

# INDEPENDENT AUDITOR'S REPORT

## Report on the financial statements

### Our opinion

In our opinion:

- Derwent London plc's Group financial statements and Company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2015 and of the Group's profit and the Group's and the Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

### What we have audited

The financial statements, included within the Report and Accounts (the 'Annual Report'), comprise:

- the balance sheets as at 31 December 2015;
- the Group income statement and Group statements of comprehensive income for the year then ended;
- the cash flow statements for the year then ended;
- the statements of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Certain required disclosures have been presented elsewhere in the Annual Report rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

## Our audit approach Overview



### Materiality

- Overall Group materiality: £46.4 million (2014: £42.0 million) which represents 1% of total assets.
- Specific materiality: £4.0 million (2014: £4.0 million) applied to property and other income, administrative expenses, provisions and working capital balances.

### Audit scope

- The Group audit team carries out the statutory audits of all components within the Group and the consolidation.

### Areas of focus

- Valuation of investment properties due to significance and subjectivity.
- Compliance with the REIT guidelines on which the Group's tax status is based due to the consequences of any breach.
- Accounting for borrowings and the associated interest rate swaps, including the conversion of the 2.75% 2016 convertible bonds in January 2015.

### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)').

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

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**Area of focus****Valuation of investment properties**

Refer to page 116 (Report of the Audit Committee), pages 141 to 143 (Notes to the financial statements – Note 16) and page 170 (Significant accounting policies).

The Group's investment properties were carried at £4,832.3 million as at 31 December 2015 and a revaluation gain of £650.0 million was accounted for under 'revaluation surplus' in the Group income statement. In excess of 99% of the value of the Group's investment property portfolio comprises offices and commercial space within central London. The remainder of the portfolio represents a retail park, cottages and strategic land in Scotland.

Valuations are carried out by third party valuers in accordance with the RICS Valuation – Professional Standards and IAS 40.

There are significant judgements and estimates to be made in relation to the valuation of the Group's investment properties. Where available, the valuations take into account evidence of market transactions for properties and locations comparable to those of the Group.

The Central London investment property portfolio mainly features office accommodation and includes:

- Standing investments: These are existing properties that are currently let. They are valued using the income capitalisation method.
- Development projects: These are properties currently under development or identified for future development. They have a different risk and investment profile to the standing investments because of the different assumptions applied. These are valued using the residual appraisal method (i.e. by estimating the fair value of the completed project using the income capitalisation method less estimated costs to completion and a market based profit margin providing a return on development risk).

The most significant judgments and estimates affecting the valuations using both the income capitalisation and residual value methods included yields and estimated rental value (ERV) growth (as described in note 16 of the financial statements). For development projects, other assumptions including costs to completion and risk premium assumptions are also factored into the valuation.

Consistent with last year, yields and ERVs have moved favourably reflecting the buoyancy of the central London property market which has driven the significant increase in valuation over the year. The revaluation gain was also boosted by new lettings and significant progress on a number of development projects where further costs have been incurred and the risk weighting applied to the valuation has decreased – hence increasing the capitalised value.

The existence of significant estimation uncertainty, coupled with the fact that only a small percentage difference in individual property valuations when aggregated could result in material misstatement, is why we have given specific audit focus and attention to this area.

**How our audit addressed the area of focus**

The valuers used by the Group are CBRE Limited for the central London portfolio and Savills for the remaining investment property portfolio in Scotland. They are well-known firms, with considerable experience of the Group's market. We assessed the competence and capabilities of the firms and verified their qualifications. We also assessed their independence by discussing the scope of their work and reviewing the terms of their engagements for unusual terms or fee arrangements. Based on this work, we are satisfied that the firms remain independent and competent and that the scope of their work was appropriate.

We tested the data in the investment property valuation for a sample of properties, including rental income, acquisitions and capital expenditure, by agreeing them to the underlying property records held by the Group. The underlying property records were themselves tested back to signed and approved lease contracts or sale/purchase contracts and approved third party invoices as applicable. For the properties currently under development, we traced the costs to date included within development appraisals to quantity surveyor reports and confirmed that they were comparable to costs incurred on similar completed projects. We also agreed a sample of costs included in the quantity surveyor reports to supporting documentation.

