

Audit Committee

The Audit Committee (the 'Committee') is appointed by the Board from the Non-Executive Directors of the Company. The Committee's terms of reference were revised and updated in January 2019 and include all matters indicated by Disclosure and Transparency Rule 7.1 and the 2018 UK Corporate Governance Code. The written terms of reference of the Committee are available on request from the Company Secretary.

Audit Committee composition and meetings

Andrew Herbert was Chair of the Audit Committee until 31 March 2020, when he stepped down from the Committee and became Chairman of the Xaar Board on 1 April 2020. Chris Morgan was appointed Chair of the Audit Committee on 1 April 2020, Chris' previous roles have given him senior executive and financial experience working across a number of technology and digital printing sectors and across a number of jurisdictions. Alison Littlely joined the Audit Committee upon appointment to the Board on 1 May 2020. Alison also brings a breadth of experience including executive experience in complex, international business operations. Margaret Rice-Jones retired from the Board and stood down from the Audit Committee on 30 June 2020. Additional information on our skills and experience can be found in the Board biographies set out on pages 56 and 57.

The Audit Committee met formally on four occasions during the year and details of the attendance at meetings by members of the Audit Committee are set out on page 71. Please see the tables on page 71 for details of the Committee members in the year and the number of Committee meetings attended. At the Committee's request, other members of the Board and senior management may be invited to attend the Audit Committee's meetings based on the meeting agenda.

Report from the Committee Chairman

I am pleased to present the Audit Committee's report describing our work during the past year. Ernst & Young LLP (EY) was reappointed as the Group external auditor at the Annual General Meeting and Adrian Bennett is the engagement partner.

The Audit Committee's primary responsibilities are the following:

- To approve and monitor key financial and accounting policies and practices
- To monitor the integrity of the financial statements, announcements and review significant financial reporting judgements contained therein
- To keep under review the adequacy and effectiveness of internal controls
- To review procedures, systems and controls for whistle-blowing, fraud detection and bribery prevention
- To review, approve and monitor internal audit activities
- To monitor and review the Group's external auditor's independence, objectivity and effectiveness
- To monitor and approve any non-audit services provided by the external auditor
- To conduct any tender process and make recommendation to the Board on the appointment, remuneration and terms of engagement of the external auditor.

The Committee is not responsible for the identification of key risks or the review of the adequacy of arrangements to mitigate those risks, which remains the responsibility of the Board. The Committee is required to report its findings to the Board at least annually, identifying any matters on which it considers that action or improvement is needed, to make recommendations on the steps to be taken, and to ensure that the required actions are implemented. For example, the Audit Committee has requested that management present an action plan in early 2021, to remediate certain internal control deficiencies identified within EPS.

The effectiveness of the Audit Committee was reviewed as a part of the overall Board evaluation exercise and no significant issues were identified.

Significant issues considered by the Committee

The Committee has a work plan that is designed to ensure its responsibilities are fully discharged over the annual reporting cycle. Specific items are added to the agenda for individual meetings as required. There were a number of significant accounting matters considered during the year including:

- Going concern/impact of COVID-19/extensive stress testing of cash position
- Revenue recognition
- Consolidation of Xaar 3D Ltd – assessment of control
- Valuation of Xaar 3D Call Option with Stratasys
- Recoverability of receivables
- Impairment of goodwill, intangible assets and PPE
- Inventory valuation and obsolescence
- The Committee also considered the significant deficiencies in internal control identified within EPS as part of the year end audit process, as described in page 74.

Key areas of management judgement

The Committee has reviewed and challenged management judgement in respect of the following areas:

Accounting judgements

- Capitalisation of development costs – note 16

The development of the High Speed Sintering in 3D was completed in December 2020, the cost and accumulated depreciation has been reclassified as part of an asset group held for sale, the Audit Committee reviewed a technical paper in consideration of this treatment.

- Consolidation of Xaar 3D – notes 22,34 and 35

A review was undertaken to consider the requirements of IFRS 10, with a technical report presented to the Audit Committee and external auditors to determine the appropriate treatment of the majority shareholding of Xaar 3D and the significant control interests of Stratasys Solutions Limited.

