

AUDIT COMMITTEE REPORT



**“Dear Shareholders,
This year we have changed the membership of the Audit Committee with the appointment of Aubrey Adams. It is the Committee’s role to robustly review and assess the accuracy and quality of the yearly audit and half-yearly review, to challenge and consider the bi-annual property valuations undertaken by the Valuer and the Company’s risk management, financial reporting and financial management functions which are undertaken by the Manager and Administrator. We also re-tendered the auditor function in May 2017 and are pleased to announce that BDO LLP remains the Auditor to the Company.”**

Membership

Jim Prower Chairman¹

Richard Jewson², Susanne Given³, Aubrey Adams⁴, Stephen Smith⁵ (until his resignation from the Company in June 2017)

1 Jim Prower, is considered to possess recent and relevant financial experience for the purpose of the AIC Code. Details of Jim Prower’s experience can be found in his biography on page 88.

2 Richard Jewson, the Chairman of the Board, was appointed to the Audit Committee on 6 July 2017 and resigned on 11 September 2017.

3 Susanne Given has previous experience of attending audit committee meetings in her role as COO of SuperGroup Plc. Susanne also chairs the Management Engagement Committee and is appointed to the Nomination Committee.

4 Aubrey Adams was appointed to the Audit Committee on 11 September 2017. He is a Fellow of the Institute of Chartered Accountants and was the pro-tem Chair of the Audit Committee at British Land Company PLC. Aubrey is also appointed to the Management Engagement Committee and Nomination Committee.

5 Stephen Smith sat on the Audit Committee until his resignation. He was also a member of the Management Engagement Committee and the Nomination Committee. Previously he had been responsible for property investment strategy at British Land Company PLC in his role as Chief Investment Officer. He also held various other non-executive positions.

Key focus for 2017

- Recommended to the Board that the Annual Report and Accounts for 2016, taken as whole, were fair, balanced and understandable and that it provided the information necessary for Shareholders to assess the Company’s position and performance, business model and strategy;
- Reviewed the Interim Report 2017 and recommended the same to the Board;
- Re-tendered the appointment of the Auditor in May 2017 and recommended the re-appointment of BDO as Auditor and the appointment of PwC LLP as tax advisors to the Company;
- Monitored the integrity of the financial statements of the Company and any formal announcements relating to the Company’s financial performance and reviewed any significant financial reporting judgements contained in them;
- Reviewed the robustness of the Company’s internal financial controls and reviewed the efficacy of the internal control and risk management systems used by the Company;
- Assessed the quality of the annual and interim property valuation prepared by the Company’s independent Valuers and challenged the assumptions used by the Valuers in preparing the valuation; and
- Reviewed and considered the basis of the Viability and Going Concern Statements made by the Directors.

Meeting attendance register

PERSON	MEETINGS ELIGIBLE TO ATTEND	MEETINGS ATTENDED
Jim Prower	5	5
Susanne Given	5	4
Stephen Smith	3	3
Aubrey Adams	2	1
Richard Jewson*	1	1

* Richard Jewson also attended the Audit Committee re-tender meeting as an observer.

➔ See Viability Statement, pages 77

The Audit Committee's role is to oversee the Company's financial reporting process including the risk management and internal financial controls in place within the Manager, the valuation of the property portfolio, the Group's compliance with accepted accounting standards and other regulatory requirements as well as the activities of the Auditors.

Committee membership and terms of reference

We operate within defined terms of reference, which are available on the Company's Website and on request from the Company Secretary.

The membership of the Committee has changed over the course of the year. Richard Jewson, the Company's Chairman, was reappointed to the Audit Committee on 6 July 2017 to support the Committee during the preparation of the Interim Report, property valuation and risk review exercise. Richard then resigned when Aubrey Adams was appointed to the Audit Committee on 11 September 2017. All of the current Audit Committee members, as well as Richard Jewson, are independent Directors of the Company. Aubrey Adams is a Fellow of the Institute of Chartered Accountants and has chaired an audit committee previously and Susanne Given has experience of sitting on an audit committee in a previous role. I am a Chartered Accountant and acted as finance director at Argent Group and several other listed companies. None of the members of the Committee is connected to the Manager or to the Auditor. The biographies of the members can be found on pages 88-89 of this Annual Report.

