue to provide the Committee with relevant reports, reviews and advice throughout the coming year.

In accordance with UK regulations, PwC also assured the Committee that it adheres to a rotation policy based on best practice and the Group engagement partner will serve a period of no longer than five years.

AUDIT COMMITTEE REPORT CONTINUED

During the year, the Committee carried out an assessment of the effectiveness of the external audit process for the previous year ended 30 September 2020. The assessment was led by the Chair of the Committee, assisted by the CFO, and focused on certain criteria which the Committee considered to be important factors in demonstrating an effective audit process. These factors included the quality of the audit process and the robustness of challenge to management, the planning and execution of the audit and the role of management in the audit process.

The Committee was satisfied that the PwC audit of the Company and Group had provided a robust and effective audit and an appropriate independent challenge of the Group's senior management. It also supported the work of the Committee through clear and objective communication on developments in financial reporting and governance.

Non-audit services

The Committee has approved the Group's internal guidelines covering the type of non-audit work that can be carried out by the external auditor of the Group, in light of the regulation set out in the EU Audit Directive and Audit Regulation 2014 (the "Regulations") and the Financial Reporting Council ("FRC") Revised Ethical Standard 2019.

The Regulations substantially curtail those non-audit services that can be provided by the auditor to the Group and in particular prohibits all tax related services, including compliance services as well as general advice and all consultancy and advisory services. The Regulations require that Board approval is required if eligible non-audit services, such as due diligence and similar assurance services, exceed 30% of the prior year Group audit fee and the Company may not allow eligible non-audit services to exceed 70% of the Group audit fee, calculated on a rolling three-year basis.

The CFO does not have delegated authority to engage the external auditor to carry out any non-audit work, but must seek approval from the Chair of the Audit Committee.

Taxation services are not provided by the Group's current audit firm; a separate firm is retained to provide tax advice and any assistance with tax compliance matters generally. In addition, due diligence exercises on acquisitions and similar transactions are not provided by the auditor, but are placed with other firms.

The external auditor is retained to carry out assurance services to the Committee in connection with "agreed upon procedures" on the Group's half year consolidated financial statements (£27,000). The external auditor also provides access to its Viewpoint technical subscription service (£1,200). With the exception of these services, PwC has not provided any non-audit services to the Group or its subsidiaries and has confirmed its independence to the Audit Committee. The total non-audit fees for the year are £28,200. Further information is set out in note 26 to the consolidated financial statements.

The Committee assures itself of the auditor's independence by receiving regular reports from the external auditor which provide details of any assignments and related fees carried out by the auditor in addition to its normal audit work and these are reviewed against the above guidelines. PwC has reconfirmed its independence for the current financial year.

Tax strategy

The Committee meets annually with the Head of Tax to review the key tax matters affecting the Group and to understand the areas of tax focus in the forthcoming year. The Committee also reviewed the Group's tax strategy and broader tax policy.

Risk management and internal control

The principal risks and uncertainties that are currently judged to have the most significant impact on the Group's long-term performance are set out in a separate section of the Strategic Report on Internal Control and Risk Management on pages 28 to 33.

The Committee is responsible for reviewing the effectiveness of the Group's system of internal control. The system of internal control is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Group has the necessary procedures in place to ensure that there is an ongoing process for identifying, evaluating and managing the principal risks to the Group. These procedures are in line with the FRC's guidance. The Board has established a clear organisational structure with defined authority levels. The day-to-day running of the Group's business is delegated to the Executive Directors of the Group who are supported by the heads of each business Sector and functional heads of the Group.

Key financial and operational measures relating to revenue, cash and receivables are reported on a weekly basis. Detailed management accounts and key performance indicators are prepared monthly using a robust proprietary reporting system to collect and analyse financial data in a consistent format. Monthly results are measured against both budget and half year reforecasts which have been approved and reviewed by the Board. All capital expenditure above predefined amounts must be supported by a paper prepared by management.

All financial data is taken directly from the trial balance of each business held in their local ERP systems and reanalysed and formatted in a separate Group management reporting system, operated by the Group Finance department. There is no rekeying of financial data by the Group businesses to report monthly financial results. The Group Finance department continues to develop the functionality of this management reporting system to provide greater insights into the activities of the Group's businesses, both financial and operational. The Group's internal auditor regularly audits the base data at each business to ensure it is properly reported through to the Group management reporting system.

As part of the year end close process each business is required to complete a self-assessment that evaluates the financial control environment in their business which is designed to identify weaknesses in controls. These assessments are critically reviewed by the Group Internal Audit Director and evaluated as part of regular Internal Audit reviews. A summary for each business is prepared for the Audit Committee. In addition, senior management of each business are required to confirm their adherence with Group accounting policies, processes and systems of internal control by means of a representation letter.

The Committee has reviewed the effectiveness of the Group's risk management and internal control systems for the period from 1 October 2020 to the date of this report. Taking into account the matters set out on pages 28 to 33 relating to principal risks and uncertainties and the reports from the Group Internal Audit Director, the Board, with the advice of the Committee, is satisfied that the Group has in place effective risk management and internal control systems.

