

Audit Committee

Provides independent assessment of the Company's financial affairs and statements, and oversees the risk process.



Darren Shapland
Audit Committee
Chairman

Audit Committee members

Membership	Year of appointment	Meetings attended
Darren Shapland (Chairman)	2014	4 (4)
Tessa Bamford	2011	4 (4)
Alan Murray	2013	4 (4)
Nadia Shouraboura	2017	4 (4)
Jacky Simmonds	2014	4 (4)
Members who left during the year		
John Daly	2014	3 (3)
Pilar López	2013	3 (4)

2018 focus

- Review financial results
- Monitor control environment
- Assess approach to risk
- Receive reports from internal and external auditors
- Review effectiveness of the Committee
- Review continuing effectiveness of Group functions that transferred to the USA during 2017/18

Dear Shareholder

I am pleased to present the report of the Audit Committee for 2017/18. This report provides an insight into the activities of the Committee during the year and how the Committee plays an oversight role for the Board. I will be available at the 2018 AGM, to respond to any questions shareholders have on this report or any of the Committee's activities.

As at 1 October 2018, the Committee was made up of five Non Executive Directors as set out in the table above. During the year ended 31 July 2018, John Daly and Pilar López also served as members of the Committee until stepping down as Non Executive Directors on 31 May 2018 and 31 July 2018 respectively.

How the Committee operates

The Committee met on four occasions during the financial year. Meetings are scheduled to coincide with key dates in the financial reporting cycle. Attendance at those meetings is set out in the table above and an overview of the Committee's area of responsibility is set out on page 54. The Committee's Terms of Reference are available at www.fergusonplc.com. In 2018/19 the Committee will increase the frequency of its meetings and meet on five occasions in order to ensure a more even spread of the Committee's workload.

The Board considers that the Committee has recent and relevant financial experience in its membership and that each member of the Committee is independent within the definition set out in the Code. Members of the Committee between them possess significant international, commercial, retail, financial and human resource skills and expertise which are relevant to an international specialist distribution company. In addition to me, Alan Murray and Pilar López (who served as a member of the Committee until stepping down on 31 July 2018) have served as the Chief Financial Officer of large international businesses during their careers. This provides the Board with assurance that the Audit Committee meets the relevant regulatory requirements relating to independence, financial experience and sectoral competence. The key strengths and experience of each member of the Committee are summarised on pages 52 and 53.

In addition to the members of the Committee, the Chairman, Group Chief Executive, Group Chief Financial Officer, Group Financial Controller and the Head of Internal Audit, together with senior representatives of Deloitte LLP ("Deloitte"), the Company's external auditors, attended and received papers for each meeting.

A private session for Committee members is held before every meeting to enable the Committee members to discuss agenda items and Audit Committee business without management present. The Committee also holds private sessions with the Group Chief Financial Officer, Head of Internal Audit and Deloitte periodically. Other senior executives are also invited to attend and provide updates to the Committee as required. An overview of the Committee's principal areas of focus during 2017/18 is provided on page 64.

Audit Committee effectiveness review

This year, the Committee's effectiveness review was conducted by Lintstock who undertook a survey of Committee members and attendees and conducted follow-up interviews that used the answers to the survey questions as a framework. Overall the Committee was rated as highly effective. The review identified a few opportunities for further improvement and these are reflected in the Committee's 2018/19 priorities, which are outlined below.

Audit Committee priorities for 2018/19

- Continued review of cyber security, with a particular focus on prioritising areas of protection.
- Conduct a benchmarking exercise for Internal Audit and identify opportunities to enhance the performance of the function.
- Review and assess the continued effectiveness of the Group's control framework, including enhancing the Committee's oversight of the IT control environment.

Financial reporting and significant financial judgements

The Committee considered the issues summarised below as significant in the context of the 2017/18 financial statements. These were discussed and reviewed with management and the external auditors and the Committee challenged judgements and sought clarification where necessary. The Committee received a report from the external auditors on the work they had performed to arrive at their conclusions and discussed in detail all material findings contained within the report.