Whilst Richard Jewson is an independent Director he is also Chairman of the Company. The Chair of the Audit Committee considered it to be beneficial to have Richard Jewson's experience on the Audit Committee at the time of the publication of the Company's Interim Results and to ensure that the Audit Committee had three members at all times in order to comply with the AIC Code and Guide.

Meetings

We met five times during 2017, following the Company's corporate calendar, which ensures that the meetings are aligned to the Company's financial reporting timetable. The Company Secretary ensures that the meetings are of sufficient length to allow the Committee to consider all the matters of importance and the Committee is satisfied that it receives full information in a timely manner to allow it to fulfil its obligations. These meetings are attended by the Committee members, as well

as representatives of the Manager, the Company Secretary and the Auditor. The Committee also met with the Company's independent Valuer, CBRE, in January 2018 as part of the year-end audit process. I, as the Committee Chairman, had regular meetings with the Company Secretary and the Head of Finance for the Manager and the Committee regularly has informal discussions throughout the year.

Risk management and internal controls

As part of each Board meeting and each Audit Committee meeting, the Board of Directors review the financial position of the Company and assess any risks in relation to the Company's business model, and the Group's future performance, liquidity and solvency as well as any risks relating to specific investments or proposed investments and specific tenants or initiatives relating to specific assets. To facilitate this process the Manager produces financial reports, which include the latest management accounts, a review and report on the Company's financial forecast, a report on proposed and existing investment and asset management initiatives, substantiation of any dividend payments and a general update on the financial health of the Company.

The Committee reviewed the principal business risks of the Company on 3 July 2017 and 13 December 2017. The Company's principal risks are found on pages 66-71 of the Annual Report.

As the Company's AIFM, the Manager is subject to reporting and ongoing compliance under the AIFMD. As part of this regulatory process, Langham Hall UK Depository LLP has been retained by the Company and is responsible for cash monitoring, asset verification and oversight of the Company and the Manager. Langham Hall UK Depository LLP report quarterly to the Board and the Manager. Please refer to page 95 for a description of Langham Hall UK Depository LLP's role.

The Manager also employs a Compliance Officer and Head of Risk to assist the regulatory team with the discharge of the Manager's obligations in accordance with the AIFMD.

The Company does not have an internal audit function and, following an internal risk review, we do not consider it necessary for the Company to have one. The Company is managed externally by the Manager. All payments of Company funds are authorised by the Manager in accordance with the duties delegated to it pursuant to the terms of the IMA and in accordance with the provisions of the AIFMD. The Manager instructs the Administrator to make the duly authorised payment and Langham Hall UK Depository LLP, as part of its role as Depository, reviews each payment. We consider that

➔ See The Board of Directors, pages 88-89

➔ See Our Principal Risks and Uncertainties, page 66-71

➔ For further information on Langham Hall UK Depository LLP, see Depository Statement, pages 95

the internal controls in place and the function undertaken by Langham Hall UK Depositary LLP makes it unnecessary for the Company to employ an internal audit function. In addition to this, the Administrator has its own internal audit performed on an annual basis, from which the Company reviews any findings and takes particular comfort. This audit has not raised any significant findings.

Financial reporting and significant judgements

We monitor the integrity of the financial information published in the Interim Report and Annual Report and consider whether the Manager has made suitable and appropriate estimates and judgements in respect of areas which could have a material impact on the financial statements. We seek support from the external Auditor to assess these significant judgements. We also consider the processes undertaken by the Manager to ensure that the financial statements are fair, balanced and understandable.

A variety of financial information and reports were prepared by the Manager and provided to the Board and to the Audit Committee over the course of the year. These included budgets, periodic re-forecasting and specific papers on the issuance of further equity, the acquisition of the Littlebrook development site, the impact of the refinancing of the syndicated loan and simultaneous issue of £500 million loan notes under the EMTN programme; as well as reviewing the Company's ability to continue to pay a progressive dividend. This financial information was fully reviewed and debated both at Committee and Board level across a number of meetings.

