AUDIT COMMITTEE REPORT

Lucinda Bell
Chair of the Audit Committee

2022 FOCUS AREAS

- Implement our new Valuer Appointment Policy which sets out our procedures in respect to valuer rotation and tenure (see page 152)
- Continue to focus on climate change matters in financial statements, including assurance from Deloitte on ESG disclosures (see page 153)
- Review the final recommendations arising from the BEIS consultation on 'Restoring trust in audit and corporate governance' and agree a timetable for their implementation (see page 153)
- Progress preparation of an Audit & Assurance Policy
- Review the effectiveness of our outsourced internal audit function

Dear Shareholder,
I am pleased to provide you with an overview of the Committee's main activities and areas of focus during the year. The Covid-19 pandemic continued to require adjustment to the way we work and provide oversight. However, our procedures operated efficiently and provided sufficient flexibility, such that disruption during the year was minimal.

Portfolio valuation

The Committee considers the valuation of the Group's property portfolio to be the principal area of judgement in determining the accuracy of the financial statements (see page 151). In order to obtain assurance that the portfolio valuation is fairly valued in accordance with the RICS Valuation Global Standards and the UK national supplement (the Red Book), a benchmarking exercise was conducted (see page 152). The Committee was satisfied with the outcome of the exercise and received further assurance that the methodology used by CBRE is robust. Following the benchmarking exercise, and the release of the 'Independent Review of Real Estate Investment Valuations' commissioned by RICS, the Committee revised its Valuer Appointment Policy (see page 152).

Climate change

As the Group is committed to being net zero carbon by 2030, it is important that our financial reporting reflects and supports this goal. The Committee received training on the assurance received from Deloitte, including in respect to its depth and breadth in comparison to our industry peers. The Committee also sought information from the external valuers on how climate change was being factored in the portfolio valuation and considered how climate change impacted other items in the financial statements. During the year, the Committee received updates on the Group's 'green finance' initiatives, including the new £350m green bond, the green funding element of our £450m RCF and the revisions made to the Group's Green Finance Framework (see pages 13, 96 and 97).

BEIS consultation on 'Audit and financial reporting governance' reform

The Company responded to the BEIS consultation on 1 July 2021, in respect to the recommendations of most significance to Derwent London. In response to the consultation, the Committee:

- reviewed the assurance received on the Group's financial disclosures, to identify areas where further assurance could be gained (see page 153);
- expanded its viability/resilience disclosures (see page 150);
- commenced preparation of an Audit and Assurance Policy; and
- discussed with management its plans to further enhance the internal control framework. During 2022, we will commission a review of our internal controls in order to identify focus areas.

During 2022, the Committee will monitor the outcome of the consultation and the implementation of any required changes to the Group's practices or reporting.

Financial Reporting Council (FRC) engagement

Following correspondence in late 2021 and early 2022 with the Corporate Reporting Review Team of the FRC, we have agreed to classify the cash flows relating to the additions to, and disposal of, trading properties within the Group Cash Flow Statement within 'net operating activities' rather than 'investing activities'. We have re-presented the statement for the year ended 31 December 2020 to reclassify £31.7m of cash receipts and £1.2m of expenditure on trading properties from 'investing activities' to 'operating activities'. This presentation has also been adopted for the year ended 31 December 2021 and will be applied consistently in future (see page 150).

External Auditor
The Committee is pleased with the performance and level of challenge received from the PwC audit team led by Sandra Dowling. In 2021, the Committee piloted the use of audit quality indicators (AQIs) to assist with its assessments of PwC's quality and performance (see page 156).

Further engagement
I welcome questions from shareholders on the Committee's activities. If you wish to discuss any aspect of this report, please contact me via our Company Secretary, David Lawler (telephone: +44 (0)20 7659 3000 or email: company.secretary@derwentlondon.com).

Lucinda Bell
Chair of the Audit Committee
23 February 2022

Committee composition and performance

During the year under review, the Committee was composed of independent Non-Executive Directors with a wide range of experience, including real estate and finance (biographies are available on pages 126 and 127). The Chair, Lucinda Bell, is a Chartered Accountant and has an appropriate level of recent and relevant financial experience to discharge her duties as Chair of the Committee.

In addition to the Committee members, meetings are attended by the Board Chairman, internal and external Auditors, and members of the Group's senior management team, at the request of the Committee Chair. To further facilitate open dialogue and assurance, the Committee holds private sessions with the Auditors without members of management being present.

During the year under review, the Committee met four times, in March, May, August and November (2020: three meetings). Two additional sub-committee meetings are held each year with the Group's external property valuers to consider the valuation of our property portfolio.

	Independent	Number of meetings	Attendance(i)
Lucinda Bell, Chair	Yes	4	100%
Claudia Arney	Yes	4	100%
Richard Dakin	Yes	4	100%
Simon Fraser(ii)	Yes	3	100%
Sanjeev Sharma(iii)	Yes	1	100%

Notes:
(i) Percentages are based on the meetings entitled to attend for the 12 months ended 31 December 2021.
(ii) Simon Fraser joined all meetings of the Committee until his retirement from the Board on 31 October 2021.
(iii) Sanjeev Sharma joined the Committee following his appointment to the Board on 1 October 2021.

