

Audit Committee Report



I am *pleased* to present the report of the Audit Committee for the financial year ended 1 April 2016.

Chairman's Introduction

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's oversight of risk and internal control has been further strengthened this year through two significant ongoing initiatives. Firstly, recognising the usefulness of an earlier presentation on cybersecurity risk from KPMG, we have initiated a series of management briefings to the Committee. The briefings explain in detail how selected key areas of business risk are managed. The Committee has already received presentations on retail product quality and safety assurance processes, and on retail erosion management. Secondly, in response to the requirements of the 2014 UK Corporate Governance Code, the Committee receives a specific update from Internal Audit at each meeting to allow it to monitor the Company's risk management and internal control systems. These updates were provided throughout the year.

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

David Adams

Chairman of the Audit Committee

1 June 2016

Fast Fact

8 Bikes in Sir Bradley Wiggins range for kids - launching in July 2016

Fast Fact

Women's bikes accounted for **25%** of all bike sales at Halfords



*Fast Fact figures relate to 4th April 2015 - 1st April 2016

Membership and Remit of the Audit Committee

a. Membership

All the members of the Audit Committee are independent Non-Executive Directors. Having been the Deputy Chief Executive and Finance Director of House of Fraser Plc, and currently chairing two other listed companies' Audit Committees, David Adams is considered by the Board to have recent and relevant financial experience and so the requisite experience to chair the Committee. Each of the other independent Non-Executive Directors has, through their other business activities, significant experience in financial matters.

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 Auditor. There have been three such meetings in the period ended 1 April 2016 and nothing of note was reported.

b. 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;
- ensuring that an effective system of internal financial and non-financial controls is maintained;
- approving a formal whistleblowing policy whereby staff 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, and includes 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; 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 full Terms of Reference are available on the Company's website or on request from the Company Secretary.

Principal Activities during the Year

The Audit Committee met three times during the year with the following timetable:

June 2015

- Review of Year End Chief Financial Officer's Report
- Recommend the Preliminary Statement to the Board for Approval
- Recommend the Annual Report to the Board for Approval
- Review of External Auditor's Report
- Review Statement of External Auditor's Independence
- Review of Internal Audit Full-Year Report, including update on the company's risk management and internal control systems
- Approval of Internal Audit Charter

November 2015

- Review of Half-Year Chief Financial Officer's Report
- Recommend the Interim Statement to the Board for Approval
- Review of External Auditor's Half-Year Report
- Review of Internal Audit Progress Report including update on the company's risk management and internal control systems
- Approval of External Auditor Non-Audit Fee Policy
- Review of anti-bribery and corruption risk assessment and approval of Anti-bribery and Corruption Policy
- Approval of Group Treasury Policy
- Management presentation on retail product quality and safety assurance processes
- Review of Committee Terms of Reference

March 2016

- Review of External Auditors Annual Strategy and Fees
- Review of Internal Audit Progress Report and Annual Strategy including update on the Company's internal control systems
- Review of Group Register of Risks and Controls
- Review of Group Whistleblowing Policy
- Management presentation on retail erosion management

Audit Committee Report continued

The Committee also met on 26 May 2016. Amongst other pieces of business, the Committee reviewed the year-end Chief Financial Officer's and external Auditor's reports, and recommended the Preliminary Statement and Annual Report to the Board for approval. The Committee received a presentation from management addressing the commercial aspects and financial reporting issues associated with supplier rebates.

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 78 to 119. The Committee's review included consideration of the following key accounting judgements:

- Impairment of Goodwill associated with Autocentres
 - Following the acquisition of Nationwide in 2010, the Group holds significant goodwill in the Halfords Autocentre business. There are a number of factors that could impact on the future profitability of the business (e.g. loss of key customer, change in market behaviour) and there is therefore a risk that the business may not meet the growth projections necessary to support the carrying value of the intangible asset (see note 11 of the financial statements).
 - The Audit Committee has received detailed reports from Halfords' finance team and external Auditor addressing this issue. Consideration has been given to ensuring that cash flow models, discount rates, sensitivity analysis and centre profitability are all reasonable. The Committee concluded that it is satisfied with the accounting treatment of impairment of goodwill.
- 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 of the financial statements). Management has an established methodology for assessing inventory provisions. Range reviews are regularly undertaken to ensure that all discontinued inventory is identified.
 - The Audit Committee has received detailed reports from Halfords' finance team and external Auditor addressing this issue. 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 Auditors

a. 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 2016, 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.

b 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, with the most recent rotation taking place in 2014.

The Audit Committee considers that the relationship with the Auditor is working well and is satisfied with its independence, objectivity and effectiveness and has not considered it necessary to require KPMG LLP to re-tender for external audit work this year. The Audit Committee has recommended to the Board, for approval by shareholders at the AGM on 26 July 2016, the reappointment of KPMG LLP as external Auditor.

c 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 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

- i. *Half year review; and*
- ii. *Internal support services supplied by the auditors in order to support the Company's own internal audit function in determining and executing the Company's annual Internal Audit plan.*

Other than for the above, for each separate service proposed to be provided by the 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 CEO giving a description of the work to be undertaken, the reasons why the Auditor is involved in the proposal and how objectivity and independence has, and is seen to be, safeguarded.

Consent is required from the Audit Committee Chair on behalf of the Audit Committee before the 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 to the Financial Statements.



i Fast Fact

Halfords helped

185k

kids onto *their*
first bike, a
5% increase
year-on-year

*Fast Fact figures relate to 4th April 2015
- 1st April 2016

Role and Effectiveness of Internal Audit

The Company has a dedicated in-house Internal Audit team, which is able to obtain advice from external specialists if necessary. The team principally reviews the effectiveness of the controls operating within the business by undertaking an agreed schedule of independent audits each year. The Audit Committee determines the nature and scope of the annual audit programme and revises it from time to time according to changing business circumstances and requirements. The Audit Committee also confirms that Internal Audit has appropriate resources available to it. The annual audit programme is derived from an audit universe including financial and commercial processes, governance issues, and key corporate risks.

Internal Audit reports on a day-to-day basis to the Group's Chief Financial Officer, but is independent in action and reporting of issues, with direct line of communication to the Audit Committee Chairman. 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.

Whistleblowing

A Whistleblowing Policy and Procedure 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 Whistleblowing Policy and Procedure 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 our employees, suppliers and any associated parties acting on our 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 the 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 page 47.