The Manager and the Auditor update us on changes to accounting policies, legislation and best practice and areas of significant judgement by the Manager. They pay particular attention to transactions which they deem important due to size or complexity. The main areas where a significant judgement is required include the assessment over fair values of investment property and interest rate derivatives, business combinations, and operating lease contracts.

Business combinations

At the time of acquiring a subsidiary that owns investment properties, the Group considers whether each acquisition represents the acquisition of a business or the acquisition of an asset. Where the acquisitions are not judged to be the acquisition of a business, they are not treated as business combinations.

Operating lease contracts

The Group has determined, based on an evaluation of the terms and conditions of the arrangements, that it retains all significant risks and rewards of ownership of its properties and so accounts for the leases as operating leases.

Valuation of property portfolio

Following production of the draft valuation by CBRE, the Manager meets with CBRE to discuss and challenge various elements of the property valuation. The Auditor, in fulfilling its function as independent auditor to the Company, also meets with CBRE to discuss, and where necessary, challenge the property valuations. The Board receives a copy of the property valuation for the portfolio once it has been tested by the Manager and after the Auditor has met with the Valuer. The Board also met with the Valuer in January 2018 to discuss and challenge the valuation and to ensure it was conducted properly, independently and could be fully supported. The property portfolio is valued by CBRE bi-annually. The performance of CBRE is assessed on an annual basis by the Management Engagement Committee in its report on pages 101-103.

The Group had property assets of £2.60 billion at 31 December 2017, as detailed on the Group Statement of Financial Position. As explained in note 15 to the financial statements, CBRE independently valued the properties in accordance with IAS 40: Investment Property. The total portfolio valuation including forward funded commitments at the year end was £2.60 billion. We have reviewed the assumptions underlying the property valuations and discussed these with the Manager, and have concluded that the valuation is appropriate.

Valuation of interest rate derivatives

The Group mitigates its exposure to interest rate risk by entering into interest rate hedging arrangements. The Group accounts for these instruments in accordance with IAS 39 and makes additional required disclosures under IFRS 7 Financial Instruments Disclosures and IFRS 13 Fair Value Measurement. The valuations are provided by the relevant counterparties of the interest rate derivatives. The Board has reviewed and approved these valuations.

Fair, balanced and understandable financial statements

The production and audit of the Company's Annual Report is a comprehensive process, requiring input from a number of contributors. To reach a conclusion on whether the Company's Annual Report is fair, balanced and understandable, as required under the AIC Code and Guide, the Board has requested that the Audit Committee advise on whether we consider that the

[↪ See Management Engagement Committee Report, pages 101-103](#)

Annual Report fulfils these requirements. In outlining our advice, we have considered the following:

- the comprehensive documentation that outlines the controls in place for the production of the Annual Report, including the verification processes to confirm the factual content;
- the detailed reviews undertaken at various stages of the production process by the Manager, Administrator, Joint Financial Adviser, Auditor and the Audit Committee, which are intended to ensure consistency and overall balance;
- controls enforced by the Manager, Administrator and other third-party service providers, to ensure complete and accurate financial records and security of the Company's assets;
- the satisfactory ISAE 3402 control report produced by the Administrator for the year ended 31 December 2017, which has been reviewed and reported upon by the Administrator's external auditor, to verify the effectiveness of the Administrator's internal controls; and
- a letter provided by the Administrator that there have been no changes to its control environment since 31 December 2017 and that all internal controls in place at the time of the last review remain active.

As a result of the work performed, we have concluded and reported to the Board that the Annual Report for the year ended 31 December 2017, taken as a whole, is fair, balanced and understandable and provides the information necessary for Shareholders to assess the Company's performance, business model and strategy. The Board's conclusions in this respect are set out in the Chairman's Governance Overview [↪](#) page 82.

External Auditor re-tender

The European Union Audit Reform Legislation came into force in 2017 meaning that, as the Company's Auditor, BDO LLP ("BDO") were unable to continue to provide the Company with audit services, along with non-audit services including corporate finance services and tax advisory work. With a view to dividing the audit and non-audit services, the Board, in accordance with our advice, decided that it would re-tender the position of Auditor to the Company.

