

# Independent auditor's report to the members of Xaar plc

## Opinion

In our opinion:

- Xaar plc's group financial statements and parent company financial statements (the 'financial statements') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2020 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards adopted pursuant to Regulation (EC) No. 1606/2002 as it applies in the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Xaar plc (the 'parent company') and its subsidiaries (the 'group') for the year ended 31 December 2020 which comprise:

Group	Parent company
Consolidated statement of financial position as at 31 December 2020	Balance sheet as at 31 December 2020
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Related notes 1 to 11 to the financial statements including a summary of significant accounting policies
Consolidated statement of changes in equity for the year then ended	
Consolidated cash flow statement for the year then ended	
Related notes 1 to 38 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Accounting Standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards adopted pursuant to Regulation (EC) No. 1606/2002 as it applies in the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the group and parent company's ability to continue to adopt the going concern basis of accounting included:

- We understood the process undertaken by management to perform the going concern assessment, including the evaluation of the ongoing impact of COVID-19 on the Group and the Group's access to available sources of liquidity;
- We obtained management's going concern assessment, including the cash flow forecasts for the going concern period to 30 April 2022. The Group has modelled a base case which is consistent with the assumptions used in the Group's impairment assessments (adjusted to exclude the consideration expected to be received on the 3D disposal); a downside scenario which assumes the proposed sale of the Xaar 3D business doesn't go ahead; and a reverse stress test based on liquidity in order to determine how much additional downside in trading could be absorbed before the cash and cash equivalents run out. No debt facilities are in place, nor required in any of these scenarios.
- We evaluated the key assumptions underpinning the Group's forecasts. In particular, we compared the trading projections in management's base case and downside scenario to the Group's performance including contracted order book and pipeline since the onset of the COVID-19 pandemic;
- We considered the results of management's reverse stress test scenario and independently calculated what changes to key assumptions would result in the Group having insufficient cash and cash equivalents. We also considered mitigating actions such as reducing non-essential capital expenditure, assessing whether they were within management's control and whether they were supported by the actual mitigation achieved in response to COVID-19, to date. We considered whether the combination of changes to key assumptions could plausibly lead to the Group's liquidity being eliminated within the period assessed;
- We tested the clerical accuracy of the models used to prepare the Group's going concern assessment; and
- We assessed the appropriateness of the Group's disclosures concerning the going concern basis of preparation.

We observed that whilst the Group reported a loss after tax for the year ended 31 December 2020 of £14.7m (2019: £71.7m), a significant portion of this was the loss from discontinued operations after tax of £10.3m (2019: £57.3m). As set out in Note 37 and the Strategic Update (page 11), the Group are expecting to sell their remaining stake in Xaar 3D, which is the rationale for the two going concern scenarios noted above. The consideration for this transaction has been excluded from both scenarios. The net decrease in cash and cash equivalents for the year ended 31 December 2020 was £4.7m (2019: net increase of £0.3m), resulting in a closing cash and cash equivalents at 31 December 2020 of £20.1m (2019: £24.8m). The Group were debt free at the Balance Sheet date and across the forecast period.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group and parent company's ability to continue as a going concern over the period to 30 April 2022.

In relation to the group and parent company's reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

## Overview of our audit approach

<b>Audit scope</b>	<ul style="list-style-type: none"> <li>• We performed an audit of the complete financial information of four components and audit procedures on specific balances for a further seven components.</li> <li>• The components where we performed full or specific audit procedures accounted for 100% of Revenue, 100% of adjusted Loss before tax, and 100% of Total assets.</li> </ul>
<b>Key audit matters</b>	<ul style="list-style-type: none"> <li>• Revenue recognition</li> <li>• Carrying value of goodwill and intangible assets</li> <li>• Recoverability of receivables</li> <li>• Consolidation of Xaar 3D</li> <li>• Valuation of inventory</li> <li>• EPS significant deficiencies</li> </ul>
<b>Materiality</b>	<ul style="list-style-type: none"> <li>• Overall group materiality of £240,000 which represents 0.5% of revenue.</li> </ul>

## Independent auditor's report (cont.)

### An overview of the scope of the parent company and group audits

#### Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each company within the group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the group and effectiveness of group-wide controls, changes in the business environment and other factors when assessing the level of work to be performed at each company.

