

RICHARD ATKINS
Chairman, Audit committee



I am pleased to introduce the audit committee report for the year ended 31 October 2019.

Audit committee members and meeting attendance

| | Meeting attendance |
|----------------|--------------------|
| Richard Atkins | 8/8 |
| Amanda Brown | 8/8 |
| Silke Scheiber | 8/8 |
| Lawton Fitt | 7/8 |

Karen Slatford joined the committee on 17 October 2019 but no meetings were held during the remainder of the year.

COMMITTEE CHAIRMAN'S INTRODUCTION

Dear fellow shareholders,

I am pleased to introduce the audit committee report for the year ended 31 October 2019. In the report below we explain how the committee discharged its responsibilities during the year, including the significant issues that we considered in relation to the financial statements and how we safeguarded the independence and objectivity of the external auditors. We are at an early stage of our relationship with KPMG LLP, who were appointed as our external auditors for the first time in respect of the prior period accounts, but this is developing satisfactorily. There was additional one-off workload for the committee in the year in reviewing management's preparations and readiness for compliance with the US Sarbanes-Oxley Act ("SOX") and also in relation to the Return of Value transaction announced in March 2019. Finally, the appointment of KPMG as our external auditors meant that they had to relinquish their previous internal audit responsibilities. This role was transferred to PricewaterhouseCoopers LLP (PwC) in the prior year and the committee has invested time during this year in developing a strong working relationship with the new internal audit team.

Composition of the committee

The audit committee comprises Richard Atkins (who serves as its chair), Amanda Brown, Silke Scheiber and Lawton Fitt and, from 17 October 2019, Karen Slatford. All members of the committee are independent non-executive directors. The board considers that:

- for UK purposes, Richard Atkins, a chartered accountant, has recent and relevant financial experience by virtue of his previous executive and current non-executive responsibilities (details of which can be found in his biography on page 67) and that the audit committee as a whole has competence relative to the sector in which the Company operates; and
- for US purposes, each of the audit committee members is independent under the SEC and NYSE definitions of that term; that Richard Atkins is an audit committee financial expert, is independent of management, and has accounting or related financial management expertise; and that all of the audit committee members are financially literate.

Executive directors and senior executives (most often the Director of Finance, the Head of Tax and Treasury and the Director of Internal Audit and Risk) attend meetings by invitation as required, but do not do so as of right. Representatives of KPMG LLP (external auditor), PricewaterhouseCoopers LLP (internal auditor) and Deloitte LLP (external tax advisors) also attend the committee meetings and meet privately with committee members, in the absence of executive management, prior to each committee meeting.

The committee normally meets at least four times during each financial year and more frequently as required.

Role and responsibilities of the committee

The committee's principal responsibilities are to:

- monitor the integrity of the financial statements of the Company and any formal announcements relating to the Company's financial performance, reviewing significant financial reporting judgements contained in them. The committee also reviews the Group's Annual Report and Accounts and Interim Report prior to submission to the full board for approval;
- monitor the Group's accounting policies and review the Company's internal financial controls and financial reporting procedures and, on behalf of the board, the Company's internal control and risk management systems;
- monitor the adequacy and effectiveness of the Company's internal controls and internal financial controls, risk management systems and insurance arrangements;
- monitor and review the effectiveness of the Company's internal audit function;
- make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, reappointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- oversee the relationship with the external auditors and review and monitor their independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK and US professional and regulatory requirements;
- develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;
- provide a forum through which the Group's external and internal auditors and external tax advisors report to the board; and
- report to the board on how it has discharged its responsibilities.

The committee's terms of reference (audit committee charter) are published on the Company's website, www.microfocus.com.

Key activities in the year ended 31 October 2019

The committee met eight times during the year, one of which was a specific meeting held in connection with the Return of Value transaction announced in March 2019, following the completion of the disposal of the SUSE business.

Save for matters directly arising from its terms of reference, the main items of business the committee discussed at those meetings were:

Reviewing the Group's readiness for the completion of the SUSE transaction

Reviewing the financial viability of the SUSE Return of Value transaction

Reviewing reports from the SOX steering group and monitoring the progress of the SOX implementation plan (please refer to pages 75 to 76 for further information on the SOX implementation)

Reviewing updates from the Controllership function, including the status of the finance transformation programme and other key projects

Reviewing reports from the disclosure committee, including an assessment of the Company's status as a Foreign Private Issuer for SEC purposes

Reviewing updates from the Treasury & Tax function

Reviewing assurance updates, including reports on the status of the Group's enterprise and fraud risk management programme and the internal audit programme

Reviewing updates on the status of Brexit planning from the Brexit Working Group

Reviewing updates from the compliance committee (until August 2019). Following an expansion of its remit, from the operational risk and compliance committee (since September 2019) on the activities of risk management and compliance

Reviewing updates on the Group's insurance programme

Reviewing reports on contentious legal matters, including internal investigations and other whistleblowing matters

Considering the effectiveness and independence of the external tax advisors.

