

# AUDIT COMMITTEE REPORT



**IAN BARLOW** —  
COMMITTEE CHAIRMAN

## Membership and meetings

The membership of the Committee and attendance at the five scheduled meetings held during the year ended 30 September 2018 are shown below:

		Independent	Date of appointment	Meetings eligible to attend
<b>Ian Barlow</b>	Chairman	Yes	01/09/16	👤👤👤👤
<b>June Barnes</b>	Member	Yes	22/05/14	👤👤👤👤
<b>Jon Di-Stefano</b>	Member	Yes	01/09/17	👤👤👤👤
<b>Duncan Hunter</b>	Member	Yes	22/05/14	👤👤👤👤

👤 Meetings attended

## Introduction

The Committee's role is to ensure a thorough and effective review of the areas within its remit and to report to the Board on its key responsibilities. This report sets out the membership and meetings structure of the Committee, its role and responsibilities and details of its key actions during the year under review.

## Dear Shareholder,

### Summary

I am pleased to present my report for the financial year ended 30 September 2018. The membership of our committee remained unchanged and relevant. In addition to our recurring responsibilities for external reporting, internal controls and risk, we reviewed the preparation for the introduction of three new important accounting standards on the recognition of income, accounting for leases and measurement of long-term financial assets which will affect the financial statements from the financial year 2019 onwards. A note on these is set out in note 1 to the consolidated financial statements on page 130. We also noted the maturing of our internal risk management processes and the internal audit programme provided by Grant Thornton, which both the committee and management have found very helpful.

### Accountability

The Audit Committee is responsible for overseeing the accounting, financial reporting, internal control and risk management processes and for supporting the Board in ensuring that the financial reporting of the Group represents a fair, balanced and understandable assessment of the Company's position and prospects. The Committee also has responsibility for the relationship with the external auditor. This Audit Committee report sets out how the Committee meets its responsibilities and the main activities during the year. The terms of reference, which can be found on the Company's website, are reviewed at least annually to ensure ongoing compliance with regulatory and governance developments.

### Members

We have a good balance of skills and experience. I have financial experience as a chartered accountant, having had a long career in finance and accounting. I am also chairman of the audit committees of two other listed companies. Jon Di-Stefano, a qualified accountant, has extensive financial and housing sector experience and Duncan Hunter's career as a managing director of corporate finance at a leading investment bank has given him valuable experience and insight. June Barnes has experience of running a large business and of risk management. Consequently the Board is satisfied that the Committee has competence relevant to the sector in which the Company operates.

The Chief Executive and Finance Director attend all meetings of the Committee, to which the Chairman is also invited. Other Executive Directors, senior members of the finance team, the external auditor and the internal auditor attend by invitation only, if required. The Committee is satisfied that it receives sufficiently detailed and relevant information from the Company's management, external auditor and internal auditor to enable it to fulfil its duties and to meet its responsibilities. The Chairman of the Committee provides a report to the Board following each Committee meeting summarising matters discussed and highlighting to the Board any issues requiring Board discussion. The Board also reviews the minutes and action points arising from each Committee meeting.

Members of the Committee spend time with executive management outside of the scheduled Committee meetings. This helps them to gain a better understanding of key issues and to identify matters requiring discussion by the Committee and areas requiring further clarification at meetings. This also enables direct contact with senior management outside the arena of a Board or committee meeting. The Committee meets with the external auditor without management being present at least twice a year.

### **Role and responsibilities**

During the year, the Committee has continued its focus on risk management processes and on internal controls. The Group executive committee structure established at the beginning of the financial year, as set out in the corporate governance report, has resulted in a more streamlined approach by management to risk reporting. The assessment of risk takes place at all levels throughout the organisation and this analysis is summarised in reports to the Committee and to the Board. Grant Thornton was appointed as internal auditor in 2016 and, during the year, we have continued to oversee their workstream and the outputs and action points arising from their reviews. Further details of the internal audit process are set out later in this report.