In assessing the risk of material misstatement to the group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the 14 reporting components of the group, we selected 11 components covering entities within the UK, US and Denmark, which represent the principal business units within the group.

Of the 11 components selected, we performed an audit of the complete financial information of four components ("full scope components") which were selected based on their size or risk characteristics. For the remaining seven components ("specific scope components"), we performed audit procedures on specific accounts within that component that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 100% (2019: 100%) of the Group's Revenue, 100% (2019: 100%) of the Group's adjusted Loss before tax and 100% (2019: 100%) of the Group's Total assets. For the current year, the full scope components contributed 93% (2019: 98%) of the Group's Revenue, 95% (2019: 99%) of the Group's adjusted Loss before tax and 97% (2019: 100%) of the Group's Total assets. The specific scope components contributed 7% (2019: 2%) of the Group's Revenue, 5% (2019: 1%) of the Group's adjusted Loss before tax and 3% (2019: 0%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

The remaining three components were not revenue generating. For these components, we performed other procedures, including analytical review, testing of consolidation journals and intercompany eliminations and foreign currency translation recalculations to respond to any potential risks of material misstatement to the Group financial statements.

#### Changes from the prior year

There is no significant change in the overall coverage from full and specific scope components. Five components that were designated as full scope in the prior year have been designated as specific scope in the current year. These were designated as full scope in the prior year given we were also engaged as statutory auditor, however as detailed in note 38, the subsidiary audit exemption has been taken in the current year, hence we have only performed the procedures on these components necessary to support the Group audit opinion.

#### Involvement with component teams

All audit work performed for the purposes of the audit was undertaken by the Group audit team.

### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Revenue recognition (£48.0 million – continuing operations, 2019: £49.4 million – continuing operations)</b></p> <p>Refer to the Audit Committee Report (page 73); Accounting policies (page 116); and note 5 of the Consolidated Financial Statements (page 127).</p> <p>Given the difficult trading environment and investor focus on the group's revenue we consider there to be a risk in relation to the manipulation by group management of the amount of revenue recorded. Management reward and incentive schemes based on achieving profit targets may also place pressure on management to manipulate revenue recognition.</p> <p>As part of the financial statement close process, certain manual adjustments are required to account for contracts with customers. There is risk that the manual adjustments are incorrectly recorded in the period.</p> <p>Further, in the product print segment, judgement is required to determine whether revenue should be recognised over time or at a point in time. Where revenue is recognised over time, estimation is required to establish how much of the performance obligation has been satisfied and how much is recorded as a contract liability.</p>	<p>We understood the group's revenue recognition policies and how they are applied, including the relevant controls, and performed a walkthrough to validate our understanding.</p> <p>In respect of the main UK trading entity, which comprised 60% of the group's revenue, we analysed the whole population of transactions from invoicing to cash collection, including adjustments to arrive at revenue recognised in the year. Where the postings did not follow our expectation, we investigated and understood the characteristics of these entries and tested a sample to assess their validity by agreeing the transactions back to source documentation.</p> <p>We performed tests of detail for a sample of revenue transactions to confirm the transactions had been appropriately recorded in the income statement with reference to IFRS 15 and corroborated that control of the products had been transferred to the customer by:</p> <ul style="list-style-type: none"> <li>• analysing the contract and terms of the sale to determine that the group had fulfilled the requirements of the contract;</li> <li>• confirming revenue could be reliably measured by reference to underlying documentation; and</li> <li>• confirming collectability of the revenue was reasonably assured by considering recent collection history and the ageing of receivables.</li> </ul> <p>We performed cut-off testing by tracing a sample of revenue items recorded either side of year-end to delivery note to determine whether revenue was recognised in the same period in which the performance obligations have been fulfilled.</p> <p>We selected a sample of post year-end credit notes to assess whether, where the credit note relates to the audit period, these credit notes were appropriately provided for in the financial statements.</p> <p>We tested journal entries posted to revenue accounts, applying parameters designed to identify entries that were not in accordance with our expectations. This included analysing and selecting journals for testing which appeared unusual in nature either due to size, preparer or being manually posted. To assess their validity, we verified the journals to originating documentation.</p>	<p>Revenue was recognised in accordance with the Group's accounting policies following the correction of audit adjustments identified in the EPS business and we identified no evidence of management override in respect of inappropriate manual journals recorded in revenue.</p> <p>In respect of the EPS business and revenue recognised over time we identified a significant deficiency in internal control as summarised in the related Key Audit Matter below.</p>