The committee met in private session both with and without management attendance at the majority of its meetings. As noted above, the committee also meets with the external auditors, internal auditors and tax advisors in private session. The committee chairman maintains regular contacts outside the formally scheduled meetings with the partners of professional firms responsible for external and internal audit and tax advice.

Significant estimates and judgements considered in relation to the Annual Report and Accounts

The committee reviewed the draft Annual Report and Accounts, together with the appropriateness and application of accounting policies and assessed all areas in which there were significant estimates or exercises of judgement. The significant matters considered by the committee were as follows:

Revenue recognition

The Group has a detailed policy on revenue recognition for each category of revenue; Licence, Maintenance, Software as a Service ("SaaS") and Consultancy. This includes the application of rules relating to determining the standalone selling price for each category of revenue in a contract, allocating the transaction price between these categories in accordance with the policy and the timing and presentation of their recognition. It also identifies the different types of commercial contracts that the Group enters into and confirms that the revenue recognition is in line with IFRS. As is the case with many technology companies, the profile of sales is weighted to the end of the financial quarter. For licence revenue in particular the impact on recognised revenue is also weighted to the end of each financial quarter. This can lead to the risk of misstatement of revenues from one period to the next.

The committee received a paper from management on key revenue recognition judgments made under IFRS 15 on contracts during the period and reviewed the appropriateness of identifying multi-element arrangements and the associated allocation of the transaction price between Licence, Maintenance, SaaS and Consultancy. The committee also considered the controls that management has in place to ensure that the transaction price allocation of revenue is appropriate. On the basis of the above, the committee concluded that the Group's revenue recognition was appropriate.

Potential impairment of goodwill and purchased intangibles

Management has completed the annual impairment review at period end of its goodwill and purchased intangibles. The net book value of the purchased intangibles is \$5,829.8m and goodwill is \$6,671.3m. The principal judgements are the achievability of business plans (and therefore future cash flows), the medium-term annual revenue growth rate by product group, long-term growth rates beyond the period covered by the five-year forecasts and the appropriateness of the pre-tax discount rate applied to future cash flows. The committee discussed a report from management setting out the basis for the assumptions, confirmation that the cash flows used were derived from board approved forecasts and a sensitivity analysis on key assumptions that showed there were reasonably possible changes in the discount rate and medium-term annual revenue growth rate by product group that could have an adverse impact. The committee agreed with the judgements made by management and that it was appropriate for additional disclosure to be made in light of the sensitivity of the impairment analysis to the discount rate and medium-term annual revenue growth rate by product group.

Provision for income taxes

Judgements have to be made by management on the tax treatment of a number of transactions in advance of the ultimate tax determination being known. In assessing the appropriateness of the provision recognised in respect of uncertain tax positions, the committee considered a report prepared by the Group's tax department setting out the basis for the assumptions made. They discussed the assumptions in light of the current tax environment and the status of tax audits in the main jurisdictions in which the Group operates. The committee concluded that the position taken on uncertain tax positions was appropriate.

Exceptional items

The committee considered a report from management that described the treatment and disclosure of amounts included within exceptional items. With the completion of three acquisitions in the prior period including the highly significant acquisition of the HPE Software business for \$6.5bn, a material level of costs have continued to be incurred during the year on on-going one off integration activities which management have deemed to be exceptional given their nature and significance. These costs have been necessary to bring together the base Micro Focus, TAG, Serena and HPE Software business into one organisation. The committee agreed that while the level of exceptional costs are high, they have been treated consistently year-on-year and reflect the substantial on-going integration activities. The classification of certain income statement items as exceptional by the Group and its impact on related non-IFRS measures have been reviewed by the committee during the year with reference to authoritative guidance and regulations as well as through discussions with management and external advisors. The committee is satisfied that the use of exceptional items and its impact on non-IFRS measures is appropriate and enhances the understanding of the Group's financial performance and its prospects. The committee concluded that exceptional items were disclosed appropriately and reflected how they review the underlying performance of the Group.

Retirement benefit obligations

The committee considered a report from management setting out the primary assumptions including mortality, inflation and the rates at which scheme liabilities had been discounted and the sensitivity of amounts recorded in the balance sheet and income statement to changes in these assumptions. The committee concluded that the assumptions used, which were supported by third party actuarial advice, were appropriate.