### **Key responsibilities**

- Financial reporting – to ensure the quality and integrity of published financial reporting and of financial statements and related disclosure.
- Risk management – to monitor the assessment of risk and the risk management and mitigation processes in place.
- Internal controls – responsible for the relationship with the Group's internal auditor and for monitoring the internal control environment of the Group.
- Governance and compliance – to ensure that the Group complies with all regulatory and governance requirements and guidelines in relation to financial reporting and accounting matters, including accounting policies and practices.
- External auditor – responsible for the supervision of the relationship with the external auditor including their qualification, independence, performance and effectiveness, and for ensuring an effective audit process.

The Committee's work on these key areas during the year ended 30 September 2018 is summarised overleaf.

## Main activities during the year

### Financial reporting

- Assisted the Board in ensuring that the information contained in the 2017 Annual Report was accurate and that the information contained in the strategic report was consistent with the financial statements and notes to the accounts. Reviewed and approved the Company's viability statement, statement of going concern and the appropriateness of accounting policies for the year ended 30 September 2017. All material Committee recommendations were actioned.
- Reviewed and discussed with the auditor the report on the audit findings on the Group accounts for the year ended 30 September 2017. Key matters discussed were:

#### i) Valuation of investment properties and the carrying value of trading properties

The Committee discussed the valuation of each property with the external valuers and/or management if held at Directors' valuation. The Committee assessed the integrity of the valuation process. Key judgements and assumptions applied to each valuation were considered as well as the valuation movement in the year. The Committee considered the key inputs to the discounted cash flow model (used for the largest assets valued, Alconbury, Rugby and Newark) or other valuation models and concluded that the assumptions applied were appropriate.

#### ii) Revenue and profit recognition

The Committee considered revenue and profit recognition in respect of sales of residential land parcels and individual units constructed on its strategic sites, assessing the conditions of the licence arrangements, and concluded they were appropriate.

- Reviewed and recommended to the Board the approval of the audited financial statements and preliminary announcement of the Group for the year ended 30 September 2017 and the Group's interim financial statements and announcement of results for the six months to 31 March 2018, together with the related investor presentations of the results, concluding that they were accurate and consistent with the audited financial statements.
- Reviewed the audit planning report prepared by the external auditor in respect of the financial year ended 30 September 2018, confirming materiality thresholds and agreeing the key audit matters for consideration by the auditor as part of the audit.

### Risk management

- Assessed the Group's risk management framework and risk appetite and reviewed the effectiveness of the risk management and internal controls processes, which are also reviewed by the Board.
- Reviewed at each meeting a risk matrix setting out the identification and evaluation of risks at a strategic and project risk level and the impact of mitigation controls. The Committee reviews the likelihood, impact and mitigation of risks and approves the resulting risk rating.
- Further details of the Group's key risks and its development of risk management processes are contained in the risk review on pages 36 to 43.

### Internal controls

- Reviewed the work carried out by Grant Thornton, who have been appointed to provide an internal audit service to the Group and to report on and provide assurance on the adequacy of the internal financial and non-financial controls. The Committee monitored the follow-up by management of actions identified in the 2017 reviews on areas previously assessed, including the risk management framework and procure to pay processes.
- Reviewed the findings from the 2018 audits and of the 15 identified action points only two remain to be addressed. In addition:
  - IT security – assessed the performance measurement of the Group's third party provider of IT services and the effectiveness of IT security management. Even though this audit was undertaken in the first half of this financial year, nine out of the 17 action points have been implemented.
  - Budgeting and forecasting – reviewed the effectiveness of budgeting and forecasting processes and the way they work throughout the Group, covering strategic, commercial and Catesby business segments together with the overheads of the business.

Grant Thornton registered three action points and gave their report a low-risk rating.

- Joint venture relationships – assessed the governance and management of relationships with joint venture partners. This was again given a low-risk rating by Grant Thornton who suggested four action points.

The Committee also approved the internal audit plan for 2019.

## Main activities during the year continued

### Governance and compliance

- The Committee receives regular technical updates to reflect changes to the regulatory, governance and reporting environment. BDO led a technical update to the Committee covering the introduction of new accounting standards, changes in narrative reporting and the disclosure requirements in relation to the 2018 UK Corporate Governance Code.
- Reviewed the performance evaluation of the Committee. During the year the Committee assessed its own performance against the role and responsibilities set out in its terms of reference. The 2018 Board evaluation process also included a detailed review and evaluation of the Audit Committee. Further details of the 2018 evaluation process are set out in the report of the Nomination Committee.
- Reviewed regular reports on the work carried out by the Group to ensure GDPR compliance. Received a presentation by Mills & Reeve, which advised the Group on compliance and provided recommendations for action. The Committee monitored progress by management against the list of recommendations arising from the review carried out by Mills & Reeve.