Item	Audit Committee review	Conclusions
Completeness of supplier rebates (recurring item)	<p>The Committee reviewed the recognition of supplier rebates which are significant to the Group and are an area of inherent risk due to the number and complexity of the arrangements. In addition, the majority of the supplier rebate arrangements cover a calendar year and therefore do not end at the same time as the Group's accounting year-end. Where the rebate arrangements are calculated at a flat rate there is limited judgement. However, for tiered rebates, judgements are required to forecast the expected level of volumes purchased to determine the appropriate rate at which a rebate is earned. This review covered the processes and controls in place during the year and the level of adherence to the Group's accounting policies and procedures.</p> <p>For further information please see note 1 of the consolidated financial statements on page 102.</p>	As a result of the review process, which included consideration of the external audit findings, the Committee concluded that the level of rebate income and rebate receivable as at 31 July 2018 was properly reflected in the consolidated financial statements.
Inventory valuation (recurring item)	<p>Judgement is applied in determining the appropriate values for slow-moving or obsolete inventory. The provisions are predominantly system-generated calculations, comparing inventory on hand against expected future sales using historic experience as the basis for provisioning, along with the results of physical stock-counts. The Committee considered the level of provisions and ensured the policy was consistently applied across the Group in the current and previous financial periods. The Committee also sought the views of the auditors.</p> <p>For further information please see note 1 of the consolidated financial statements on page 102.</p>	Following their review, which included consideration of the external audit findings, the Committee concluded that provisions for obsolete and slow moving inventory are fairly stated in the consolidated financial statements.
Nordic business disposal (one-off item)	<p>The Committee reviewed the accounting for the disposal of the Nordic business including a review of the profit on disposal calculation, the recycling of foreign exchange in reserves, the separation of the properties and the profit on disposal of properties sold in the year. The review included information about the proceeds received, the assets disposed of, any associated disposal costs and the judgements taken in relation to the recycling of foreign exchange in reserves.</p> <p>For further information please see note 29 of the consolidated financial statements on page 138.</p>	Following the review and consideration of the external audit findings, the Committee concluded that the disposal of the Nordic business had been properly reflected in the consolidated financial statements.
Carrying value of interests in associates (one-off item)	<p>The Committee reviewed the carrying value of the interests in associates for impairment, including a review of the assumptions underlying the value in use calculations and a review of other valuation models. The Committee considered the judgements used to determine the appropriate carrying value.</p> <p>For further information see note 15 of the consolidated financial statements on page 121.</p>	The Committee agreed with management's assessment that an impairment charge had arisen relating to the Group's Swiss associate due to reduced expectations of profitability and the temporary suspension of dividends indicated to the market in a number of public announcements.

FRC Corporate Reporting Review team request¹

In April 2018, the Company received a letter from the FRC's Corporate Reporting Review team in relation to its regular review and assessment of the quality of corporate reporting in the UK. The letter requested further information on the Company's approach to judgements and estimates and inventory provision in its 2017 Annual Report and Accounts as well as providing commentary on certain other disclosures. The points raised in the letter were reviewed by management, the Chairman and the Audit Committee Chairman and discussed with Deloitte and a response to the requests for further information was provided. The Corporate Reporting Review team subsequently confirmed in writing that, as a result of the response provided, it had closed its enquiries. The Committee confirms that the points raised were considered in the preparation of the 2018 Annual Report and Accounts and have been appropriately reflected.

1. We note the inherent limitations of the FRC's review. The FRC stated that the scope of its review was based on the Company's 2017 Annual Report and Accounts and was conducted by FRC staff who have an understanding of the relevant legal and accounting framework. The review did not benefit from detailed knowledge of the Company's business or an understanding of the underlying transactions entered into. The FRC's review only covered specific disclosures and does not provide assurance that the Company's 2017 Annual Report and Accounts are correct in all material respects.

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Audit Committee continued

Principal areas of focus

The Committee has a rolling programme of agenda items to ensure that relevant matters are properly considered. Some of the key items which were discussed by the Committee during 2017/18, and how they were presented to the Committee, are summarised below.

Financial results

Detailed reports were presented to the Committee ahead of the full and half-year results announcements. Reports relevant to the assessment of the Company's financial statements were received from the Group Chief Financial Officer, Group Financial Controller, Head of Group Financial Reporting, Deloitte, Group General Counsel and Group Company Secretary. Previews of accounting matters were also received from the Group Chief Financial Officer and discussed by the Committee well in advance of the review and approval of the half and full-year financial statements.

Internal audit

Reports presented at each Committee meeting by the Group Head of Internal Audit on the results of audits performed by the Internal Audit function, testing of the internal control environment and progress against any improvement actions previously identified. Briefings at each meeting also covered the performance and effectiveness of the Internal Audit function with particular focus on the transfer of Group Internal Audit roles from the UK to the USA and progress against areas identified for improvement in the 2017 Internal Audit effectiveness review. Further information on the Internal Audit function's activity is provided on pages 65 and 66.