Fair, balanced and understandable

The committee is satisfied, and has recommended to the board, that the 2019 Annual Report and Accounts, taken as a whole, provide a fair, balanced and understandable assessment of the Company's position and prospects at 31 October 2019 and the information necessary for shareholders to assess the Company's performance, business model and strategy. A paper prepared by management provided the committee with the detail necessary to reach this conclusion, which was supported by the collective judgement of the committee that:

- the description of the business agrees with its own understanding;
- the stated risks reflect the issues that concern the individual members of the committee;
- suitable weight has been given to both "good" and "bad" news and there was an appropriate balance between these;
- the discussion of performance properly reflects the performance of the period;
- the narrative reporting is consistent with the financial statements and the notes to the accounts; and
- there is a clear and well-articulated link between all areas of disclosure.

The committee also assessed the robustness of the processes followed in preparing the 2019 Annual Report and Accounts, which included the following:

- Papers provided by the executive directors and senior management summarising all areas where significant judgements have been applied;
- Papers outlining the process by which the financial statements were prepared and reviewed by the finance management team and other senior managers and the executive directors; and
- The review by the audit committee and its own discussions with the external auditors, senior management and executive directors.

Viability statement

The committee also assisted the board in relation to producing the Group's viability statement. This work encompassed a detailed consideration of the viability statement, including a review of the principal risks and uncertainties facing the Company and of the stress testing carried out. Following its review the committee agreed to recommend to the board that it was appropriate to make a viability statement for a four-year period and that the board could have a reasonable expectation that the Group would remain viable and have access to sufficient liquid resources to meet its liabilities as they fell due throughout that period. The viability statement is on page 43.

External audit

External auditor appointment

The committee has the primary responsibility for monitoring the independence and objectivity of the external auditors and assessing their performance and effectiveness. Informed by this knowledge, the committee makes recommendations to the board on the appointment and reappointment of the external auditors, taking into account partner rotation and other relevant factors.

The current external auditors, KPMG LLP and the lead partner Tudor Aw, undertook their first audit of the Group for the period ended 31 October 2018, having been appointed following a competitive audit tender process in the 2017 financial year. That tender process sought to identify an audit firm who would provide the highest quality, most effective and efficient audits. Critical success factors included sector experience and knowledge, cultural fit, geographical coverage, the audit record of the lead partner and firm as well as the use of technology. Under UK rules, the appointment of the senior statutory auditor (the lead audit partner) rotates every five years, regardless of whether there has been an audit tender.

The committee agrees the scope and focus areas of the external audit, including key risks and the alignment of this with the Group's known risks and the work of other assurance functions. The committee has primary responsibility for agreeing the fees payable for the statutory audit and all other fees payable to the external audit firm.

Non-audit services and fees

It can occasionally be more efficient or necessary to engage the external auditors to provide non-audit services because of their knowledge and experience and/or for reasons of confidentiality. However, safeguarding the objectivity and independence of the external auditors is an overriding priority. For this reason, the committee has approved a written policy governing the services that can be provided by the external auditors. The policy also sets out a process for prior approval of both the nature of the service to be provided and the associated fees. The external auditors would only be appointed to perform a service when doing so would be consistent with both the requirements and principles of the relevant external regulations, and when their skills and experience make the firm the most suitable supplier.

We classify work that the external auditors might be permitted to perform into one of three categories and manage these as follows:

- Audit services – the scope and fees for the statutory audit are agreed by the committee;
- Audit-related services (including the review of interim financial information and work such as Sarbanes-Oxley attestation which the auditors are required to perform) – the scope of any such services and the fees must be pre-approved by the committee; and
- Other non-audit services (such as taxation compliance support and other assurance-type work) – the scope of any such services and the fees must be pre-approved by the committee, with an additional requirement that where the expected fee exceeds a predetermined level, the appointment must be subject to the Group's normal tender procedures.

There is a further requirement that the external auditors may not undertake any work that would generate a fee which is material relative to the audit fee or to the compensation of the individuals performing the audit.

Our policy includes a list of services which the external auditors are prohibited from performing. To mitigate any risks threatening, or appearing to threaten, the external auditors' independence and objectivity, they may not perform any functions of management, undertake any work which they may later need to audit or rely upon in the audit or serve in an advocacy role for the Company or which may otherwise create a conflict of interest.