Internal audit

The Group maintains an internal audit department which reports directly to both the CFO and Chair of the Audit Committee. The department comprises a Group Internal Audit Director and a Group Internal Auditor based at the Group's offices in London.

In January 2021, the Group Internal Audit Director presented his audit plan for the year to the Committee for their approval. Travel restrictions continued to be in place for most of 2021 (especially travel to North America and Australia) but internal audit was able to rely on the processes implemented last year and carry out internal audit reviews to deliver the plan. The department continued to effectively rely on remote visits with the use of appropriate communication technology where site visits were not possible.

The scope of work carried out by internal audit generally focuses on the internal financial, operational and compliance controls operating within each business, including risk management activities and business process improvements. Formal written reports are prepared on the results of each internal audit visit that set out internal control weaknesses/risks identified during their work, together with recommendations to improve the internal control environment and mitigate these weaknesses/risks. These reports are timely and regularly discussed with senior management within Diploma PLC.

At the end of the financial year, the Group Internal Audit Director formally reports to the Committee on the results of the internal audit work carried out by his department during the year. The Committee reviews management's responses to matters raised, including the time taken to resolve such matters. Update reports on progress against the plan are provided at regular intervals and the Audit Chair also meets separately with the Group Internal Audit Director at least twice a year to review some of the department's reports and discuss their findings.

There were no significant or high-risk matters identified in the internal audits undertaken during the current financial year. Several recommendations were again made this year to the businesses in regard to implementing adequate and effective internal controls and procedures aimed at improving existing processes around cybersecurity, inventory management and procurement.

The internal audit department also continues to monitor the businesses' compliance with Group policies on anti-bribery/corruption sanctions and the other compliance requirements.

The Committee conducted the annual review of the effectiveness of the internal audit department, including its audit plan, general performance and relationship with the external auditors. Based on its review, the Committee was satisfied with the effectiveness of the Group's internal audit function, specifically the Committee is satisfied that the internal audit department is sufficiently independent of executive management and has sufficient resources and scope that is appropriate for the size and nature of the Group.

Sanctions

The Audit Committee continued to work with the Head of Legal, executive management and senior management of the Group, to ensure ongoing compliance with all applicable sanctions. The Committee will continue to monitor developments until the sanctions are suspended or revoked.

Anti-bribery and corruption

A Group policy on anti-bribery and corruption addresses the requirements of the Bribery Act 2010. The Committee periodically reviews this policy and the procedures to ensure continued and effective compliance in its businesses around the world. The Group also provides an e-learning training programme to all its businesses. This training has been undertaken by all senior management and employees in customer or supplier-facing roles and in particular by management and employees from companies that have recently joined the Group.

Whistleblowing

The Committee also monitors the adequacy of the Group's whistleblowing policy, which provides the framework to encourage and give employees confidence to "blow the whistle" and report irregularities. The policy, together with hotline posters, are placed on site noticeboards across the Group. Employees are encouraged to raise concerns via the confidential multilingual hotline, which is managed by an independent external company and is available 24/7, 365 days a year.

All reports are provided to the Group Company Secretary for review, to ensure that they are appropriately investigated – with the support of internal audit and external resource, if required. Most matters reported through the whistleblowing service relate to personnel/HR matters and, while these are not areas for review by the Committee, such matters are duly investigated in the same manner as any other issue raised.

Key duties and focus in 2021

The Audit Committee is responsible for ensuring that the Group maintains a strong control environment. It provides effective governance over the Group's financial reporting, including oversight and review of the systems of internal control and risk management, the performance of internal and external audit functions, as well as the behaviour expected of the Group's employees through the whistleblowing policy and similar codes of conduct. The Committee continues to focus on monitoring and overseeing management on these improvements to governance, compliance and financial safeguards.

The Committee's role and responsibilities are set out in its Terms of Reference, which were reviewed during the year and are approved by the Board.

The Committee's key responsibilities and focus during the year ended 30 September 2021 have been:

- Reviewed and agreed the scope of audit work to be undertaken by the external auditor and agreed the terms of engagement and fees to be paid for the external audit.
- Reviewed the 2020 Annual Report & Accounts and received reports from the CFO and the external auditor on the key accounting issues and areas of significant judgement.
- Reviewed the report on compliance with the UK Corporate Governance Code 2018 and reports on the provision of information to the auditor.
- Reviewed the report from the CFO on the controls in place to mitigate fraud risk.
- Reviewed the Half Year Announcement and received reports from the external auditor on the key accounting issues and areas of significant judgement including an assessment of the impact of Covid-19 on the trading results and the interim going concern assessment.
- Reviewed the trading updates.
- Reviewed the effectiveness of the Group's internal control and risk management procedures, also taking into account the impact of Covid-19, and, where appropriate, made recommendations to the Board on areas for improvement.
- Invited the Group Internal Audit Director to attend meetings to review the results of the internal audit work for the current year and to agree the scope and focus of internal audit work to be carried out in the following year.
- Reviewed the UK Corporate Governance Code 2018 and future reporting under section 172 Companies Act 2006.
- Approved the Committee work programme for 2022.
- Approved the Going Concern and Viability Statements.
- Continued to monitor developments in audit reform and changing best practice.
- Responded to the BEIS "Restoring trust in audit and corporate governance" reform proposals.