## Independent auditor's report (cont.)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Revenue recognition (£48.0 million – continuing operations, 2019: £49.4 million – continuing operations)</b> continued</p>	<p>We performed full and specific scope audit procedures over this risk area in 4 locations which covered 100% of the risk amount.</p> <p><b>Revenue recognised over time</b> For a sample of items, we reviewed the respective sales contract to determine whether the customer:</p> <ul style="list-style-type: none"> <li>• Simultaneously receives and consumes the benefits; or</li> <li>• Controls the asset that is being created or enhanced; or</li> <li>• Has an enforceable requirement to pay for performance to date.</li> </ul> <p>Where any of these criteria are fulfilled, revenue should be recognised over time in accordance with IFRS 15. For these items, we evaluated judgements made by management regarding the expected costs to complete and the timing and recognition of variation orders, by obtaining and reviewing the variation order and comparing the cost assumptions to similar projects. We also verified a sample of actual costs incurred to date through to purchase invoice or timesheet records. Where the criteria have not been fulfilled we confirmed management has recognised revenue at a point in time, when the performance obligation has been achieved.</p> <p>We performed full scope audit procedures over this risk area in 1 location which covered 100% of the risk amount.</p>	

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Carrying value of goodwill and intangible assets (£5.4 million, 2019: £10.9 million)</b></p> <p>Refer to the Audit Committee Report (page 73); Accounting policies (page 121); and note 15 of the Consolidated Financial Statements (page 137).</p> <p>IFRS requires impairment testing to be undertaken when there are indicators that an impairment may exist, and in the case of goodwill at least annually. Given the significant balances in respect of goodwill and recent trading losses, there is a risk that the Group's cash generating units ('CGUs') may not achieve the anticipated business performance to support their respective carrying values.</p> <p>Judgement is required in estimating the recoverable value of each CGU, including the determination of the future cash flows, long-term growth rates applied to these cash flows, together with the rate at which they are discounted.</p>	<p>We examined management's methodology together with their model for assessing the valuation of goodwill and intangible asset balance to understand the composition of management's future cash flow forecasts, and the process and related controls undertaken to prepare them. This included confirming the underlying cash flows were consistent with the Board approved budget and strategic plan, did not include reorganisations and enhancements not committed at the balance sheet date and assessing the identified CGUs for appropriateness. We also re-performed the calculations in the model to test the mathematical integrity.</p> <p>We assessed the robustness of the budgeting process and cash flow forecasting models, including consistency with the strategic plans for the group and assessment of historical forecast accuracy and impact of COVID-19 to date and over the forecast period.</p> <p>We tested the key inputs to management's impairment models by:</p> <ul style="list-style-type: none"> <li>• analysing the historical accuracy of budgets to actual results to determine whether forecast cash flows are reliable based on past experience;</li> <li>• assessing the discount rate used by obtaining the underlying data used in the calculation and benchmarking it against an EY range derived from comparable organisations and market data, involving EY internal specialists to assist us with this assessment; and</li> <li>• comparing the forecast growth rates to observable market data and challenging whether the forecast growth rates have been appropriately adjusted to reflect the changes in the group's strategy.</li> </ul> <p>We calculated the degree to which the key inputs and assumptions would need to fluctuate before an impairment was triggered and considered the likelihood of this occurring. We performed our own sensitivities on the group's forecasts and determined whether adequate headroom remained.</p> <p>We assessed whether there were any other indicators of impairment, which would give rise to the impairment of an individual asset.</p> <p>We audited the related disclosures with reference to the requirements of IAS 36 and confirmed their consistency with the audited impairment models.</p>	<p>We agree with management's conclusion that no impairment of goodwill is required in the current year.</p> <p>We have concluded that the methodology applied is reasonable, that the forecast period is appropriate and that management's models are mathematically accurate.</p> <p>The additional sensitivity disclosures in note 14 of the Group financial statements adequately reflect that a reasonably possible change in certain key assumptions could lead to a different conclusion in respect of the recoverability of goodwill.</p>