The Committee's role and responsibilities are set out in the terms of reference, which were last updated in February 2022 and are available on the Company's website at: **www.derwentlondon.com/investors/governance/board-committees**

The 2021 evaluation of the Board, its committees and individual Directors, was internally facilitated by Mark Breuer, the Chairman of the Board, in accordance with our three-year cycle of evaluations (see page 141). The review confirmed that the Committee continues to operate effectively, with no significant matters raised.

Financial reporting

One of the Committee's principal responsibilities is to review and report to the Board on the clarity and accuracy of the Group's financial statements, including the annual Report & Accounts and interim statement.

When conducting its reviews, the Committee considers the overall requirement that the financial statements present a 'true and fair view' and the following:

- the accounting policies and practices applied (see note 43 on pages 263 to 267) including in respect to any significant transactions during the year, for example the unwinding of the previous investment and, surrender and regear of leases with The Portman Estate and the three off-market West End transactions with Lazari Investments (see pages 89, 90, 92, 93, 250 and 254);
- the effectiveness and application of internal financial controls (see page 154);
- material accounting assumptions and estimates made by management (see note 3 on pages 215 and 216);
- significant judgements or key audit matters identified by the external Auditor (see pages 202 to 204); and
- compliance with relevant accounting standards and other regulatory financial reporting requirements including the UK Corporate Governance Code and European Single Electronic Format (ESEF) requirements.

In order to assess the financial statements, the Committee regularly reviews reports from the CFO, members of the Finance team and the external Auditor who are invited to attend the Committee's meetings. Through face-to-face discussions and detailed written reports, the Committee members are able to understand the business rationale for transactions and how they are being recorded and disclosed in the financial statements.

In accordance with DTR4.1.14R, Derwent London is required to publish its annual Report & Accounts in eXtensible HyperText Mark-up Language (XHTML) and key elements of its financial statements need to be 'tagged' using eXtensible Business Reporting Language (XBRL) in accordance with single electronic format taxonomy. The 2021 Report & Accounts will be formatted and 'tagged' in accordance with these requirements.

The Committee received updates on how management were preparing for the new requirements, which included:

- the appointment of an external specialist (Toppan Merrill) to assist with tagging;
- a trial run was completed to test our processes using the 2020 Report & Accounts;
- a detailed review process for the checking of all tags was established; and
- a timetable was prepared to ensure both the PDF and XHTML formats of the 2021 Report & Accounts would be available at the same time and published on the Company's website.

AUDIT COMMITTEE REPORT CONTINUED

Review of the 2021 Report & Accounts

At the request of the Board, the Committee was asked to review the Group's Report & Accounts and to consider whether, taken as a whole, it was fair, balanced and understandable. In carrying out its review, the Committee had regard to the following:

Fairness and balance

- Is the report open and honest, are we reporting on our weaknesses, difficulties and challenges alongside our successes and opportunities?
- Do we provide clear explanations of our KPIs and is there strong linkage between our KPIs and our strategy?
- Do we show our progress over time and is there consistency in our metrics and measurements?

Understandable

- Do we explain our business model, strategy and accounting policies simply, using precise and clear language?
- Do we break up lengthy narrative with quotes, tables, case studies and graphics?
- Do we have a consistent tone across the Report & Accounts?
- Are we clearly 'signposting' to where additional information can be found?

Specific considerations for the 2021 Report & Accounts:

- Whether we clearly explain the climate change-related risks and opportunities facing the Group and our progress against our Net Zero Carbon Pathway (see pages 12, 13 and 68 to 73).
- Whether we provide sufficient disclosures on the assurance of information reported within the annual Report & Accounts (see page 153).
- Whether our 2021 Report & Accounts contains disclosures which are consistent with Task Force on Climate-Related Financial Disclosures recommendations in accordance with Listing Rule 9.8.6(8)(b) (see pages 68 to 73).
- Enhanced disclosures in respect of:
  - Reasons to invest in Derwent London (pages 6 and 7).
  - Reshaping the portfolio, restocking the pipeline (pages 20 and 21).
  - Our project pipeline & 'super-sites' (pages 24 and 25).
  - Providing enhanced amenity (pages 30 and 31).
  - How the Board monitors and assesses the Group's culture (page 131).
  - Diversity and inclusion (pages 57 to 59).
  - Risk documentation, monitoring and management structure (pages 102 and 160).
  - Our emerging risks (pages 104 and 105).

The Committee paid particular attention to these changes to ensure they did not impact on the balance and clarity of the Report & Accounts. Following its review, the Committee confirmed to the Board that the 2021 Report & Accounts is fair, balanced and provides sufficient clarity for shareholders to understand our business model, strategy, position and performance.