Presentations from the Group Chief Financial Officer

The Committee received presentations from the Group Chief Financial Officer at each meeting on topics that included the Company's financial results, key half-year and year-end accounting topics, the operation of the Group's base financial control framework, the structure and strength of the Group finance team and the effectiveness of the Company's external auditor.

Presentations from business Chief Financial Officers

Presentations from Chief Financial Officers from Group businesses were received by the Committee. These presentations included the structure and strength of their respective finance teams, the implementation of financial systems and the effectiveness of the financial control environment.

Review of internal controls

The Committee received reports from a number of key areas of the business to gain an appropriate level of assurance. In addition to the Internal Audit reports on the control environment, the Committee received reports from the Group General Counsel on the implementation of the Group's anti-bribery and corruption programme and from the Group Head of Risk on the significant risks facing the Group and the mitigating controls in place (for further information on the Committee's oversight of risk see page 66). Reports were also received from the Group Chief Information Officer and Group General Counsel on the strength and performance of the Group's information security systems. The updates covered progress reports, opportunities for enhancement, the nature and level of the cyber security threats facing the Group and analysis provided by an independent specialist IT security consultancy. The Group Chief Information Officer and Group Head of Internal Audit reported to the Committee on IT controls and assurance activities. The updates focused on the results of IT general controls testing and improvements to the IT general controls environment.

Forward planning

The Committee reviewed and approved the plan for and scope of the external audit and agreed the fees of the external auditor. The Internal Audit plan for 2018/19, including the Internal Audit budget and resourcing plan, was reviewed by the Committee and approved. The Internal Audit charter, which sets out the purpose, structure and governance framework for the internal audit function, was updated and approved.

Audit Committee key achievements – 2017/18

An overview of the Committee's 2017/18 objectives and how the Committee has achieved them is set out below:

2017/18 objectives	Achievements
Continue to review and monitor the approach to risk management and the level of risk driven through changes to the operating model, industry changes and technological developments	<ul style="list-style-type: none"> – Reviews undertaken in March and September of key risks and their management – The Group's adequacy of the controls in place to mitigate the Group's principal risks were considered in detail – Feedback provided to management as part of this review process
Continued increase in focus on the Group's approach to information security	<ul style="list-style-type: none"> – The Committee has continued to monitor information security and maintained its increased focus on this area – Information security programme updates were presented to the Committee at six-monthly intervals – Reviews of the IT controls environment were presented to the Committee at six-monthly intervals
Continue to monitor finance systems transformation to ensure that the associated projects are effectively completed	<ul style="list-style-type: none"> – Reports received from management and reviewed by the Committee as well as reports from internal and external auditors
Review and assess the continued effectiveness of the Group's control framework and base financial controls including their continued effective operation following the transfer of certain functions from the UK to the USA	<ul style="list-style-type: none"> – Group control framework and base financial controls regularly reviewed by the Committee – Regular reports on the control framework and testing of base financial controls received from Internal Audit

External audit

Auditor reappointment

The Committee reviews the external auditor appointment and the need to tender the audit annually. The Company confirms that it complied with the provisions of the Code and the Competition and Markets Authority Order for the financial year under review.

Following an external tender process, Deloitte was first appointed as the Company's external auditor for the 2015/16 audit and has served as the Company's auditor for three years. Deloitte's reappointment was approved by shareholders at the 2017 Annual General Meeting. Ian Waller has served as lead audit partner since Deloitte's appointment. In line with the Audit Practices Board Ethical Standard 3 the lead audit partner is due to be rotated following the 2019/20 audit.

For the financial year ending 31 July 2019, the Committee has recommended to the Board that Deloitte be reappointed as the external auditor and the Directors will be proposing the reappointment of Deloitte at the 2018 Annual General Meeting. The Committee confirms that the Company complied with the provisions of the Statutory Audit Services Order 2014 during the financial year ended 31 July 2018.

Assessing auditor effectiveness, auditor independence and objectivity and non-audit services

During the year, the lead audit partner, together with other relevant and appropriate Deloitte partners, attended all the Audit Committee meetings. They provided the Committee with information and advice including detailed reports on the financial statements, critical accounting judgements and estimates and the internal control environment.

The terms, areas of responsibility and scope of Deloitte's 2017/18 audit were reviewed and approved by the Committee. During the year, Deloitte provided external audit services for regulatory and statutory reporting. Deloitte are expected to report to the Committee any material departures from Group accounting policies and procedures that are identified during the course of their audit work. Deloitte's 2017/18 external audit plan has been successfully completed at the date of this report. No material items were found or reported in the financial year.