## Independent auditor's report (cont.)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Recoverability of receivables (£6.2 million net of provisions of £0.6 million, 2019: £6.4 million net of provisions of £8.0 million)</b></p> <p>Refer to the Audit Committee Report (page 73); Accounting policies (page 122); and note 21 of the Consolidated Financial Statements (page 141).</p> <p>Whilst the majority of aged open balances are fully provided, given the extended credit terms that were provided to customers in previous periods, judgement is required to establish how much of the open receivables balance is recoverable. There is a risk that management's judgements and estimates over recoverability are inappropriate, when considering the specific balances and the requirements of IFRS 9.</p>	<p>We understood the group's process for estimating the expected credit loss provision under IFRS 9 and other specific provisions and how they are applied, including the relevant controls, and performed a walkthrough to validate our understanding.</p> <p>We requested and obtained confirmation of receivables balances from key customers and compared their return to the amounts recorded in the ledger as at 31 December 2020, investigating any differences and agreeing reconciling items to relevant supporting documentation. For any of these customers that did not provide a return, we performed alternative procedures by obtaining proof of payment or evidence of delivery of the product/service.</p> <p>We selected a sample of receivable balances and verified them to cash received post year-end, reflecting either full settlement or payments against an agreed payment plan.</p> <p>We discussed with the credit control team the status of account balances with key customers and the steps being taken to recover overdue balances and assessed whether the accounting provision appropriately reflects the facts and circumstances.</p> <p>We analysed the historical accuracy of the receivables provisions to actual results to determine whether management's forecasting is reliable based on past experience.</p> <p>We assessed the adequacy of management's provision for expected credit losses by reviewing recent historical losses with consideration given to current trading conditions and potential future losses. We recalculated managements provision, testing related inputs as appropriate.</p> <p>We reviewed publicly available information for key customers to identify and evaluate any matters relating to their financial viability that might result in a recoverability risk to the related receivable balance.</p>	<p>We did not identify any evidence of material misstatement related to the carrying value of receivables. Management continue to apply an appropriate expected credit loss provision, plus specific provisions for aged balances where there is additional doubt over the recoverability of the remaining balance.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Consolidation of Xaar 3D</b></p> <p>Refer to the Audit Committee Report (page 73); Accounting policies (page 116); and note 22 of the Consolidated Financial Statements (page 144).</p> <p>Management judgement is required as to whether the Group still controls Xaar 3D Limited and consequently whether the Group should continue to consolidate Xaar 3D in accordance with IFRS 10, given that Stratasys has a 45% shareholding and a call option to purchase the remaining share capital at any point over a three-year period to December 2022.</p> <p>Further consideration was required as to whether the held for sale classification at the year end impacts upon the control conclusion.</p> <p>As detailed in note 2, management concluded that the Group continues to control Xaar 3D and should therefore continue to consolidate the business in the Group financial statements.</p>	<p>We have obtained and reviewed management's accounting paper and the signed shareholder agreement setting out their control conclusion as at the year end. We have compared the content of this paper against the requirements of IFRS 10, namely whether Xaar continues to:</p> <ul style="list-style-type: none"> <li>• retain power over Xaar 3D;</li> <li>• be exposed to and have the right to variable returns; and</li> <li>• have the ability to use its power to affect these returns.</li> </ul> <p>As part of these procedures, we considered whether there have been any changes to the relevant activities, including specifically the following areas:</p> <ul style="list-style-type: none"> <li>• Whether the written call option was in the money and likelihood of exercise;</li> <li>• The make-up of the Xaar 3D board;</li> <li>• The process to make key strategic and operational decisions over the relevant activities; and</li> <li>• Who the key decision makers are.</li> </ul> <p>We confirmed there were no changes to the supply agreement between Xaar/Xaar 3D and distribution agreement between Xaar 3D/Stratasys.</p>	<p>We agree with management's judgement that Xaar continues to control the 3D business as at 31 December 2020.</p>
<p><b>Valuation of inventory (£10.4 million including provision of £24.6 million, 2019: £16.2 million including provision of £21.3 million)</b></p> <p>Refer to the Audit Committee Report (page 73); Accounting policies (page 122); and note 20 of the Consolidated Financial Statements (page 141).</p> <p>Given the level of slow moving finished goods, judgement is required to assess the future uptake of new products by customers, the price for which products can be sold, overall success of the sales and marketing strategy and the resulting carrying value recorded in the financial statements. There is a risk that the provision recorded by management does not accurately reflect the level of exposure and that inventory is incorrectly valued.</p>	<p>We understood the group's policies on inventory provisions and how they are applied, including the relevant controls, and performed a walkthrough to validate our understanding.</p> <p>We obtained calculations to support the standard costs used and performed procedures to assess whether only normal production variances had been capitalised in the year-end inventory balance and material abnormal inefficiencies had been appropriately expensed. We checked that inventory was appropriately revalued to actual cost at the period end.</p> <p>We performed tests of clerical and mathematical accuracy on management's inventory provision calculations.</p> <p>We performed procedures to validate the appropriateness of any management judgements applied in calculating inventory provisions.</p> <p>For a sample of inventory lines, we reviewed post year-end selling prices in comparison to the values assumed in the book values recorded. Where the book value exceeded realisable value, we considered whether management had recorded an appropriate provision.</p>	<p>The inventory provisions have been appropriately updated to reflect the impact of the latest strategic review and resulting future recoverable amount.</p> <p>In respect of the EPS business and inventory management, we identified a significant deficiency in internal control as summarised in the related Key Audit Matter below.</p>