Financial Reporting Council: Presentation of cash flow statement

Following correspondence in late 2021 and early 2022 with the Corporate Reporting Review Team of the Financial Reporting Council (FRC), we have agreed to classify the cash flows relating to the additions to, and disposal of, trading properties within the Group Cash Flow Statement within 'net operating activities' rather than 'investing activities'.

We have re-presented the statement for the year ended 31 December 2020 to reclassify £31.7m of cash receipts and £1.2m of expenditure on trading properties from 'investing activities' to 'operating activities'. This has the effect of increasing the net cash from operations in 2020 from £85.4m to £115.9m with a corresponding increase in the net cash used in investing activities from £62.0m to £92.5m. This presentation has also been adopted for the year ended 31 December 2021 and will be applied consistently in future. There is no net impact upon the cash flow statement overall and there is no impact on any balance sheet or income statement figures.

The review conducted by the FRC was based solely on the Group's published 2020 Report & Accounts and does not provide any assurance that the Report & Accounts are correct in all material respects.

Going Concern and Viability

In order to improve and expand our disclosures, we have combined our Going Concern and Viability Statements. Our disclosures now include the following assessments:

Short-term assessment: considers the prospects of the Company over the next 12 months and whether the business is a 'going concern', which includes a detailed review of the following:

- the Group's latest rolling forecast (including sensitivity analysis) for the next two years, in particular the cash flows, borrowings and undrawn facilities;
- the headroom under the Group's financial covenants; and
- the risks included on the Group's risk register that could impact on the Group's liquidity and solvency over the next 12 months.

Medium-term assessment: considers whether the Company would remain able to continue in operation and meet its liabilities as they fall due over a five-year period. This assessment involves detailed scenarios, stress testing, sensitivity analysis and review of assumptions and estimates.

Long-term assessment: considers the factors which could impact on the Company and its business model in the next five to 10 years, including the Group's principal and emerging risks, alongside factors such as technological, social and environmental changes.

The Committee reviewed the process and assumptions behind the short-, medium- and long-term assessments conducted by management before recommending these disclosures to the Board for final approval.

Going Concern & Viability page 98 →

Significant financial judgements, key assumptions and estimates

Any key accounting issues or judgements made by management are monitored and discussed with the Committee throughout the year. The table below provides information on the key issues discussed with the Committee in 2021 and the judgements adopted.

Issue	Assumptions or estimates	Judgement
Valuation of the Group's property portfolio		
Due to its size, nature and the direct impact upon the Group's net asset value, the Committee considers this to be the primary area of judgement in determining the accuracy of the financial statements.	The valuation considers a range of assumptions including future rental income, investment yields, anticipated outgoings and maintenance costs, future expenditure and appropriate returns. The external valuers also make reference to market evidence of transaction prices for similar properties (see note 16 on pages 226 to 229).	The valuation is performed twice yearly by a combination of CBRE Limited and Savills (UK) Limited (the 'external valuers') and, due to its significance, is also reviewed by the external Auditor. The Committee reviewed the underlying assumptions used in the valuation and the external valuers' objectivity and methodology. In addition, during the year under review, a benchmarking exercise was conducted to provide further assurance to the Committee (see page 152). These procedures enabled the Committee to be satisfied with the assumptions and estimates used in the valuation of the Group's property portfolio.
Impairment review		
Covid-19, the resulting lockdowns and other restrictions have impacted the businesses of many of our occupiers, particularly those in the retail and hospitality sectors. The impact was more significant in 2020, but certain sectors have continued to face lower than normal volumes and margins in 2021. Though it has recovered significantly in recent quarters, rent collection continued to be impacted in 2021 and we have provided some financial support, where needed. Trade receivable balances have been reduced significantly since 31 December 2020.	Impairment testing of trade receivables and accrued income recognised in advance of receipt has been carried out in accordance with IFRS 9, using the expected credit loss model. This has required judgements to be made in relation to recoverability and estimated probability of default across our whole portfolio. In some cases, the probability of default has been estimated as significantly lower compared with 31 December 2020 and rent arrears were also considerably lower at 31 December 2021 than a year earlier.	The probability of default was considered using a risk-based approach. In particular, our top 50 tenants, those in administration or CVA or in high risk sectors, such as retail and hospitality, were looked at in detail with the remaining balances classified by sector. The review was carried out by the Finance team in conjunction with the Credit Committee and a detailed paper was reviewed by the Audit Committee on 16 February 2022 and was subject to significant discussion.
Climate change		
The subject of climate change, the responsibility of office owners and the needs of our occupiers in this area, have all grown significantly in importance through 2021. We have a programme to upgrade the energy efficiency of our older buildings and have considered how the costs of such retro-fitting should be reflected in our financial statements, including our property valuations.	During 2021, a feasibility and cost report was commissioned to estimate the costs of upgrading our older buildings to achieve an EPC rating of B or above by 2030. This information has been shared with our valuers and is being factored into our capital expenditure programmes for 2022 onwards.	Where any immediate action or expenditure is needed, the relevant amounts would be provided for but, these costs are expected to arise over several years as future refurbishment plans are prepared, which should add value to the buildings and are not current capital commitments.
Taxation and REIT compliance		
Should the Group not comply with UK REIT regulations, it could incur tax penalties or ultimately be expelled from the REIT regime, which would have a significant effect on the financial statements.	As a REIT, the Group benefits from tax advantages. Income and chargeable gains on the qualifying property rental business are exempt from corporation tax. Income that does not qualify as property income within the REIT rules is subject to corporation tax in the normal way. There are a number of tests that are applied annually, and in relation to forecasts, to ensure the Group remains well within the limits allowed within those tests.	The Group employs a qualified and experienced Head of Tax whom the Committee meets at least annually. The Committee noted the frequency with which compliance with the tests and regulations was reported to the Board and considered the substantial margin by which the Group complied. Based on this and the level of headroom shown in the latest Group forecasts, the Committee agreed that, once again, no further action was required.
Borrowings and derivatives		
The calculation of fair values for the Group's financial instruments, such as the USPP notes, 2025 convertible bonds and interest rate swaps, is a technical and complex area and the amounts involved are significant.	The fair values of the Group's borrowings and interest rate swaps are provided by an independent third party based on information provided to them by the Group. This includes the terms of each of the financial instruments and data available in the financial markets (see note 24 on pages 235 to 244).	The Committee noted that the valuations were carried out by an independent third party which had valued the instruments in previous years and that the external Auditor used its own treasury specialists to re-perform the valuation and to assess the reasonableness thereof. The external Auditor subsequently confirmed that no issues had arisen relating to the valuations. The Committee was satisfied with the level of assurance gained from these procedures.

