

AUDIT AND RISK COMMITTEE REPORT

ROBERT SINCLAIR

The Audit and Risk Committee is chaired by Robert Sinclair. The other members of the Committee are Nicholas Thompson, Roger Lewis and Vic Holmes. Meetings of the Audit and Risk Committee are attended by the Finance Director of Picton Capital Limited and other members of the finance team, and the external auditor. The external auditor is given the opportunity to discuss matters without management presence.



TERMS OF REFERENCE

The Committee's terms of reference include consideration of the following issues:

- Financial reporting, including significant accounting judgements and accounting policies;
- Adoption of the Group's Risk Management Policy;
- Monitoring and evaluating the risks relating to the Group;
- Evaluation of the Group's risk profile and risk appetite, and whether these are aligned with its investment objectives;
- Internal controls and risk management systems;
- Ensuring that key risks are being effectively measured, managed and mitigated;
- The Group's relationship with the external auditor, including effectiveness and independence;
- Internal audit and the programme of controls testing; and
- Reporting responsibilities.

ACTIVITY

The Audit and Risk Committee met three times during the year ended 31 March 2017 and considered the following matters:

- External audit strategy and plan;
- Audit and accounting issues of significance;
- The Annual and Interim Reports of the Group;
- Reports from the external auditor;
- The Group's Risk Management Policy
- The effectiveness of the audit process and the independence of KPMG Channel Islands Limited;
- Review of the Risk Matrix and mitigating controls; and
- Stock Exchange announcements.

AUDIT AND RISK COMMITTEE REPORT

CONTINUED

FINANCIAL REPORTING AND SIGNIFICANT REPORTING MATTERS

The Committee considers all financial information published in the annual and half-year financial statements and considers accounting policies adopted by the Group, presentation and disclosure of the financial information and the key judgements made by management in preparing the financial statements.

The Directors are responsible for preparing the Annual Report. At the request of the Board, the Committee considered whether the 2017 Annual Report was fair, balanced and understandable and whether it provided the necessary information for shareholders to assess the Group's performance, business model and strategy.

The key area of judgement that the Committee considered in reviewing the financial statements was the valuation of the Group's investment properties.

The valuation is conducted on a quarterly basis by independent valuers, and is subject to oversight by the Property Valuation Committee. It is a key component of the annual and half year financial statements and is inherently subjective, requiring significant judgement. Members of the Property Valuation Committee, together with the Investment Manager, meet with the independent valuer on a quarterly basis to review the valuations and underlying assumptions, including the year end valuation process. The Chairman of the Property Valuation Committee reported to the Audit and Risk Committee at its meeting in May 2017 and confirmed that the following matters had been considered in discussions with the independent valuers:

- Property market conditions;
- Yields on properties within the portfolio;
- Letting activity and vacant properties;
- Covenant strength and lease lengths;
- Estimated rental values; and
- Comparable market evidence.

The Audit and Risk Committee reviewed the report from the Chairman of the Property Valuation Committee including the assumptions applied to the valuation and considered their appropriateness, as well as considering current market trends and conditions, and valuation movements compared to previous quarters. The Committee considered the valuation and agreed that this was appropriate for the financial statements. The Committee was satisfied that the 2017 Annual Report is fair, balanced and understandable and included the necessary information as set out above, and it has confirmed this to the Board.

RISK MANAGEMENT POLICY

The Committee has considered and adopted a Risk Management Policy for the Group.

The purpose of the Risk Management Policy is to strengthen the proper management of risks through proactive risk identification, risk management, and risk acceptance pertaining to all activities undertaken by the Group. The Risk Management Policy is intended to:

- Ensure that major risks are reported to the Board for review and acceptance;
- Result in the management of those risks that may significantly affect the pursuit of the stated strategic goals and objectives;
- Embed a culture of evaluation and identifying risks at multiple levels within the Group; and
- Meet legal and regulatory requirements.

INTERNAL CONTROLS

The Board is responsible for the Company's internal control system and for reviewing its effectiveness. It has therefore established a process designed to meet the particular needs of the Company in managing the risks to which it is exposed.

As part of this process, a risk matrix has been prepared that identifies the Company's key functions and the individual activities undertaken within those functions. From this, the Board has identified the Company's principal risks and the controls employed to manage those risks. These are reviewed at each Audit and Risk Committee meeting. Also the Committee has agreed a programme of additional controls testing which is carried out by the external auditor, in order to provide the Board with comfort that the controls are operating as intended and have been in place throughout the year. The Board also monitors the investment performance of the Company against its objectives and receives reports from the Investment Manager and Administrator each quarter on their activities. The Committee has received and reviewed a copy of CBRE Limited's Real Estate Accounting Services – Service Organisation Control Report as at 31 December 2016, prepared in accordance with International Standard on Assurance Engagements 3402, in respect of property management accounting services provided to Picton Capital Limited.

Given the scale of the Group's operations, the Board has determined that a separate internal audit function is unnecessary and that additional procedures carried out by the external auditor in conjunction with the audit of the Group's accounts will provide the Board with sufficient assurance regarding the internal control systems in place.

INDEPENDENCE OF AUDITOR

It is the policy of the Group that non-audit work will not be awarded to the external auditor if there is a risk their independence may be conflicted. The Committee monitors the level of fees incurred for non-audit services to ensure that this is not material, and obtains confirmation, where appropriate, that separate personnel are involved in any non-audit services provided to the Group. The Committee must approve in advance all non-audit assignments to be carried out by the external auditor.

The fees payable to the Group's auditor and its member firms are as follows:

	31 March 2017 £000	31 March 2016 £000
Audit fees	108	104
Interim review fees	14	19
Non-audit fees	23	19
	145	142

The non-audit fees include £14,000 for additional controls testing and £4,000 for tax services, carried out by KPMG Channel Islands Limited, and £5,000 in respect of the Picton Capital Limited FCA CASS review, carried out by KPMG LLP.

ANNUAL AUDITOR ASSESSMENT

On an annual basis, the Committee assesses the qualifications, expertise and independence of the Group's external auditor, as well as the effectiveness of the audit process. It does this through discussion and enquiry with senior management, review of a detailed assessment questionnaire and confirmation from the external auditor. The Committee also considers the external audit plan, setting out the auditor's assessment of the key audit risk areas and reporting received from the external auditor in respect of both the half year and year end reports and accounts.

As part of the review of auditor independence and effectiveness, KPMG Channel Islands Limited has confirmed that:

- They have internal procedures in place to identify any aspects of non-audit work which could compromise their role as auditor and to ensure the objectivity of the audit report;
- The total fees paid by the Group during the year do not represent a material part of their total fee income; and
- They consider that they have maintained their independence throughout the year.

In evaluating KPMG Channel Islands Limited the Committee completed its assessment of the external auditor for the financial period under review. It has satisfied itself as to their qualifications and expertise and remains confident that their objectivity and independence are not in any way impaired by reason of the non-audit services which they provide to the Group.

KPMG Channel Islands Limited have been auditor to the Group since the year ended 31 December 2009 following a tender process in July 2009. The current audit engagement partner, Neale Jehan, has now served five years and will be rotated following the 2017 audit. The Committee recommends that KPMG Channel Islands Limited are recommended for reappointment at the next Annual General Meeting.

Robert Sinclair

Chairman of the Audit and Risk Committee

6 June 2017