## Independent auditor's report (cont.)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Valuation of inventory (£10.4 million including provision of £24.6 million, 2019: £16.2 million including provision of £21.3 million)</b> continued</p>	<p>We discussed the latest sales and marketing strategies and considered the implications for the level of provision recorded. This included comparing forecast product usage to customer orders, considering historical usage, historical accuracy of provisioning and understanding management's future plans to utilise the inventory.</p>	
<p><b>EPS business</b></p> <p>As disclosed within the Corporate Governance Statement on page 70 and Audit Committee Report on page 74, three significant deficiencies were identified in relation to the EPS business and its controls over:</p> <ul style="list-style-type: none"> <li>• Inventory management and valuation</li> <li>• Revenue recognised over time and the valuation of accrued income at year end</li> <li>• The financial statement close process</li> </ul> <p>These deficiencies were identified as part of the external audit process and manifested themselves in a significant number of audit differences. Adjustments were made to correct for the financial impact of the issues arising from these deficiencies and management have disclosed the deficiencies in accordance with the UK Corporate Governance Code, however further action is required in 2021 to remediate the underlying process and control issues.</p>	<p>We executed our planned audit approach over the EPS business. As a result of the audit differences identified we performed additional procedures to understand the root cause of the issues and to establish whether the audit differences reflected the total error within the account balances impacted. These procedures were supplemented by additional sample testing and audit procedures to test the appropriateness of the revisions made by management to reconciliations.</p> <p>We reassessed the materiality applied in our audit of the EPS business and re-assessed the associated aggregation risk.</p> <p>We increased the level of Partner oversight and review of our work over the EPS business to further mitigate the additional risk presented by the identified control deficiencies</p> <p>We met with the Board of Directors to understand the process they had undertaken to assess the effectiveness of the risk management and internal control systems and their remediation plans.</p> <p>We reviewed the disclosures made within the Annual Report and Accounts for compliance with the UK Corporate Governance Code and consistency with the findings from the audit process.</p>	<p>We reported and discussed the deficiencies we identified at EPS with the Audit Committee and made a number of related internal control recommendations.</p> <p>The sections of the annual report that describe the review of the effectiveness of the entity's risk management and internal control system and related significant deficiencies in EPS, are materially consistent with the financial statements and our knowledge obtained in the course of performing the audit.</p>

In the prior year, our auditor's report included a key audit matter in relation to capitalised development costs and COVID-19. Given there were no further capitalised development costs in the current year, this was removed as a key audit matter. Given the continued impact of COVID-19, we have embedded this within the other key audit matters listed above, such as the impairment of goodwill and intangible assets, as opposed to it being a separate key audit matter.

## Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

### Materiality

*The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.*

We determined materiality for the Group to be £240,000 (2019: £247,000), which is 0.5% (2019: 0.5%) of revenue. We believe that revenue provides us with the most appropriate basis given it is the main KPI for the Group, whilst the Group reports an adjusted loss before tax.

We determined materiality for the parent Company to be £240,000, which we capped at the group materiality.

During the course of our audit, we reassessed initial materiality and updated for the final result for the year.

### Performance materiality

*The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.*

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% (2019: 50%) of our materiality, being £120,000 (2019: £124,000). We have maintained performance materiality at this percentage reflecting our observations of the Group's systems and processes, susceptibility of the financial statements to management override and historical audit findings.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £24,000 to £91,000 (2019: £25,000 to £93,000).

### Reporting threshold

*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £12,000 (2019: £12,000), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

## Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

## Independent auditor's report (cont.)

### Opinions on other matters prescribed by the Companies Act 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements;
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (the FCA Rules), is consistent with the financial statements and has been prepared in accordance with applicable legal requirements; and
- information about the company's corporate governance statement and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules.

### Matters on which we are required to report by exception

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in:

- the strategic report or the directors' report; or
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 of the FCA Rules.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- a Corporate Governance Statement has not been prepared by the company.

### Corporate Governance Statement

The Listing Rules require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the group and company's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements or our knowledge obtained during the audit:

- Directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 64;
- Directors' explanation as to their assessment of the company's prospects, the period this assessment covers and why the period is appropriate set out on page 65;
- Directors' statement on fair, balanced and understandable set out on page 51;
- Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 41;
- The section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on pages 41 and 74; and
- The section describing the work of the Audit Committee set out on page 72.

## Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 97, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

### Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the group and determined that the most significant are those that relate to the reporting framework (IFRS, FRS 101, the Companies Act 2006 and the UK Corporate Governance Code) and the relevant tax compliance regulations in the jurisdictions in which the Group operates. In addition, we concluded that there are certain significant laws and regulations which may have an effect on the determination of the amounts and disclosures in the financial statements being the Listing Rules of the UK Listing Authority, and those regulations relating to health and safety and employee matters.
- We understood how Xaar plc is complying with those frameworks by making enquiries of management, the Company Secretary, and those responsible for legal and compliance procedures. We corroborated our enquiries through our review of board minutes, papers provided to the Audit Committee, discussion with the Audit Committee and any correspondence received from regulatory bodies.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by reviewing the Group's risk register, enquiry with management and the Audit Committee during the planning and execution phases of our audit. We also considered performance targets and their influence on efforts made by management to manage earnings or influence the perceptions of analysts. We considered the programmes and controls that the Group has established to address risks identified, or that otherwise prevent, deter and detect fraud and how senior management monitors those programmes and controls. Where the risk was considered to be higher, we performed audit procedures to address each identified fraud risk including revenue recognition as discussed above. These procedures included testing manual journals and were designed to provide reasonable assurance that the financial statements were free from fraud or error.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved journal entry testing, with a focus on manual consolidation journals and journals indicating large or unusual transactions based on our understanding of the business; enquiries of the Company Secretary, head of legal, management; and focussed testing, as referred to in the key audit matters section above. In addition, we completed procedures to conclude on the compliance of the disclosures in the Annual Report and Accounts with the requirements of the relevant accounting standards, UK legislation and the UK Corporate Governance Code.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

## Independent auditor's report (cont.)

### Other matters we are required to address

- Following the recommendation from the Audit Committee we were appointed by the company on 2 June 2020 to audit the financial statements for the year ending 31 December 2020 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 2 years, covering the years ending 2019 and 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company and we remain independent of the group and the parent company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

### Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Adrian Bennett

Senior statutory auditor  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
Cambridge

27 April 2021