AUDIT COMMITTEE REPORT CONTINUED

Portfolio valuation

Our property portfolio is valued by the external valuers for our interim and year end results. As at 31 December 2021, it was valued at £5.697bn (2020: £5.356bn) and principally consists of 77 properties.

The valuation of the portfolio is a major component of net asset value. Movements in that valuation are a significant part of how we measure our progress and a key determinant of the Group's total return (a KPI and a performance measure for our Executive Directors' variable remuneration – see pages 45 and 183). Due to its significance, the Committee monitors the objectivity and independence of the external valuers' work and hosts the valuation meetings. The valuation meetings typically occur in February and July, prior to Audit Committee meetings.

Due to his position as Managing Director of Capital Advisors Limited (a wholly-owned subsidiary of CBRE Limited), Richard Dakin does not take part in discussions regarding the valuation of the Group's property portfolio (see page 139).

Key matters discussed during the meetings include:

- London office demand, investment volumes and vacancy rates;
- the assumptions underlying the valuation and the quality of data;
- valuation methodology and whether it was adversely impacted by Covid-19;
- any valuation which required a greater level of judgement than normal, for example development properties;
- how climate change was factored into the valuation; and
- any valuation movements that were not broadly in line with that of the MSCI benchmark.

The assumptions underlying the valuation are discussed with the external Auditor and an update on the matters discussed at the meetings is provided to the Board.

A well placed portfolio pages 18 to 19 →

Valuation benchmarking

The Committee commissioned a benchmarking exercise in relation to the property valuation, which was performed during Q2 2021. The purpose of the exercise was to assure the Committee that the valuation of our portfolio was fair and aligned with the RICS Valuation Global Standards and the Red Book.

The benchmarking exercise entailed:

- Three valuers, including CBRE, valued a sample of our portfolio (comprised of five assets) which represent a cross-section of properties from on-site development to long-dated income.
- The sample totalled approximately £700m of assets (c.13% of our portfolio value).
- The valuation date was 31 March 2021.
- Each valuer used a similar methodology and the resulting valuations were broadly aligned.

The Committee was satisfied with the benchmarking results which provided further assurance that the methodology used by CBRE was robust.

Effectiveness of the Group's valuers

A review into the effectiveness of the external valuers is performed after the year end and interim valuations, with assistance from Nigel George, Executive Director.

The effectiveness review for 2021 was conducted in February and August and considered the following:

- experience, qualification and objectivity of the valuation team;
- quality of presentation and data; and
- robustness of the valuation.

At both meetings it was concluded that the external valuers performed to a high standard and, whilst it was not ideal having the process performed remotely, it was conducted well and the timetable for delivery was achieved.

Overview of our Valuer Appointment Policy

When reviewing its Valuer Appointment Policy, the Committee took into consideration the outcome of the RICS 'Independent Review of Real Estate Investment Valuations' performed by Peter Pereira Gray (the RICS review) and published in January 2022.

The Committee's revised Valuer Appointment Policy states that the Group's external valuer should be rotated at least every five years, subject to annual assessment of their effectiveness and objectivity. The RICS review recommends that the maximum term of appointment for a valuation firm is nine years.

There are no contractual obligations which could restrict the Group's choice of valuer or a minimum appointment period.