We met with the external valuers independently of management and obtained the valuation reports for all properties. We read the valuation reports and confirmed that the valuation approach for each was in accordance with RICS Valuation – Professional Standards and IAS 40 and suitable for use in determining the carrying value for the purpose of the financial statements. We involved our internal valuation specialists to compare the valuations of each property to our independently formed market expectations and to discuss and challenge the valuation methodology and assumptions. In doing this we used evidence of comparable market transactions and focused in particular on properties where the growth in capital values was higher or lower than our expectations based on market indices.

Consistent with last year, we identified the following assets for further testing: standing investments where the valuation fell outside the expected range; ongoing and planned development projects; high value assets over £100m; and acquisitions.

In relation to these assets, we found that yield rates and ERVs were predominantly consistent with comparable information for central London offices and assumptions appropriately reflected comparable market information. Where assumptions fell outside of our expected range, we assessed whether additional evidence presented in arriving at the final valuations was appropriate, and, whether this was robustly challenged by the external independent valuers where appropriate. Variances were predominantly due to property specific factors such as new lettings at higher rents, movements in ERV or yield to reflect market transactions in close proximity or the de-risking of development projects nearing completion. We verified the movements to supporting documentation including evidence of comparable market transactions where appropriate.

We challenged the Directors on the upward movements in the valuations and found that they were able to provide explanations and refer to appropriate supporting evidence.

# INDEPENDENT AUDITOR'S REPORT

## CONTINUED

Area of focus	How our audit addressed the area of focus
<p><b>Compliance with REIT guidelines</b> Refer to page 117 (Report of the Audit Committee) and page 131 (Significant judgements, key assumptions and estimates).</p> <p>The UK REIT regime grants companies tax exempt status provided they meet the rules within the regime. The rules are complex and the tax exempt status has a significant impact on the financial statements. The complexity of the rules creates a risk of inadvertently breaching and the Group's profit becoming subject to tax.</p>	<p>We confirmed our understanding of management's approach to ensuring compliance with the REIT regime rules.</p> <p>We obtained management's calculations and supporting documentation, checking their accuracy by verifying the inputs, which included the underlying financial information, and calculation. We involved our internal specialists to verify the accuracy of the application of the rules.</p> <p>We found that the assessment prepared was free from material error and consistent with the UK REIT guidelines.</p>
<p><b>Accounting for borrowings and derivatives</b> Refer to page 117 (Report of the Audit Committee), pages 148 to 155 (Notes to the financial statements – Note 23) and page 171 (Significant accounting policies).</p> <p>The Group has secured and unsecured debt totalling £895.0 million (2014: £1,019.8 million). The debt includes unsecured convertible debt of £140.2 million (2014: £308.0 million) with an option for the Group to convert the debt when certain criteria have been met. On 17 December 2014, the Group exercised its option to redeem its £175m 2.75% 2016 convertible bonds, and on 30 January 2015 all bond holders elected to convert their debt to shares. The accounting for convertible debt can be complex and therefore is considered an area of audit focus.</p> <p>The Group uses interest rate swaps on a portion of its debt. The interest rate swaps were valued at 31 December 2015 by external valuers and the fair value was £17.6 million (2014: £25.2 million). The valuation of the swaps is based on market movements which can fluctuate significantly in the year and could have a material impact on the Group financial statements. The valuation also involves judgement and therefore is considered an area of audit focus.</p>	<p>We read the loan contracts to understand the terms and conditions. The carrying value of all debt was agreed to third party confirmations.</p> <p>In 2014, we obtained the convertible bond documentation and reviewed it to ensure we understood each of the clauses and the accounting impact of conversion. We obtained management's proposed accounting treatment for the Group and Company and checked that it was consistent with the convertible bond documentation and accounting standards. In 2015, we confirmed the proposed accounting treatment had been correctly applied.</p> <p>For derivatives, we agreed the carrying value to valuations obtained directly from the third party valuers, JC Rathbone Associates. We assessed the competence and capabilities of the external valuers by considering their qualifications and market experience. We involved our internal specialists who performed independent valuations to recalculate the value using independent market data.</p> <p>No material issues were identified in our work on the debt arrangements in place as at 31 December 2015.</p>