### External auditor

- Assessment and confirmation of the qualifications, expertise, independence and objectivity of the external auditor. The Committee considered the effectiveness of the auditor and the audit process and concluded that both were effective. Committee members each reviewed an effectiveness questionnaire, taking into account feedback from management, which was discussed at a Committee meeting before recommending to the Board the reappointment of the auditor.
- Approval of the terms of engagement and the fees of the auditor for work related to the review of the interim results for the six months to 31 March 2018 and for the audit for the year ended 30 September 2018. The Committee reviews any non-audit fees paid to the auditor and is satisfied that these are within the Group policy for the agreement and authorisation of non-audit services and do not compromise their independence.

### Financial year ended 30 September 2018

Since the year end, the Committee has reviewed and recommended for Board approval the Annual Report and Accounts and preliminary announcement for the year ended 30 September 2018 and the investor presentation of results. The Committee is satisfied with the accuracy and consistency of information included in the Annual Report and Accounts for the year ended 30 September 2018 and that, taken as a whole, they are fair, balanced and understandable and that the financial statements represent a true and fair view of the financial state of the Group. The Committee has reviewed the assumptions upon which the going concern principle has been adopted for the preparation of the financial statements and has approved the long-term viability statement, which is set out on page 35.

### Financial reporting and significant judgements

The significant areas of judgement considered by the Committee and discussed and assessed with the external auditor in relation to the year ended 30 September 2018 were as follows:

#### 1. Valuation of investment properties and carrying value of trading properties

It is important to value the Group's property interests in order to ascertain the fair value of investment properties and the carrying value of trading properties, which are held at the lower of cost and net realisable value. Property valuations also inform the calculations of EPRA NAV. At 30 September 2018 the total EPRA value of all

the Group's property interests was £609.1 million, which was made up of investment properties, trading properties, properties within property, plant and equipment, property related trade and other receivables and the Group's share of properties and related receivables held by joint ventures and associates. Independent valuers, CBRE Limited, valued 90 per cent of the property interests and the Directors valued the remaining 10 per cent.

Due to the subjective nature of property valuations, significant judgement is required. Members of the Committee met with the external valuers, without management present, to discuss the half-year and year-end valuations. Each property valuation was discussed individually with the integrity of the valuation process also assessed. Key judgements and assumptions applied to each valuation were considered as well as the valuation movement in the relevant period. For the strategic land assets valued, a discounted cash flow model was used reflecting the scale of the assets and the length of time over which the assets will be realised. The Committee considered the key inputs to the discounted cash flow models, namely the quantum and timing of significant cash outflows, land prices and forecast house price and cost inflation, the assumed profit required by housebuilders, and the applied discount rates. It was concluded that the assumptions applied to the valuations were appropriate.

Members of the Committee also discussed and reviewed Directors' valuations and considered that the key assumptions applied to the valuations were appropriate.

## Financial reporting and significant judgements continued

### 2. Revenue and profit recognition

The Committee considered revenue and profit recognition in respect of sales of residential land parcels and individual units constructed on its strategic sites.

Proceeds from land parcel sales under licence arrangements are receivable in stages; a fixed price element initially being earned when risks and rewards of ownership transfer, with a further variable overage element being receivable when homes are sold. Total receipts are ultimately dependent upon sales prices achieved by housebuilders. Members of the Committee assessed the substantive conditions attaching to these arrangements when deciding how much and at what point revenue should be recognised, which was determined with reference to contractual terms, forecast timescales over which these amounts were payable and the ability to reliably measure variable consideration elements. Amounts were discounted to adjust for the time value of money. The Committee also considered the methodology and allocation of directly attributable costs of servicing each land parcel prior to sale which includes an allocation of site-wide infrastructure costs.

As with the sale of residential land parcels, some commercial land sale contracts entered into provide for deferred and sometimes variable consideration. This adds a certain complexity as to the point at which revenue should be recognised in the financial statements and the value at which it should be measured.