As our current valuer (CBRE) has exceeded the maximum tenure under the revised policy, Knight Frank have been appointed to value at least 50% of the London-based portfolio for the June 2022 valuation. CBRE will value the balance of the London-based portfolio with Knight Frank 'shadowing'. Subject to Knight Frank's overall performance, Knight Frank will be appointed on 100% of the London-based portfolio for the December 2022 valuation.

Savills will be engaged to value our Scottish land which accounts for c.1% of the Group's portfolio. The Committee will consider its policy in respect to the valuation of the Scottish land in 2023.

Restoring trust in audit and corporate governance

The Committee welcomes all developments which aim to improve transparency in governance and trust in our disclosures. The Company responded to the BEIS consultation on 1 July 2021, in respect to the recommendations of most significance to Derwent London.

The results of the consultation, and the final agreed reforms, are anticipated to be published during 2022. The Committee will monitor the outcome of the consultation and the implementation of any required changes to the Group's practices or reporting.

The table below provides an overview of some of the proposed reforms included in the consultation, and how we anticipate responding, if these become applicable to Derwent London:

Proposed reforms

Directors' accountability for internal controls, dividends and capital maintenance	
Internal controls and detecting fraud	An independent review will be commissioned during 2022 to provide clear focus areas on how we can further strengthen our internal control framework, including in respect to fraud detection/prevention.
Legality and affordability of dividends	In our 2022 Report & Accounts, we intend to widen our disclosures in respect to distributable reserves.
New corporate reporting	
Resilience statement	On pages 98 and 99, we have started to transition to a 'Resilience statement' by expanding our disclosures on the short-, medium- and long-term threats to the Company's resilience. If required, we will prepare a 'Resilience statement' for the 2022 Report & Accounts.
Audit & Assurance Policy	During 2022, we will continue to progress the development of an Audit & Assurance Policy.
Company directors	
Executive pay and strengthening clawback and malus provisions	As part of the Remuneration Policy review being conducted during 2022, the Remuneration Committee will consider the inclusion of additional conditions to its malus and clawback provisions. The conditions which currently apply to our malus and clawback provisions are disclosed in note 1 on page 178.

The BEIS consultation proposed various reforms in respect of the purpose and scope of audits, auditor reporting and audit market supervision and competition. If applicable, we intend to implement any reforms as part of our next competitive external audit tender. The Committee's current intention is to conduct this tender for the 2024 year end audit (see page 156).

If the final recommended reforms require the Audit Committee to undertake additional responsibilities, these will be added to the Committee's terms of reference.

Assurance

Derwent London's approach to assurance is influenced by our low tolerance to risk taking (see page 101) and our conservative management style. If sufficient assurance cannot be gained, we seek independent assurance from our outsourced internal auditors, external auditors, independent advisers and specialist consultants.

The main area of reporting risk relates to the valuation of our portfolio. The valuation of our portfolio is a major component of net asset value and is a key determinant for our investors when assessing our performance. In addition, movements in the valuation are a significant part of how we measure our progress and a key determinant of the Group's total return. Due to its significance, the biannual valuation is subject to a detailed internal review by our investment and valuation team, which consists of experienced and qualified professionals, and is overseen by the Valuers Committee and Audit Committee. The external valuers are subject to annual evaluations which focuses on their objectivity (see page 152).

Key aspects of the ESG data that we disclose in our annual Report & Accounts is subject to 'reasonable assurance' verification by Deloitte LLP, including in respect of:

— Environmental, energy and carbon reporting (all Scope 1, 2 and 3 GHG emissions data, intensity ratio and energy data);
— Health and safety statistics (all minor accidents, RIDDORs, fatalities and improvement notices data); and
— Our Green Finance Framework, which received independent assurance from Deloitte that it is aligned with the Loan Market Association's Extended Green Loan Principles.

The assurance statements are published in our annual Responsibility Reports which are available on our website.

During 2021, we started to review the assurance we receive in respect to corporate reporting, the handling of risks and internal controls. To date, the exercise has highlighted the following key actions:

— As detailed above, our key ESG data is subject to annual assurance by Deloitte, however, historically the Committee was not presented with the outcome of these reviews. In November 2021, the Committee received training on the assurance provided by Deloitte and, in February 2022, the Committee reviewed the outcome of the latest assurance reviews. Going forward, Deloitte will provide regular updates to the Committee on their assurance work.
— We identified that our EPRA disclosures published in the annual Report & Accounts are not currently subject to external verification. A peer analysis confirmed that this was normal practice within our industry. We will consider how we could gain independent assurance on these disclosures during 2022.
— The Group has been voluntarily disclosing under the Task Force on Climate-Related Financial Disclosures (TCFD) for the past three years. As these disclosures are now mandatory for the 2021 Report & Accounts and all future reports, the Committee agreed that Deloitte would perform a review of our disclosures and share their comments with the Committee. The Committee will consider whether further assurance is required over our TCFD disclosures during 2022.

