Audit Committee

Committee Chairman

Ian Barlow

Other members

June Barnes

Jon Di-Stefano

Robert Dyson

Duncan Hunter

Dear Shareholder,

I am pleased to present the report of the Audit Committee for the financial year ended 30 September 2017. During the year, Jon Di-Stefano, ACA was appointed as a member of the Committee, bringing with him extensive financial and housing sector experience. Together with my financial experience as a chartered accountant, having had a long career in finance and accounting, and Duncan Hunter's career as a managing director of finance at a leading investment bank, the Board is satisfied that three members of the Committee have recent and relevant financial experience working with financial and reporting matters. I am also chairman of the audit committees of two other listed companies. The Board considers that the Audit Committee as a whole has competence relevant to the sector in which the Company operates. All members of the Committee are independent.

The following report sets out the meetings and membership structure of the Committee, its role and responsibilities and details of its main activities during the year under review.

Meetings and membership structure

The membership of the Committee and attendance at the scheduled meetings held during the year ended 30 September 2017 are shown below:

		Independent	Date of appointment to the Committee	Meetings attended/ eligible to attend
Ian Barlow	Chairman	Yes	1 September 2016	5/5
June Barnes	Member	Yes	22 May 2014	5/5
Jon Di-Stefano	Member	Yes	1 September 2017	0/0[1]
Robert Dyson	Member	Yes	22 May 2014	5/5
Duncan Hunter	Member	Yes	22 May 2014	5/5

1. No meetings were held post his appointment date.

Meetings are aligned to the Group's financial and regulatory reporting timetable and a detailed schedule of annual agenda items, managed by the Company Secretary, ensures that the Committee complies with all matters required under the UK Corporate Governance Code and the duties and responsibilities under its terms of reference, which are reviewed annually to ensure ongoing compliance with regulatory developments.

The Company Secretary is secretary to the Committee. The Chief Executive and Finance Director attend all meetings of the Committee, to which the Chairman and the Group's external auditor are also invited. Other Executive Directors, senior members of the finance team and the internal auditor attend by invitation only, if required. The Committee is satisfied that it receives sufficient and relevant information from the Company's management, external auditor and internal auditor to enable it to fulfil its duties. The Chairman of the Committee provides a report to the Board following each Committee meeting on the matters discussed by the Committee. The Committee meets with the auditor without management being present at least twice a year. In addition to the scheduled Committee meetings, members of the Committee spend time with executive management to ensure a good understanding of the key issues to be considered by the Committee and to identify areas requiring further clarification or discussion at meetings.

Role and responsibilities

The Committee's role is to ensure the integrity of published financial information and to monitor controls within the Group. The Committee is also responsible for the supervision of the relationship with the external auditor, BDO LLP (BDO), including their performance and effectiveness, and ensuring an effective audit process.

The Committee's key responsibilities are to review and report to the Board on:

- financial reporting;
- risk management;
- internal controls;
- governance and compliance; and
- the external auditor.

The Committee's terms of reference can be found on the Company's website at www.urbanandcivic.com.

Main activities

The main activities of the Committee during the year were as follows:

During the year, the Committee has continued to focus on the development of the Group's approach to the management and reporting of risk and has overseen the reporting by Grant Thornton following their appointment to carry out an internal audit review. We commenced the internal audit process in 2016 and our work this year has been to develop an appropriate programme for 2017 and to agree the audit areas for 2018. Further details of the internal audit process are set out later in this report. The Committee also considered and agreed with the auditor the method for revenue recognition in compliance with both current and prospective accounting standards, following the sale of certain land parcels for the first time.

The Committee's work covers five main areas and our key work in these areas during the year ended 30 September 2017 is summarised below:

Financial reporting

During the year the Audit Committee has:

- reviewed the audited financial statements and preliminary announcement of the Group for the year ended 30 September 2016, including consideration of key accounting issues and areas of significant judgement. The Committee reviewed and discussed with the auditor the audit findings on the Group accounts for the year ended 30 September 2016. The Committee recommended the approval of the financial statements to the Board;
- reviewed the Company's going concern and viability statement for the year ended 30 September 2016, taking into account the business plan five-year forecast and equity requirements for the period to 30 September 2021;
- reviewed the investor presentation of the results for the year ended 30 September 2016 to ensure accuracy and consistency with the Report and Accounts;
- reviewed the Group's interim financial statements and announcement of results for the six months to 31 March 2017 and recommended their approval to the Board;
- engaged with executive management at an early stage on the 2017 audit timetable and the year-end timetable for the production of the Report and Accounts;
- reviewed the Audit Planning Report prepared by the external auditor in respect of the financial year ended 30 September 2017, confirming materiality thresholds and agreeing the key audit matters for consideration by the auditor as part of the audit; and
- considered and agreed with the auditor the key accounting treatments (including the method for revenue recognition within acceptable parameters of current and future accounting standards) and significant accounting judgements in respect of the Group's accounts for the year ended 30 September 2017 (as described on page 102), including:
  - the valuation of investment properties and carrying value of trading properties;
  - revenue and profit recognition policies.

Risk management

The Audit Committee reviews and approves the risk management framework and processes, which are also reviewed by the Board. The Board has recently established an Executive Management Committee and one of its key responsibilities will be to review risks at project level and report up to the Board.

