Audit Committee Report
Committee Chairman's introduction

As Chairman of the Audit Committee, I am pleased to present the report in respect of 2017. This report summarises the work of the Committee in the course of the year.

Jane Lodge
Chairman, Audit Committee

The Audit Committee has written terms of reference, which are available on the company's website, and include the responsibilities set out in Provision C.3.2 of the Code.

Ms J A Lodge chaired the Committee throughout the period under review. The other members of the Committee in 2017 were Mr P N Withers, Mr P A J Neep, who stepped down on 26 April 2017, and Mr M S Swift who joined on that date. The Company Secretary acts as Secretary to the Committee.

The Board views Ms J A Lodge as the Committee member with both recent and relevant financial expertise as stipulated in Provision C.3.1 of the Code. In the course of the year there were four meetings. These were attended as required by the Group Finance Director and members of senior management as invitees. Representatives of the statutory auditors also attend as appropriate.

The Committee and the statutory auditors operate procedures to ensure that the auditors remain objective and independent. These procedures include the pre-approval of the scope of the audit by the Committee.

Statutory auditors
KPMG LLP were first appointed as the company's statutory auditors at the 2015 Annual General Meeting, and their re-appointment is subject to approval at each subsequent Annual General Meeting.

Statutory audit
KPMG conducted no non-audit work for the company in 2017, generating no fees (2016: £20,000). Details of audit and non-audit services are shown in Note 8 to the financial statements. The ratio of non-audit fees to audit fees is 0:1 (2016: 0.06:1). The Committee noted the lack of non-audit work when reviewing the statutory auditors' independence.

The Committee is charged with reviewing the effectiveness of the auditors. The following processes are used for this purpose:

- The Committee received a detailed audit plan from the statutory auditors at the beginning of the annual audit process which included an outline of the proposed scope of the audit, and identification of key audit risks and areas of focus. This was discussed and agreed with the Committee.
- The Committee challenged the work done by the statutory auditors to test management's assumptions and estimates in relation to the significant issues.
- A survey was conducted of all businesses within the group to assess the effectiveness of the group and local statutory audit teams.
- At the completion of the statutory audit the Committee received feedback from the Group Finance Director on how effectively issues were addressed at the statutory audit clearance meetings.

Based on the above processes and feedback, and its own ongoing assessment of the statutory auditors' performance (for example, through consideration of the statutory auditors' reports and interactions with the group audit partner), the Committee was satisfied with the independence, objectivity and overall effectiveness of the statutory auditors with regard to the 2017 audit process.

Significant issues
The significant issues considered by the Committee during 2017, and how these were addressed, are as follows:

Exceptional items
Devro is undergoing a major transformation including the construction and start-up of two new plants in China and the US which completed in 2016, a restructuring of operations in Scotland and Australia initiated in 2014 and the Devro 100 programme, which will upgrade the group's sales capabilities, significantly reduce unit cost of manufacture and launch the next generation of differentiated products. The Devro 100 programme resulted in exceptional costs in 2017, and additional exceptional costs are expected in 2018.

Audit Committee Report continued

The costs associated with this programme have been significant and judgement has been required to determine whether these costs should be disclosed as exceptional items, taking account of their nature and size, and, in particular, whether they are incremental to normal operations. In some cases provisions have been set up in previous periods for the estimated liability for these costs.

The Committee has addressed these matters through reviewing and discussing reports from management outlining the nature and amount of the relevant costs, the amounts settled during the year for provisions held at the end of 2016, the estimates involved and the proposed accounting treatments, in particular reviewing the disclosure of amounts as exceptional items, and the associated descriptions included in the financial statements. The statutory auditors have also carefully examined this area and have reported their assessment to the Committee.

Carrying value of inventory

The perishable nature of the group's inventory means it is appropriate to hold a provision for obsolescence based on age from the date of manufacture. The group makes additional specific provisions in the event that any quality issues or damaged inventory are identified. Also in the case where products are being developed for particular applications, the group makes additional specific provisions in the event that such products do not meet the required customer specifications. The Committee has assessed the judgements of management relating to the carrying value of inventory, both with respect to the continued appropriateness of the group's accounting policy in providing for inventory obsolescence, and for any additional specific provisions. The statutory auditors have also focused on this area and reported their findings to the Committee.

Other matters

In addition to the significant issues referred to above, the following key areas of judgement and estimation were also considered by the Committee during 2017:

Pension obligations

The cost of defined benefit pension schemes is determined using actuarial valuations, which are based on assumptions including discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. The Committee reviewed and discussed the appropriateness of the assumptions, using input provided by external actuarial advisers and the associated reports presented by management. In particular the Committee focused on changes in assumptions compared with the prior year to understand the basis for these changes. The statutory auditors have also reviewed these assumptions, including benchmarking against those being used for comparable third party pension schemes, and reported their assessment to the Committee.

Tax

The group operates around the world and earns profits that are subject to tax at differing rates in different jurisdictions. The varying nature and complexity of the tax laws in these jurisdictions requires the group to review its tax positions and make appropriate adjustments. The Committee has reviewed reports from management setting out the key changes affecting the tax position of the group for the year, and has discussed these reports with management to understand the changes and review the input from external tax advisers on these matters. In particular the Committee focused on key changes in tax laws during the year, including the tax reforms that were enacted in the US on 22 December 2017. In addition the Committee has reviewed the key assumptions related to the uncertain tax provisions, and discussed the basis for these provisions with management. The statutory auditors have also reviewed the tax calculations, related assumptions and basis for the uncertain tax provisions and reported their assessment to the Committee.

Alternative Performance Measures (APMs)

In addition to the statutory financial measures, the group also presents certain APMs (which are not defined by IFRS) in the Annual Report, to help assess the operating performance and financial position of the group. The Committee has reviewed the APMs presented, the degree of prominence given to such measures alongside the equivalent statutory measures and also the associated disclosure in the Financial Review explaining the reasons for presenting such APMs and the reconciliations to equivalent statutory measures. The statutory auditors have also reviewed the use of APMs in the Annual Report, and associated disclosures, and reported their assessment to the Committee.

Whistleblowing procedure

The company's whistleblowing procedures are also reviewed regularly. Following a decision by the Committee in 2013, a confidential, multi-language system, entitled "SpeakUp", was set up and communicated to everyone in the group. The Committee believe that these arrangements facilitate a proportionate and independent investigation of matters raised.

Fair, balanced and understandable

The Committee acknowledges that, taken as a whole, the Annual Report and Accounts should be fair, balanced and understandable. The Committee advises the Board on whether it believes that the Annual Report and Accounts meet this requirement. In order for the Committee to make this assessment, it considers reports from management received during the year, monitoring financial performance and at year end in support of the financial statements and also reports from the statutory auditors on the findings of their annual audit. Formal review processes are in place to ensure that the Annual Report and Accounts are factually accurate.

The Committee also satisfies itself that the key messages in the narrative are consistent with the financial reporting, and that the Annual Report and Accounts as a whole are clear and understandable both in terms of the language used, and the layout and framework.

Following its review, the Committee was satisfied that the 2017 Annual Report and Accounts present a fair, balanced and understandable overview, including the necessary information for shareholders to assess the group's position, performance, business model and strategy.

The responsibility statement of the directors in respect of the Annual Report and Accounts is on pages 64 to 65.

Jane Lodge
Chairman, Audit Committee
14 March 2018