AUDIT COMMITTEE REPORT CONTINUED

Internal financial controls

On an ongoing basis, the Audit Committee reviews the adequacy and effectiveness of the Group's system of internal financial controls which are described briefly in the table below.

While Derwent London is a large business in terms of the size of its balance sheet and market capitalisation, we are relatively small when considering the number of people working directly in the business. Our Group structure is organised to be simple and transparent (i.e. relatively few subsidiaries) and our internal control procedures and policies are well established, reviewed annually and subject to external verification by our internal auditors, RSM (see page 155).

The Committee receives detailed reports on the operation and effectiveness of the internal financial controls from members of the senior management team and the internal auditors. In addition, the outcome of the external audit at year end and the half-year review are considered in respect to internal controls.

As training and staff awareness forms part of the Group's internal control framework, the Audit and Risk Committee receives updates on the policies and procedures in place and how these are being communicated to, and complied with, by our staff.

We utilise IT systems and automated workflows to manage our financial processes, including the processing and authorisation of payments and data input (see the table below). All BACS payment files are encrypted on generation and access is monitored by our security systems.

In 2021, the Digital Innovation & Technology (DIT) team implemented an ITIL-aligned service desk platform and new processes/controls were designed for our financial systems in respect to user management. These workflows promote automation, ensure the correct approvals have been gained, and provide full auditability of any work carried out. The DIT team regularly ensures that all business-critical IT systems, such as financial packages, are securely accessible remotely.

The Committee have agreed that a review will be commissioned during 2022, to provide clear focus areas on how we can further strengthen our internal control framework, including in respect to fraud detection/prevention. In addition, during 2022, we will roll out software to automate the creation and approval of expenses.

The Committee remains satisfied that the review of internal financial controls did not reveal any significant weaknesses or failures and they continue to operate effectively.

Further information on risk management and non-financial internal controls is available in the Risk Committee report.

Risk management page 159 →

Overview of internal financial controls

Governance framework	Our governance framework (see page 133) supports effective internal control through an approved schedule of matters reserved for decision by the Board and the Executive Directors, supported by defined responsibilities, levels of authority and supporting committees.
Financial reviews and internal procedures	Comprehensive systems of financial reporting and forecasting which are conducted frequently and include both sensitivity and variance analysis. An annual budgeting exercise is carried out with three rolling forecasts prepared. A five-year strategic review is prepared annually. Breakeven and sensitivity analyses are included in both the five-year strategic review and the rolling forecasts.
Treasury and tax procedures	Treasury is controlled by the Chief Financial Officer and Treasurer. All transactions are checked and monitored. All complex or large transactions are discussed in advance with the Board and Executive Directors and are externally reviewed by our advisers. Taxation is a complex area and is subject to frequent external review. Corporate tax returns are prepared by the Tax Assistant and reviewed by the Group Head of Tax and, on a sample basis, by RSM. Other higher risk areas like PAYE and CIS (the Construction Industry Scheme which requires us to deduct tax at source from the labour element of a subcontractor's invoice unless they are properly authorised by HMRC) is subject to thorough examination and testing. We maintain an open relationship with HMRC and have a 'low risk' tax status. Further information on tax risk and tax governance is on pages 65 and 106.
Risk identification and monitoring	The Risk Committee regularly reviews the Group's risk registers, the schedule of key controls and key risk indicators. The schedule of key controls provides evidence of how the controls are being operated and their effectiveness. Our risk management procedures are robust and include initiatives such as a 'tenants on watch' register and a back-up IT facility. The Risk Committee's report is on pages 158 to 165.
IT controls	All financial transactions are recorded and, where required, approved utilising finance systems or automated workflows. Role based access is in place for all financial solutions, managed by the DIT service desk. Data transfers between programs are either automated or imported with minimal manual intervention to maintain the integrity of the data.
Training and staff awareness	Staff are aware of the delegated authority limits set by the Board and confirm their understanding of our internal policies which are contained on our Group intranet and in our employee handbook. Staff have six-monthly performance reviews with any training requirements identified and agreed within six months. The Group operates a whistleblowing policy which includes access to an independent helpline for anonymous reporting of concerns (see page 136).
External verification	During the year, no significant deficiencies had been raised by PwC as a result of their control testing undertaken as part of the annual audit. The outsourced internal auditors, RSM, perform various assurance reviews as part of the annual Internal Audit Plan. The implementation of recommendations arising from the RSM reviews are monitored by the Audit Committee. The Group's VAT procedures are subject to ongoing periodic review by external advisers. Comprehensive reviews of the Group's financial controls have also been undertaken with assistance from external advisers. Regular annual credit ratings, including risk assessments, are conducted. Each year, at renewal, a comprehensive review of the Group's insurance cover is prepared by its independent insurance adviser.

Fraud risk assessment

On an annual basis, the Committee reviews the Group's fraud risk assessment prepared by management which details the policies and processes which safeguard the Company's assets, prevent and detect fraud and errors.