- Discontinued operations – note 11

The accounting treatment on the closure of Thin Film operations, and the potential disposal of the Xaar 3D business to be reclassified as held for sale and discontinued operations has been considered and presented to the Audit Committee and external auditors.

Estimation uncertainty

- Xaar 3D option – note 22

The Xaar 3D option is a financial liability measured at fair value, which is calculated using the Black-Scholes model, the model uses a number of inputs that require estimation: the underlying price of the shares, the option strikeprice, time until expiration and implied volatility of underlying shares and LIBOR. Third party experts are used to provide these inputs, but the estimates remain uncertain.

- Inventory provision – note 20

A policy is used to calculate the inventory provisions based upon use and ageing of inventory, a significant proportion of the inventory provision relates to discontinued operations.

- Credit provision for the allowance of doubtful debts – note 21


A review has been undertaken to consider the requirements of IFRS 9 and the expected credit loss provision requirements based on historical default and loss experience.

- Impairment of capitalised development costs – note 16

The impairment of capitalised development costs relates to the full impairment of the Thin Film development costs in 2019, the transfer of 3D development costs to asset group held for sale has not led to an impairment valuation.

- Impairment of goodwill in relation to EPS – note 15

The Group tests goodwill annually for impairment. A budget has been prepared for EPS and a cash flow forecast derived to determine a value in use calculation. The recoverable amount is estimated and discounted with regards to a discount rate applicable to EPS, this reflects external third party advice and input estimates of the risk free rate, equity beta and market premium calculated at the year end. Sensitivity analysis is undertaken, but the estimates remain uncertain and rely upon forward guidance.

 **Additional disclosure in relation to key sources of estimation uncertainty and critical accounting judgements is provided in the Group financial statements – note 2 on pages 115 and 116.**

Key activities

In discharging its responsibilities, the Committee has completed the following activities:

Financial statements and reports

- Reviewed the Annual Report, financial statements and the half-yearly financial report including disclosures made therein, and confirms that taken as a whole, they are fair, balanced and understandable, and provide the information necessary for shareholders to assess the position, performance, strategy, and business model of the Company
- Reviewed Going Concern and Viability Statements
- Reviewed reports from the external auditor on their work and findings

Audit Committee (cont.)

- Reviewed the effectiveness of the Group's internal control environment
- Reviewed and challenged the forecasts and scenarios relating to COVID-19 impact on the Going Concern and Viability Statements and reviewed the associated disclosures around COVID-19 and is satisfied that the Group can continue as a going concern and the appropriate disclosures have been made.

Internal controls and compliance

To assist the Board with its responsibilities to effectively determine the nature and extent of the Group's significant risks (as described on pages 41 and 42), the Committee carries out a robust annual assessment of the principal risks and uncertainties facing the Group. The Board remains ultimately responsible for determining the nature and extent of the effectiveness of the risk management and internal controls system which mitigate potential impacts on shareholder investments and the Company's assets.

During the external audit process, significant deficiencies in internal control were identified in the EPS subsidiary in respect of the adequacy of (i) controls in the financial reporting close process to ensure the completeness and accuracy of closing entries, (ii) controls over revenue to ensure amounts recognised at year-end are complete and accurate, specifically management review of inputs and calculations for the valuation of accrued income recognised at year-end (see note 5) and (iii) controls over inventory management and valuation of inventory and work in progress (see note 20). Adjustments were identified and processed as appropriate in the audited results.

The Audit Committee reviewed the work of the external auditors in the relevant areas and determined that further work will be undertaken by management to develop an action plan to implement improved management, financial statement close process and controls within EPS, and to present these improved controls to the Audit Committee for evaluation in 2021.

The Committee undertakes this evaluation having:

- Reviewed the internal audit task list that in 2020 was unable to progress as planned due to the impact of COVID restricting the ability to travel to overseas sites alongside requirements to work from home. A review was undertaken for the approach of internal audit and greater methodology emphasis on management controls
- Reviewed the internal financial controls and risk management systems
- Reviewed fraud detection and the systems and controls for the prevention of bribery including employee confirmation of abiding by the Code of Conduct, Anti-bribery & Corruption, and Whistle-blowing policies
- Reviewed and approved actions for improvements to Treasury Management
- The Committee considered and challenged reports from the internal auditors on the effectiveness of internal controls and noted the material weaknesses identified by the external audit process in financial reporting close and management controls of EPS.