The Committee conducts an annual review of external auditor effectiveness. The review survey is completed by each operating business, as well as the Group Finance, Internal Audit, Insurance, Treasury and Tax teams and the Chief Information Officer. It is designed to take into consideration relevant professional and regulatory requirements, requires respondents to rate the performance of the external auditor against a range of measures, including the adequacy of planning, sufficiency of resource, thoroughness of review and testing, the thoroughness and robustness of audit challenge, adequacy and application of knowledge of the Group, usefulness of feedback and the quality of reporting. The Committee discussed auditor effectiveness, taking into account the results of the survey, and provided feedback to Deloitte.

Deloitte's performance in 2016/17 was highly rated, and opportunities to further enhance their service were discussed and agreed with the Committee. The Committee was satisfied that Deloitte provided an effective audit service in 2016/17. A review of the effectiveness of the audit for the year ended 31 July 2018 will be conducted during 2018/19.

The Company has policies and procedures in place to ensure that the independence and objectivity of the external auditor are not impaired. These include restrictions on the types of services which the external auditor can provide, in line with the Audit Practices Board Ethical Standards on Auditing. Details of the services that the external auditors cannot be engaged to perform are provided at www.fergusonplc.com.

Deloitte also provides specific assurance to the Committee on the arrangements and safeguards it has in place to maintain its independence and objectivity, including an internal process to pre-approve provision of non-audit services and the use of separate teams where non-audit services are being provided to the Group. This internal process requires all proposed audit and non-audit services to receive approval from the lead audit partner before commencing any work and includes assessment of the proposed services against the Ethical Standard.

The Committee believes that the safeguards in place are robust and continues to be satisfied with the independence and objectivity of Deloitte.

When considering the award of non-audit work to the external auditor, an assessment is made to consider if it is more effective for the work to be carried out by the external auditor who has existing knowledge of the Company and all appointments are made on a case-by-case basis. The prior consent of the Committee Chairman is required before the Company's external auditor is appointed to undertake non-audit work where such work is expected to exceed \$65,000. Where the fee for non-audit work is expected to be less than \$65,000, the Committee Chairman must be notified that the external auditors are to be engaged to provide a non-audit service but approval is not required in advance. The external auditor will not be appointed to provide non-audit services where the Chairman or the Committee considers it might impair their independence or objectivity in carrying out the audit. At each meeting the Committee reviews any new non-audit engagement of the Company's external auditor and reviews the level of fees for all non-audit work.

Audit and non-audit fees

During the year, Deloitte was appointed to undertake non-audit work. Fees for non-audit work performed by Deloitte as a percentage of audit fees for the year ended 31 July 2018 were 13 per cent (2017: 23 per cent). Further disclosure of the non-audit fees incurred during the year ended 31 July 2018, can be found in note 4 to the consolidated financial statements on page 113. Non-audit services related mainly to entity changes required in preparation for the disposal of Silvan A/S and the disposal of some Nordic property companies and assets. It was considered to be in the best interests of the Group to use Deloitte due to efficiencies gained from their existing knowledge of the Company. In addition, Deloitte were appointed by Lone Star Funds, a global private equity firm, in relation to their purchase of Stark Group to provide audit and review assurance on certain financial statements. Fees for this work, which are detailed on page 113, were paid by Ferguson and recharged to Lone Star so are not included within the disclosure of non-audit fees paid to the auditor. The Committee believes that Deloitte's continued objectivity and independence was unaffected due to the nature and scale of the work undertaken.

Internal audit

The scope of activity of internal audit is monitored and reviewed at each Committee meeting. An annual plan was agreed by the Committee in July 2018 which covers the activities to July 2019. During the year, the Head of Internal Audit attended all Committee meetings and provided the Committee with a detailed report on internal audit activities which the Committee reviewed and discussed in detail. The Committee considered the matters raised and the adequacy of management's response to them, including the time taken to resolve any such matters. During 2018, certain Group Services functions (including Internal Audit) transferred to the USA, reflecting the increasing size and importance to the Group of its largest operation, the US business. As a consequence, the role of

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Audit Committee continued

Head of Internal Audit also transferred to the USA and a new Head of Internal Audit was appointed in November 2017. The appointment was made by the Committee and the Head of Internal Audit continues to report to the Committee Chairman.

Throughout the year the Committee reviewed progress against the opportunities for improvement identified during last year's Internal Audit effectiveness review and satisfied itself that the improvements had been implemented. During the year the new Head of Internal Audit presented updates on the effectiveness of the function and identified and suggested areas where improvements to the function's effectiveness could be made. The Committee reviewed and discussed the new Head of Internal Audit's plans for continuing to improve the effectiveness of the Internal Audit function, including enhancing in-house IT audit capabilities, implementing an ongoing quality assurance improvement programme, a slight increase in headcount for more effective audit coverage, and training and development programmes.