The largest costs incurred by the Company relate to capital expenditure or property transactions which are subject to approval in accordance with the Board's delegated authority limits, before costs are incurred (by the Cost Committee for costs up to £5m, the CEO and the Executive Directors for costs up to £20m and by the Board for any capital expenditure over £20m). Approval is documented in minutes which are required to be seen before the budgets are assigned. The approved budgets are then subject to internal monitoring to ensure they remain within the approved limits.

The Board's delegated authority limits page 132 →

The risks identified by the fraud risk assessment, in respect to financial fraud and error, are mitigated through the following key controls:

- A two-stage approval process is required for invoices and transactions, either through the use of software or forms. There is a further two-stage approval process for the release of final payments.
- Sufficient support/evidence is required by the Finance team which is subject to validation before payments are made.
- Payroll is prepared by an experienced team and reviewed by the Head of HR and the Treasurer. Payment variance reports are prepared to explain movements.
- Training is provided to staff to ensure they are aware of the latest methods used by those attempting to defraud the Company.
- Use of third parties to produce or review information, including in respect to project monitoring agencies, internal and external Auditors etc.
- Preparation of a detailed budget and three rolling forecasts against which actuals are compared.
- The process of producing the quarterly management accounts involves detailed variance analysis to prior periods and forecasts, as well as a number of reconciliations of both balance sheet and income statement items.

Further information on cyber security page 162 →

Internal audit

RSM were appointed as the Group's outsourced internal audit function in December 2018 following a competitive tender process and are considered by the Committee to be independent. In addition to performing an internal audit function, another team from RSM also review our year end tax returns.

The Internal Audit Plan for 2021 was approved jointly by the Risk and Audit Committees and included a combination of risk-based audits and projects (see the table below). The outcome of the audits were presented to the Risk and Audit Committees and reported to the Board. The Committees were pleased with the level of assurance received from the audits.

The Committee receives a report on internal audit activity at each meeting and monitors the status of internal audit recommendations and management's responsiveness to their implementation. The other Board committees are kept updated on the outcome of any reviews which fall within their areas of responsibility.

Audits performed during 2021	Audits to be performed under the Internal Audit Plan 2022
— Procurement and contract management	— Health and safety
— Lease management	— Cyber security
— Management of HR data	— Strategic planning
— Tax governance and reporting	— Joint venture governance
— Core financial controls	— Financial controls
— IT general controls	

A formal review of the effectiveness of the internal auditor and the internal audit process was conducted in February 2022 and considered the following:

- the qualification and expertise of RSM's internal audit team;
- the relationship established and the extent to which RSM have built an understanding of our business and systems;
- depth and breadth of internal audits;
- quality of reporting, including in respect to the regular Internal Audit Progress Reports provided to the Audit and Risk Committees; and
- quality of planning and ability to meet deadlines.

The Committee concluded that the internal audit process had been conducted effectively.

Members of the Company Secretarial team

AUDIT COMMITTEE REPORT CONTINUED

External Auditor

The Committee has primary responsibility for managing the relationship with the external Auditor, including assessing their performance, effectiveness and independence annually and recommending to the Board their reappointment or removal.

Following a comprehensive tender in 2014, PricewaterhouseCoopers LLP (PwC) were appointed as the Group's Auditor. The Committee's current intention is to conduct its next competitive tender for the 2024 year end audit, in accordance with current regulation that requires a tender every 10 years. The Company has chosen this timetable due to the recent change in audit partner in 2020, who will serve for four years prior to the tender in order to provide continuity over the next two year end audits. This timetable is subject to annual assessment of the Auditor's effectiveness and independence.

There are no contractual obligations which restrict the Committee's choice of Auditor or a minimum appointment period.

The Company has complied with the provisions of the Competition and Markets Authority's Order for the financial year under review in respect to audit tendering and the provision of non-audit services.

Annual review of the external Auditor

Following the year end audit, the Committee assessed the effectiveness of the external Auditor. This effectiveness review is performed on an annual basis and aims to ensure a robust audit is performed, auditor performance is optimised and encourages candid feedback and communication between the Auditor and the Committee. The assessment considered:

- the qualification and expertise of the Lead Audit Partner and the wider audit team;
- the availability of resources to perform a comprehensive and timely audit;
- adherence to the Non-Audit Services Policy;
- length of tenure and ability to perform an independent audit;
- quality of the audit plan, overall audit and outcome report;
- quality of planning and ability to meet deadlines; and
- quality of audit in respect of key judgements and estimates.

Independence

An important aspect of managing the external Auditor relationship is ensuring there are adequate safeguards to protect Auditor objectivity and independence. In assessing this matter, the Committee considered the following:

- the Auditor's independence letter which annually confirms their independence and compliance with the Financial Reporting Council's (FRC) Ethical Standard;
- how the Auditor demonstrated professional scepticism and challenged management's assumptions where necessary;
- the tenure of the external Auditor and the lead audit partner;
- the outcome of the FRC's inspection of PwC's audit quality;
- the operation, and compliance with, the Group's policy on non-audit work being performed by the Auditor; and
- how the Auditor identified risks to audit quality and how these were addressed, including the network level controls the Auditor relied upon.