The Committee having performed the annual review of the Group's internal control processes considers the system to be effective and in accordance with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting as issued by the FRC, with the exception of the EPS internal controls identified above.

The Committee remains of the view that the statement made regarding the Company's viability period continues to be an accurate assessment of the Company's viability as at the date of the report. The Viability Statement can be found in full on page 65.

External audit

- Following the conclusion and sharing of the 2019 audit results, there was an extensive collaborative effort by the Xaar and the EY teams to review the process in detail and identify improvements for future audit efforts including working team adjustments to better handle engagement given the dynamic COVID-19 situation. This process work and the related recommendations were reviewed by the Audit Committee and were instrumental in aiding the planning of the 2020 audit
- The Audit Committee provided a forum for reporting and discussion with the Group's external auditors in respect of the Group's half-year and full-year results. The Committee had dedicated time for these activities and reviewed the audit work with emphasis on significant risk areas identified and discussed by the external auditor in their report
- The scope of the audit work to be undertaken by the auditor was reviewed and agreed on
- The Committee aligned the fees to be paid to the external auditor relating to their services rendered for the annual audit and interim review
- The independence and objectivity of the external auditor was assessed by the Committee.

The Chairman of the Audit Committee will be available at the AGM to answer any questions about the work of the Committee.

FRC's Audit Quality Review

EY's external audit of the Company for the year ending December 2019 was subject to an FRC Audit Quality Review (AQR) during the second half of 2020. The Committee has been kept fully informed of the progress and conclusions of the review with no key findings to report and certain good practices identified. The AQR review focused on a number of key audit matters including revenue recognition, consolidation of Xaar 3D, recoverability of receivables, impairment of goodwill and intangible assets, and the impact of COVID-19. These remain areas of audit focus in the current year, with the Committee continuing to oversee the proposed approach and conclusions.

External auditor

This was the second year for Ernst & Young LLP (EY) as the Company's auditor having first been appointed in July 2019. The Committee has met with the auditor on at least three occasions during the year and it is expected that the Committee will continue to meet with the auditor a minimum of two times each year. The Chief Executive Officer and Chief Financial Officer, and other relevant managers and Board members, attend these sessions by invitation, except for a period of each meeting where the Committee members may meet with the auditor without any member of executive management present.

The Committee is required to assess the qualifications, expertise, resources, and independence of the external auditor, and the objectivity and effectiveness of the audit process. The Committee reviews the type of work, effectiveness of, and level of fees charged by the auditor on an annual basis and recommends to the Board the appointment, reappointment, term, remuneration, and terms of engagement of the external auditor.

The Committee safeguards auditor objectivity and independence through maintaining a dialogue with the auditor and by monitoring all fees paid. It is the policy of the Group not to engage the statutory auditor in any non-audit related services. This includes tax services. Specifically, the policy states that the preparation of tax forms, payroll tax, calculation of indirect tax and the provision of tax advice cannot be provided by the statutory auditor.

Note 8 to the Consolidated financial statements includes disclosure of the auditor's remuneration for the year.

The Committee, taking into consideration relevant UK professional and regulatory requirements, regularly considers the independence and objectivity of the auditor. The Committee receives an annual statement from the auditor detailing their independence policies and safeguards, and confirming their independence, taking into account relevant ethical guidance regarding the provision of non-audit services by the external auditor.

The Committee considers the effectiveness of the external audit and the Group's relationship with the external auditor on an ongoing basis. In completing the review of the effectiveness of the annual audit in 2020, the Committee was able to conclude the audit undertaken by Ernst & Young LLP was effective. This review consisted of considering a number of key points together with the senior financial management of the Group. A similar exercise will be undertaken following completion of audit procedures on the 2021 results and reported on in next year's Annual Report.



Chris Morgan

Chair of the Audit Committee