In April 2017, the Company invited, BDO, Deloitte LLP ("Deloitte"), PricewaterhouseCooper LLP ("PwC") and KPMG LLP ("KPMG") to tender for the position as Auditor to the Company. Following receipt of written proposals, the

Committee asked BDO, Deloitte and KPMG to return to deliver a formal presentation to it in May 2017. The tender documents and presentations received were of exceptionally high quality. The Committee gave particular consideration to the depth and breadth of experience plus the qualifications and real estate credentials of the respective audit teams. Alongside this, a focus of each proposal included value for money, an ability to deliver the audit within the timescales set and quality of audit services in relation to recent FRC quality assessments made of the respective firms. The Audit Committee decided to recommend that BDO be reappointed as Auditor due to its strong tender pitch and its comprehensive and in-depth knowledge of the Company. Another key aspect was the high level of team continuity, at all levels, that the Company has received from BDO since the Company's IPO. BDO have agreed a fixed fee for this audit of this Annual Report and review of the Interim Report for the next three years up to and including 2019. BDO were therefore re-appointed as Auditor to the Company in May 2017.

As part of the re-tender process we considered BDO's compensation, past performance and continuing independence. Richard Levy will remain the lead Audit Partner until year-end 2018, at which point he is due to rotate following the fifth year of the audit in line with Ethical Standards. Richard has been the lead Audit Partner since year-end 2014. It is intended that Geraint Jones, who we met as part of the audit tender process, then takes over the position as Lead Audit Partner. The Company has met with the key members of the Audit team over the course of the year and BDO have formally confirmed its independence as part of the reporting process as well as during the re-tender process. We consider that the Audit team assigned to the Company by BDO has a good understanding of the Company's business which enables it to produce a detailed, high-quality, in-depth audit and permits the team to scrutinise and challenge the Company's financial procedures and significant judgements. We also considered BDO's internal quality control procedures and found them to be sufficient. The FRC confirmed in its 2016 Audit Quality Review of BDO that none of BDO's audits needed significant improvements. The Committee is satisfied that the Audit process is transparent and of good quality.

Audit process

We meet with the Auditor before the preparation of the interim and annual results began, to plan and discuss the scope of the audit or review as appropriate, and challenge where necessary to ensure its rigour. At these meetings the Auditors prepare a detailed audit or review plan which is discussed and questioned by us to ensure that all areas of the business are appropriately

[↪](#) See Chairman's Governance Overview, pages 80-82

reviewed and that the materiality thresholds are set at the appropriate level which varies depending on the matter in question. The timescale for the delivery of the Audit or review is also set at this meeting. We meet with the Auditor again just prior to the conclusion of the review or Audit to consider, challenge and evaluate findings in depth. As an example, we questioned the Auditor in depth on the process it adopted to challenge the 2017 property valuation to ensure it was effective and we discussed a query raised by a Shareholder relating to the Company's treatment of fixed uplift rental adjustments at the half yearly review. Neither the audit nor the interim review uncovered any significant findings.

We continue to believe that, in some circumstances, the external Auditor's understanding of the Company's business can be beneficial in improving the efficiency and effectiveness of advisory work. For this reason we continue to engage BDO as reporting accountants on the Company's secondary offerings in the normal course of the Company's business. Following the audit tender, PwC LLP were appointed to assist with financial and tax due diligence on corporate acquisitions and to provide specific tax compliance advice.

The Company paid £77,500 in fees to the Auditor for non-audit services during 2017. These fees are set out in the table below.

WORK UNDERTAKEN	RATIONALE FOR USING THE EXTERNAL AUDITOR	FEE (£)
Reporting accountant on the Company's secondary offerings and public debt issuance	Detailed knowledge and understanding of the business and the requirements of the exercise, having acted as reporting accountant on previous equity fundraisings for the Company. Low risk of self-interest and self-review threat, as the work is not used in the audit of the financial statements.	£77,500

Jim Prower Chairman of the Audit Committee
7 March 2018