During the year ended 31 October 2019, the fees paid to the external auditors were:

| | 12 months ended 31 October 2019 \$m | 18 months ended 31 October 2018 \$m |
|--|--|---|
| Audit services | 16.7 | 14.1 |
| Audit-related services | 3.6 | 0.9 |
| Sub-total: audit and audit-related fees | 20.3 | 15.0 |
| Other assurance services | – | 0.7 |
| Services related to taxation | 0.1 | 0.4 |
| Other non-audit services | – | 0.1 |
| Sub-total: fees other than audit and audit-related fees | 0.1 | 1.2 |
| Total | 20.4 | 16.2 |

Non-audit fees paid in the year ended 31 October 2019 amounted to 0.5% of the audit and audit-related fees (18 months ended 31 October 2018, 8%), which the committee concluded was an acceptably low level.

Of the audit-related services undertaken in the year ended 31 October 2019 only one was considered to be significant. This related to the controls attestation of the Group's implementation of Sarbanes-Oxley Section 404, for which a fee of \$3.0m was paid.

Independence and objectivity of the external auditors

The committee is responsible for safeguarding the independence and objectivity of the external auditors and has developed a robust policy designed to ensure that this is not compromised. As explained above, the committee manages the risks that the external auditors undertake inappropriate non-audit work, or earn material levels of fees for non-audit services. It also considers the standing and experience of the external audit partner and takes comfort from the fact that KPMG took office relatively recently and from the external auditors' confirmation that they have complied with relevant UK and US independence standards.

The committee is satisfied that the independence and objectivity of the external auditors has been maintained throughout the year ended 31 October 2019 and to the date of this report.

Effectiveness of the external auditors

The committee has reviewed the performance of the external auditors, taking into account the fulfilment of the agreed audit plan, the views of management, the external auditors' findings reported to the committee and the audit team's responses to questions from committee members. The committee also reviewed publicly-available information published by the Financial Reporting Council ("FRC") in relation to KPMG LLP at the level of the UK audit firm. Based on this information the committee concluded that the external audit process was operating effectively and KPMG were effective in their role as external auditor.

Interactions with the Financial Reporting Council

There were no interactions with the FRC's Corporate Reporting Review team during the year.

During the year, the FRC's Audit Quality Review (AQR) team reviewed KPMG's audit of the 2018 Annual Report and Accounts as part of its normal inspection processes. The AQR team provided the committee chairman with a summary of their findings, which he discussed with the lead audit partner. Those findings were then presented to the committee at its December 2019 meeting. There were no material issues raised in relation to the financial statements, limited areas of audit improvement identified and the committee concluded that it had no concerns about the quality of the 2018 audit.

The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014

The Company confirms that it complied with the provisions of this legislation throughout the year ended 31 October 2019.

Internal control and risk management

Effective internal control and risk management

Following the annual cycle of work of the committee, it concluded that sound risk management and internal control systems had been maintained during the period. With respect to risk management, under the Risk Management Framework the committee receives and reviews a report at each meeting on the principal risks across the Group, which is discussed with senior management. The committee was satisfied with the process and risks identified. It was also satisfied that there was a high level of assurance provided by the internal auditors, the external reviews conducted by KPMG for the interim period and their full period-end audit, together with the input of the Group's tax advisors, Deloitte.

The board is ultimately responsible for establishing and monitoring internal control systems throughout the Group and reviewing their effectiveness. It carries out a review, at least annually, covering all material controls including financial, operational and compliance controls and risk management systems.

It recognises that rigorous systems of internal control are critical to the Group's achievement of its business objectives, that those systems are designed to manage rather than eliminate risk and that they can only provide reasonable and not absolute assurance against material misstatement or loss.

As the Company's ADRs are listed in the US, the Group's internal controls over financial reporting are subject to the requirements of the Sarbanes-Oxley Act 2002 ("SOX"). Please refer to pages 75 to 76 for the update on the Group's SOX implementation plan. The requirements under SOX require a greater degree of formal documentation of controls. However, the audit committee has reviewed and discussed this position with its auditors and satisfied itself that the current control environment is effective under the UK Corporate Governance Code.

There is an on-going internal process under the Risk Management Framework for identifying, evaluating and managing the significant risks faced by the Group in association with the work performed by the outsourced internal audit function. This process has been in place throughout the period and up to the date of approval of the Annual Report and Accounts and it is regularly reviewed by the board and accords with the FRC Guidance on Audit Committees published in April 2016.

As part of the process that the Group has in place to review the effectiveness of the internal control system, there are procedures designed to capture and evaluate failings and weaknesses and, in the case of those categorised by the board as "significant", procedures exist to ensure that necessary action is taken to remedy any such failings. The review covers all material controls, including financial, operational and compliance controls.

The committee reports on a regular basis to the board on the Group's internal financial control procedures and makes recommendations to the board in this area.