The Committee reviewed these methods of revenue and profit recognition and concluded they were appropriate.

### Assessment of the effectiveness and independence of the external auditor

The Audit Committee has reviewed, as it does every year, the effectiveness of the external auditor taking into account their independence, objectivity, expertise and resources and has concluded that both the audit and audit process were effective. The Audit Committee considered the fulfilment of the audit plan and the degree to which BDO was able to assess key accounting and audit judgements and the content of the audit clearance report issued by them. The Committee considers that the auditor provides effective and appropriate challenge to management where required. This process was carried out through both formal and informal meetings with the external audit team.

BDO was previously auditor to the Terrace Hill Group and has been the auditor to the Urban&Civic Group since its Listing in May 2014. The Committee has previously reviewed the requirements relating to the tender of auditors and concluded that the date of appointment of BDO is deemed to be May 2014. As reported last year, a competitive tender will therefore be required by 2024. Audit engagement partners are required to rotate every five years and a rotation will not be required for Thomas Goodworth until the year ending 30 September 2021.

The Company supports BDO's policy that senior management of the audit team should rotate after seven years.

After reviewing the external auditor's performance during the year, the Committee has concluded that BDO remain effective in their role as external auditor and recommends to the Board that they be reappointed for a further year. A resolution to this effect will be proposed at the 2019 AGM. The Committee will continue to review the effectiveness and independence of the auditor on an ongoing basis.

### Anti-corruption and bribery and whistleblowing procedures

In line with the Bribery Act 2010, the Group has in place written policies on avoiding and not tolerating bribery or corruption. The Board has approved an anti-corruption and bribery policy, a gifts and hospitality policy and a whistleblowing policy, which have been circulated to all Directors and staff. The anti-corruption and bribery policy and whistleblowing policy are also found on the Company website. All staff are provided with copies of these policies on joining the Group and are required to confirm in writing, on an annual basis, that they have complied with the anti-corruption and bribery policy and gifts and hospitality policy throughout the year. The Committee reviews, on a six-monthly basis, declarations made by Directors and staff under the Group's gifts and hospitality policy above an agreed threshold.

Under the whistleblowing policy, Directors, management, employees and external stakeholders can report in confidence any concerns they may have of malpractice, financial irregularity or breaches of any Group procedures. During the year, the Committee received anti-bribery and whistleblowing reports from management. It has been agreed that, going forward, the Board will be responsible for monitoring the procedures and effectiveness of the whistleblowing policy and for any reports made under the policy. This is consistent with the requirements of the 2018 UK Corporate Governance Code.

### Future accounting changes

The Audit Committee has been briefed by management and the external auditors on the effect of the following new accounting standards from the financial year 2019 onward.

#### IFRS 15 'Revenue from Contracts with Customers'

This standard will result in a significant change to the way revenue is recognised, particularly in respect of the Group's licensed overages. The impact of the incoming standard on this year's results is set out in note 1 of the financial statements.

#### IFRS 16 'Lease Accounting'

Leases will now be required to be brought on balance sheet as both a right to use asset and an associated liability. This new standard would result in the Group bringing on balance sheet operating leases for the first time. The impact of the incoming standard on this year's results is set out in note 1 of the financial statements.

#### IFRS 9 'Financial Instruments'

The introduction of IFRS 9 should not materially impact the Group in the first instance although it is likely that long-term receivables under licence arrangements will be reviewed more frequently to ensure no losses are expected.

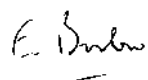
**Long-term viability statement**

The Committee has assessed the prospects and financial viability of the Group and has approved the long-term viability statement set out on page 35.

**2019 priorities**

The Committee's continued focus for the year ended 30 September 2019 will be the assessment of risk management within the Group and the review of reports prepared by Grant Thornton as part of the ongoing internal controls programme. The next phase of the internal controls review will cover investments and divestments, outsourced contract management, capital expenditure, health and safety, and HR and succession planning. The Committee will also continue to focus on financial reporting related to the half-year and year-end processes. During the year ending 30 September 2019, the Committee will work with management and be assisted by the auditor in overseeing the introduction of new accounting standards as discussed above.

I will report further on the activities of the Committee in next year's Audit Committee report.

**Ian Barlow**

Chairman of the Audit Committee

28 November 2018