In assessing how the Auditor demonstrated professional scepticism and challenged management's assumptions, the Committee considered the depth of discussions held with the Auditor, particularly in respect to challenging the Group's approach to its significant judgements and estimates (see pages 151 and 202 to 204). Sandra Dowling has been lead audit partner since the 2020 half-year review. The Committee has been pleased with the challenge raised by Sandra and her team during the year.

Audit quality

Audit quality can be challenging to define and measure. In response to the FRC thematic review on Audit Quality Indicators (AQIs) released in May 2020, the Committee agreed the six AQIs which would be used to assess PwC in the financial year ended 31 December 2021.

The Committee found that the use of AQIs was an effective addition to its review processes and they will continue to be used for the year ending 31 December 2022.

Outcome

After taking all of these matters into account, the Committee concluded that PwC had performed their audit effectively, efficiently, and to a high quality. Accordingly, the Committee has recommended to the Board that PwC be reappointed as Auditor to the Group for the year ending 31 December 2022, subject to reappointment at the 2022 AGM.

Any feedback arising from the annual assessment will be discussed with the external Auditor for implementation into the audit plan for the next year end audit.

The 'Independent Auditor's report to the members of Derwent London plc' is available on pages 201 to 208, and its audit opinion is consistent with the report received by the Audit Committee.

Independent auditor's report page 201 →

Non-audit services in 2021

During 2021, in addition to the interim results review, PwC were asked to assist with the preparation and issue of comfort letters as part of the new green bond issuance (see page 13). The total fee for this project was £90,000.

This service was approved in accordance with the Group's Non-Audit Service Policy and received Committee approval prior to commencement.

The Committee noted that this type of service is permissible under the UK FRC Ethical Standard 2019. The Committee was in agreement with the rationale that PwC were best placed to perform this service due to their knowledge and understanding of the Group.

The non-audit services provided by PwC during the year under review totalled £150,000 (see table on page 157). The Committee confirmed that it does not believe that the level or nature of the non-audit services provided during 2021 have impacted on PwC's actual or perceived independence as Auditors.

Overview of our Non-Audit Services Policy

The objective of maintaining the Non-Audit Services Policy is to ensure the independence of the external Auditor is not compromised and that the provision of such services do not impair the external Auditor's objectivity.

Under the policy, all services provided by the external Auditor (other than the audit itself) are regarded as non-audit services. Our policy draws a distinction between permissible services (which could be provided subject to conditions set by the Committee) and prohibited services (which may not be provided by the external Auditor except in exceptional circumstances when the Auditor has been provided with approval by the Financial Conduct Authority). The type of non-audit services deemed to be permissible includes review of the half-year results and assurance work on non-financial data.

In accordance with audit legislation, the total fees for non-audit services provided by the external Auditor to the Group shall be limited to no more than 70% of the average of the statutory audit fee for the Company paid to the Auditor in the last three consecutive financial years.

The Committee has provided pre-approval limits which allow management to appoint the external Auditor to conduct permissible non-audit services if they fall below an amount it deems as trivial.

The approval limits for non-audit services are provided below and are subject to annual review:

Value	Approval required prior to engagement
Up to £25,000	Chief Financial Officer
£25,000 to £100,000	At least two members of the Audit Committee (including the Committee Chair)
£100,001 and above	Board of Directors

When reviewing requests for permitted non-audit services, the Audit Committee will assess:

- whether the provision of such services impairs the Auditor's independence or objectivity and any safeguards in place to eliminate or reduce such threats;
- the nature of the non-audit services;
- whether the skills and experience make the Auditor the most suitable supplier of the non-audit service;
- the fee to be incurred for non-audit services, both for individual non-audit services and in aggregate, relative to the Group audit fee; and
- the criteria which govern the compensation of the individuals performing the audit.

In accordance with the FRC Ethical Standard, the Audit Committee would also assess whether it is probable that an objective, reasonable and informed third party would conclude independence is not compromised.

Non-audit services in the past three consecutive financial years

Our Non-Audit Services Policy requires that the total fees for non-audit services are limited to no more than 70% of the average statutory audit fee in the last three consecutive financial years. Given the low value of non-audit services historically provided, the level of non-audit services remains well below the 70% fee cap.

	2021		2020		2019	
	£'000	%	£'000	%	£'000	%
Audit of Derwent London plc and subsidiaries[(i)(ii)]	471	76	494	92	404	91
Review of interim results	60	10	44	8	42	9
Other non-audit services	90	14	–	–	–	–
Total fees	621	100	538	100	446	100

Notes:

(i) The audit fee in relation to the year ended 31 December 2020 includes a cost overrun of £79,000. This was largely due to the inefficiencies of remote working and the extended timetable that resulted from the lockdown in place throughout the audit period.

(ii) The audit fee in relation to the year ended 31 December 2019 includes a cost overrun of £17,275.