The main activities of the Committee during the year continued:

The Board has ultimate responsibility for risk and a report on risk management is set out on pages 33 to 37. During the year, the Committee has:

- reviewed and discussed the risk appetite of the Group prior to a discussion and adoption by the Board, which has overall responsibility for determining the nature and extent of the principal risks it is willing to take in achieving strategic objectives;
- identified and evaluated risks at a strategic and project risk level and discussed risk management controls and mitigation actions with management. A risk matrix was then submitted to the Board for approval;
- reviewed risk management reporting and driven more regular and formal reviews of the key risks facing the Group and the related risk mitigation. Management prepares a risk matrix for regular review by the Committee, which provides details of key risks and the impact of controls. The Committee reviews the likelihood, impact and mitigation of risks and approves the resulting risk rating. Further details of the key risks facing the Group are contained in the risk review on pages 33 to 37; and
- approved the new management committee structure, set out in the Corporate Governance report on page 82, to ensure appropriate and adequate "bottom-up" reporting on project risk.

Internal controls

Following an assessment of the Group's internal controls structure in 2016, the Committee appointed Grant Thornton 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.

During the year, the Committee:

- approved the engagement letter and fees for the internal audit review;
- approved the internal audit plan for 2017 and 2018, agreeing a detailed annual plan and a higher level long-term plan;
- reviewed the findings from audits of the risk management framework, management and development of projects and procure to pay processes; and
- monitored the follow-up of actions identified and recommended by the reports.

Governance and compliance

The Audit Committee has:

- reviewed all declarations made under the Group's Gifts and Hospitality policy above an agreed threshold on a six-monthly basis;
- reviewed the Committee's compliance with the FRC Guidance on Audit Committees, published in April 2016. The Committee is satisfied that it complies with the guidance;
- reviewed the performance evaluation of the Committee. During the year, the Board carried out a performance evaluation process for the Board as a whole and its committees, as described in the report of the Nomination Committee on page 96. The Audit Committee concluded that meetings are conducted in a focused and efficient way with a strong discipline over the year-end financial reporting process. The progress of risk management and internal controls review was commended, although with acknowledgement that there is further work to be done;
- approved revisions to the Committee's terms of reference which reflected the appointment of an outsourced internal audit function and the publication of best practice guidelines in April 2017, following the introduction in 2016 of the revised UK Corporate Governance Code and the FRC Guidance on Audit Committees; and
- received development training from BDO on corporate reporting requirements and cyber security.

External auditor

The Audit Committee has:

- approved 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 2017 and for the audit for the year ended 30 September 2017. Audit and non-audit fees are disclosed in note 3 to the consolidated financial statements on page 143;
- reviewed at each meeting any fees paid to the auditor. The Committee is satisfied that these are within the Group policy for the agreement and authorisation of non-audit services and do not compromise their independence;
- reviewed the effectiveness of the auditor and the audit process, concluding that both were effective. The Committee members each reviewed an effectiveness questionnaire which was discussed at a Committee meeting. The Committee also considered the feedback from executive management. The effectiveness and independence of the auditor are discussed later in this report; and
- received assurance from BDO of their independence and objectivity.

Financial year ended 30 September 2017

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 2017 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 2017 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 approved the long-term viability statement, which is set out on page 32.

Financial reporting and significant judgements

The significant areas of judgement considered by the Committee and assessed with the external auditor in relation to the year ended 30 September 2017 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 2017 the total EPRA value of all the Group's property interests was £551.3 million, which was made up of investment properties, trading properties, properties within property, plant and equipment and the Group's share of properties held by joint ventures and associates. Independent valuers, CBRE Limited, valued 76 per cent of the property interests and the Directors valued the remaining 24 per cent, with around half of this 24 per cent being referenced to sales subsequent to the year-end.

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 year. For the largest assets valued, Alconbury, Rugby and Newark, 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 model, 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.

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 and forecast timescales over which these amounts were payable. 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 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

BDO has been the auditor to the Urban&Civic Group since its Listing in May 2014 and was previously auditor to the Terrace Hill Group. The Committee has reviewed the requirements relating to the tender of auditors and concluded that the date of appointment of BDO is deemed to be May 2014. A competitive tender will therefore be required by 2024. Thomas Edward Goodworth became our new audit partner during the year ended 30 September 2016 and, since audit engagement partners are only required to rotate every five years, a rotation will not be required 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.

The Audit Committee has reviewed 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. This was carried out through both formal and informal meetings with the external audit team.

The Committee agrees 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 2018 AGM.

2018 priorities

Outside of financial reporting related to the half year and year-end processes, the Committee's key focus for the year ended 30 September 2018 will be the ongoing assessment of risk management within the Group, the review of enhanced reporting from management committees and the review of reports prepared by Grant Thornton as part of the ongoing internal controls programme. In the year ending 30 September 2018, the second phase of the internal controls review will take place, covering information security and control of IT related risk, the effectiveness of budgeting and forecasting processes, the processes for identifying, mitigating and controlling health and safety risks and a further review of projects. I will report on this process in next year's Audit Committee report.

I. E. Barlow

Ian Barlow
Chairman of the Audit Committee
27 November 2017