Based on its ongoing review of the function, the Committee was satisfied with the effectiveness of the Group's Internal Audit function.

Risk

Risk management and viability statement

Risk management reports prepared by the Group Head of Risk were submitted to the Committee in March and September 2018. These reports summarise submissions from all areas of the business which the Executive Committee and senior management have reviewed. Risks relating to material joint ventures and associates are considered as part of this process. The six-monthly reports identify the significant risks to the Group, the controls in place and highlight the tolerance levels that the Executive Committee and, ultimately, the Board are prepared to accept. The Audit Committee reviewed the effectiveness of the Company's overall risk management framework, including the generic procedures for risk identification, assessment, mitigation, monitoring and reporting and was satisfied with their effectiveness.

The Committee also reviewed management's work in conducting a robust assessment of those risks which would threaten the future performance or liquidity of the Company, including its resilience to the threats of viability posed by certain of those risks in severe but plausible scenarios. These assessments included the stress testing of a series of cash flow projections to evaluate the impact of a number of unlikely, but realistic, worst-case scenarios. The Company's Viability Statement can be found on page 45.

Internal controls

During the year, the Committee monitored and reviewed the effectiveness of the Group's internal control systems, accounting policies and practices, standards of risk management and risk management procedures and compliance controls, as well as the Company's statements on internal controls, before they were agreed by the Board for this Annual Report and Accounts.

The Group's internal control systems are designed to manage rather than eliminate business risk. Such systems are necessary to safeguard shareholders' investment and the Company's assets and depend on regular evaluation of the extent of the risks to which the Company is exposed. The Committee receives regular reports throughout the year to assure itself that the Company's systems comply with the requirements of the Code. The Committee can confirm that the Company's systems have been in place for the full financial year and up to the date on which the financial statements were approved, that they are effective and that they are regularly reviewed by the Committee on behalf of the Board. The Committee

is of the view that the Company has a well-designed system of internal control. These systems can only provide reasonable, but not absolute, assurance that risks are managed to an acceptable level.

In relation to the financial reporting process, at the business level, line management is required to implement base financial and other controls in line with a clear set of detailed policies relating to financial reporting and other accounting matters and act in accordance with the Group Code of Conduct. At Group level, the Group finance function oversees the financial reporting process through setting the policies and requiring a bi-annual self-certification of implementation by the businesses. At a further level, assurance functions (Internal and External Audits) test various aspects of the processes and report to the Committee.

The Chairman of the Committee reports any matters arising from the Committee's review to the Board following each meeting. This update covers the way in which the risk management and internal control processes are applied and any significant failings or weaknesses in, or exceptions to, these processes. There were no significant failings or weaknesses identified. These processes have been in place throughout the year ended 31 July 2018 and have continued to the date of this report.

Further information on the Company's risk management systems is set out in the section on Principal risks and their management on pages 44 to 49.

Whistleblowing and fraud

The Group's whistleblowing policy, which supports the Group-wide Code of Conduct, is monitored by the Committee. A summary of the Group's Code of Conduct is available at www.fergusonplc.com. The Committee received reports at each Committee meeting providing details of matters reported through the Group's international confidential telephone reporting lines and secure website reporting facility, which are operated on its behalf by an independent third party. All matters reported are investigated by the relevant operating company and reported to the Committee, together with details of any corrective action taken. The Committee also received reports at Committee meetings providing details of fraud losses on a half-yearly basis.

Fair, balanced and understandable assessment

At the request of the Board, the Committee assessed whether the content of the 2017/18 Annual Report and Accounts, taken as a whole, was fair, balanced and understandable. In order to make this declaration, a formal process was followed to ensure the Committee has access to all relevant information including a report from management detailing the approach taken in the preparation of the Annual Report and Accounts to ensure compliance. The Committee and all Board members received drafts of the Annual Report and Accounts in sufficient time to allow them to challenge the disclosures where necessary. During this process the Committee also reviewed the use of alternative performance measures in this Annual Report and Accounts and the underlying methodology used, and were satisfied that they enhance understanding of the performance of the business. The Committee advised the Board it was satisfied that, taken as a whole, the 2017/18 Annual Report and Accounts was fair, balanced and understandable and provided the necessary information for shareholders to assess the Company's position and performance, business model and strategy. The Directors' responsibilities statement can be found on page 69.



Darren Shapland
on behalf of the Audit Committee