### How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group's properties are spread across 26 statutory entities with the Group financial statements being a consolidation of these entities, the Company and the Group's joint ventures. All parts of the Group, with the exception of one of the joint ventures, were identified as requiring an audit of their complete financial information, either due to their size or their risk characteristics or statutory requirement. This work, all of which was carried out by the Group audit team, together with additional procedures performed on the consolidation, gave us sufficient appropriate audit evidence for our opinion on the Group financial statements as a whole.

### Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall Group materiality</b>	£46.4 million (2014: £42.0 million).
<b>How we determined it</b>	1% of total assets.
<b>Specific materiality</b>	£4.0 million (2014: £4.0 million)
<b>How we determined it</b>	Based on 5% of profit before tax excluding investment property valuation movements and profit on disposal of investment properties.
<b>Rationale for benchmark applied</b>	<p>The key driver of the business and determinant of the Group's value is direct property investments. Due to this, the key area of focus in the audit is the valuation of investment properties. On this basis, we set an overall Group materiality level based on total assets.</p> <p>In addition, a number of key performance indicators of the Group are driven by income statement items and we therefore also applied a lower specific materiality for testing property and other income, administrative expenses, provisions and working capital balances.</p>

We agreed with the Audit Committee to cap specific materiality at £4.0 million and that we would report to them misstatements identified during our audit above £2.3 million (2014: £2.1 million) for financial statement line items where overall materiality applied and £0.2 million (2014: £0.2 million) for line items where specific materiality applied, as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

### Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 92, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and Company have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Company's ability to continue as a going concern.

# INDEPENDENT AUDITOR'S REPORT CONTINUED

## Other required reporting Consistency of other information Companies Act 2006 opinions

In our opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## ISAs (UK & Ireland) reporting

### Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

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| <ul style="list-style-type: none"> <li>information in the Annual Report is:           <ul style="list-style-type: none"> <li>– materially inconsistent with the information in the audited financial statements; or</li> <li>– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Company acquired in the course of performing our audit; or</li> <li>– otherwise misleading.</li> </ul> </li> </ul>   | <p>We have no exceptions to report.</p> |
| <ul style="list-style-type: none"> <li>the statement given by the Directors on page 90, in accordance with provision C.1.1 of the UK Corporate Governance Code (the 'Code'), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company acquired in the course of performing our audit.</li> </ul> | <p>We have no exceptions to report.</p> |
| <ul style="list-style-type: none"> <li>the section of the Annual Report on page 116, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.</li> </ul>  | <p>We have no exceptions to report.</p> |

## The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

### Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

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| <ul style="list-style-type: none"> <li>the Directors' confirmation on page 90 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.</li> </ul>   | <p>We have nothing material to add or to draw attention to.</p> |
| <ul style="list-style-type: none"> <li>the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.</li> </ul>   | <p>We have nothing material to add or to draw attention to.</p> |
| <ul style="list-style-type: none"> <li>the Directors' explanation on page 77 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.</li> </ul> | <p>We have nothing material to add or to draw attention to.</p> |

Under the Listing Rules we are required to review the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the Directors' statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

## Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

## **Directors' remuneration**

### **Directors' remuneration report – Companies Act 2006 opinion**

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

### **Other Companies Act 2006 reporting**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

### **Corporate governance statement**

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

### **Responsibilities for the financial statements and the audit Our responsibilities and those of the Directors**

As explained more fully in the Statement of Directors' responsibilities set out on page 83, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### **What an audit of financial statements involves**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **CRAIG HUGHES (SENIOR STATUTORY AUDITOR)**

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

25 FEBRUARY 2016