The external auditors provide a supplementary, independent and autonomous perspective on those areas of the internal control system which they assess in the course of their work. Their findings are regularly reported to both the committee and the board.

The key elements of the control system are:

- The Group operates a structured, objectives-driven approach to fulfil its core purpose and goals in respect of sustained profitability and growth;
- Systems and procedures are in place for all major transaction types with appropriate authorisation controls;
- All contracts are reviewed. The level of review depends on the size and complexity of the contracts and associated risks. There are formal limits above which the review level is escalated;
- Reconciliations are performed on a timely basis for all major accounts; and
- Research and development and capital expenditure programmes are subject to formal review and monitoring procedures.

The board recognises the need to understand and control the variety of risks to which the Group is exposed. During the period, in order to address this on behalf of the board, the committee oversaw the executive management's risk management activities under the RMF. The executive management took responsibility for regular evaluation of generic and specific risks within the business and the implementation of mitigation plans to address them.

Risks are assessed with reference to the achievement of the Group's business objectives and according to current market and economic issues. The continuous monitoring of strategic and operational risks is the responsibility of the board and executive management respectively. The risk process has been in place for the period under review and is up to date at the time of this report. Please refer to pages 54 to 63 for the report on principal risks and uncertainties.

The committee considers any significant control matters raised in reports from management and by the internal and external auditors. It then reports its findings to the board. Where weaknesses are identified, the committee requires appropriate action to be taken by management and may request internal audit to perform a specific review into these areas if required.

Financial reporting

In addition to the general internal controls and risk management processes described above, the Group also has specific internal controls and risk management systems to govern the financial reporting process:

- There are Group policies covering what is reported monthly to the board and the executive committee. The Group's financial reporting system has been guided by the requirement to ensure consistency and visibility of management information to enable the board and the executive team to review the Group's worldwide operations effectively;
- Cash flow forecasts are produced monthly by all operations. These are reviewed by the Group treasury function to ensure effective cash management by the Group;
- Management representations covering compliance with Group policies and the accuracy of financial information are collected on a half-yearly basis;
- All the major trading entities completed a self-assessment on the effectiveness of their internal control environment;
- The consolidation process entails the combining and adjusting of financial information contained in the individual financial statements of the Company and its subsidiary undertakings in order to prepare consolidated annual report and accounts that present financial information for the Group as a single economic entity. The Group accounting policies set out the basis of preparation and consolidation, including the elimination of inter-company transactions, balances and unrealised gains between Group companies;
- Financial information from subsidiaries is reviewed for accuracy by internal review and externally audited where required; and
- The consolidated financial statements are completed in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB") and in conformity with IFRS as adopted by the European Union (collectively "IFRS"), IFRS Interpretations committee, the Companies Act 2006 and Article 4 of the IAS Regulation.

The board, with advice from the committee, is satisfied that an effective system of internal control and risk management processes are in place which enable the Company to identify, evaluate and manage key risks and which accord with the FRC Guidance on Audit Committees published in April 2016. These processes have been in place since the start of the financial period up to the date of approval of the Annual Report and Accounts. Further details of the risks faced by the Group are set out on pages 54 to 63.

Internal audit

PwC provided internal audit services to the Group throughout the year ended 31 October 2019 and has been the Group's internal audit provider since their appointment on 1 September 2017. The Group's Director of Internal Audit and Risk provides oversight and coordination of internal audit. In order to ensure independence, internal audit has a direct reporting line to the committee and to me, its chairman.

The committee monitored and reviewed the scope and results of the internal auditor's activities as well as its effectiveness during the period. The annual internal audit plan is approved by the committee at the beginning of the financial period, with any subsequent changes to the plan requiring committee approval. The nature and scope of the internal auditor's work is reviewed and approved and the results of the audits are assessed alongside management's responses. Issues with the audit reports which are graded as needing improvement are considered in detail by the committee along with the appropriateness of mitigation plans to resolve the issues identified.

At each meeting, the committee received reports from PwC in order to ascertain progress in completing the internal audit plan and to review results of the audits.

Whistleblowing

The Group has a whistleblowing policy, which forms part of the Group's Worldwide Code of Conduct and Business Ethics. This allows employees to raise issues of concern in relation to dishonesty or malpractice on an entirely confidential basis. The committee receives regular reports as to whether any matters have been raised within the Group and any applicable details.

Committee evaluation

As noted on page 73, an externally facilitated review was undertaken during the year. The committee was considered to be operating effectively, with its reviews being conducted at the level of detail required. The committee's approach to risk management was highly regarded, including the opportunity for specific "deep dives" to be conducted at board meetings.

Richard Atkins

Chairman, Audit committee
3 February 2020