# Audit & Risk Committee Report

**Role of the Committee**

- Monitor the integrity of the Group's financial statements, accounting policies and the key judgements made in the financial statements.
- Assess whether the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.
- Oversee the Group's relationship with our External Auditor.
- Review the effectiveness of the Group's internal control systems.
- Monitor the Group's risk management systems and the identification of our principal risks.
- Monitor the effectiveness of the Internal Audit function.
- Review the Group's compliance framework.
- Monitor health, safety and operational risks and the Group's insurance programmes.

A copy of the Committee's terms of reference, which were updated in January 2018 can be found on the Group's website: **www.dalatahotelgroup.com.**

## Dear Shareholder,

**As Chairman of the Audit and Risk Committee (the 'Committee') I am very pleased to present the Committee's report for 2017. It has been a busy year for the Committee, we have covered a wide range of matters within our remit, and I outline these in the following sections.**

On the financial reporting front, as outlined on pages 74 and 75 most of the significant accounting judgements arise from the acquisition activity of the Group, whether during 2017 or the valuation of assets acquired in previous years. The company seeks the advice of qualified independent experts to determine the value of property and also consults with external accounting experts on occasion to confirm its approach on finer technical points. I am happy to report that in making the important judgement calls, the Committee's view in all cases was endorsed by the External Auditor.

As the business grows the risks evolve and the compliance environment becomes more complex. During the year the Company invested further resources in risk management and the Committee expects to see ongoing improvement in the Company's risk management capacity in 2018.

We maintain a very good working relationship with the External Auditor who attends all of the Committee's meetings. The Committee also meets the External Auditor without management present following the presentation of their report on both the interim and full year financial statements.

In 2017 we held two additional meetings in order to deal in depth with specific accounting matters. In June we received a presentation on the estimates of useful lives for fixtures, fittings and equipment. The evidence presented strongly supported the adoption of a more granular approach to depreciation of guestroom fixtures, fittings and equipment, in particular. In October we reviewed, with the finance team, the likely impact of IFRS 16 *Leases*, which when adopted will have a significant effect on our accounts. We shared our findings with you at our capital markets event in November, which I attended, and I believe our proactive work in this area was well received by those who analyse our financial data.

Our Internal Audit team led by Macarten McGuigan continues to provide assurance through detailed reporting at each of our meetings.

The Committee proactively monitored the design, project management and installation of new financial and procurement systems during the year. These have been significant changes. The Committee also receives updates on the development of human resources in the finance function and regularly invites members of the finance team to attend and participate at Committee meetings.

We monitor carefully the management of health and safety and operational risk. The Group operates a self-insurance programme and the Committee invites the Company's insurance broker and claims advisor to present annually on the management of claims and assessment of losses.

During the year the Company received correspondence from the Irish Auditing and Accounting Supervisory Authority (IAASA) with enquiries in relation to our 2016 accounts. We were happy to engage with IAASA and I believe that the presentation and disclosures in this year's financial statements reflect a number of suggestions made by the regulator.

The Committee considered the requirements of the Irish Companies Act 2014 in relation to the Directors' Compliance Statement, and is satisfied that appropriate steps have been taken to ensure full compliance by the Company with these requirements.

The Committee reviewed the draft Going Concern and Viability Statement prior to recommending it for approval by the Board. The Viability Statement is included in the Risk Management Report on pages 42 and 43.

Looking to 2018 I expect the Committee to be no less busy as the business proceeds with its planned expansion. Cyber security will stay on our agenda as well as the implementation of the enforcement provisions of the General Data Protection Regulation (GDPR), in addition to the day to day business.

You may be assured that the Audit and Risk Committee will maintain its proactive approach and engagement with management to maintain high standards of accountability across the Group.

**Robert Dix**
Chairman,
Audit & Risk Committee

## SIGNIFICANT FINANCIAL JUDGEMENTS FOR 2017

In considering the Group's financial statements for 2017 the Committee reviewed a number of key judgement areas. These were reviewed with Group Finance, Executive Management and KPMG at our meetings. These related to the following areas.

| Matter | Judgements |
|---|---|
| **Accounting for acquisitions**<br><br>The Group completed a number of business combinations and asset purchases during the year. | During 2017, the Group completed the acquisition of two hotels, which were accounted for as business combinations, Clarion Hotel, Liffey Valley and Hotel La Tour Birmingham. Details of both transactions are set out in note 9 to the Group consolidated financial statements on page 130.<br><br>The Group completed a number of property transactions during the year including the purchase of long leasehold interests and freehold interests in certain properties, the details of which are outlined on page 138 in note 11 to the Group consolidated financial statements. These were accounted for as asset purchases.<br><br>The Committee has evaluated the accounting treatment of the consideration paid and costs incurred as presented by management for each of the aforementioned transactions. Management have reported in detail to the Committee in relation to the accounting treatment applied to each transaction and the treatment of associated transaction costs in each case. In addition, the Committee discussed the transactions during the year with management and with the External Auditor. Accordingly, the Committee is satisfied that the correct accounting method has been chosen for each of the aforementioned transactions.<br><br>Where applicable, the Committee has considered the valuations which underpin the accounting and which were performed by suitably qualified professional valuers, as reported to them by management.<br><br>Based on the above, the Committee is satisfied that the assumptions used and judgements made for business combinations in determining the fair values are reasonable and is satisfied that the fair value of the acquired assets and liabilities has been correctly stated and appropriately disclosed in the Group consolidated financial statements. |
| **Sale and leaseback transactions**<br><br>The Group completed two sale and leaseback transactions during the year. | The Group completed the sale and leaseback of Clayton Hotel Cardiff and Hotel La Tour, Birmingham during 2017, the details of which are also set out in note 11 to the Group consolidated financial statements on page 138. Both of the resulting leases were classified as operating leases.<br><br>Management have reported in detail to the Committee in relation to the key judgements underpinning the classification of these leases as operating leases. In addition, the Committee discussed these transactions during the year with management and with the External Auditor.<br><br>The Committee is satisfied that the assumptions used and judgements made in accounting for these transactions are reasonable, that these leases have been correctly accounted for as operating leases and that appropriate disclosures are included in the Group consolidated financial statements. |
| **Building revaluations**<br><br>In line with the Group's revaluation policy for land and buildings, valuations are carried out by suitably qualified professional valuers at each reporting period end. | The net carrying value of land and buildings at 31 December 2017 was €848.8 million (note 11, page 138). The carrying value of land and buildings is determined using fair value. The calculation of fair value and the allocation of fair value to land and buildings requires judgement. The determination of residual values and the allocation of fair value to land and buildings also impacts depreciation.<br><br>Management has engaged appropriately qualified professional valuation specialists to determine the value attributable to land and buildings.<br><br>Management have reported in detail to the Committee in relation to the valuation, as determined by suitably qualified professional valuers, of land and buildings at 31 December 2017. The Committee has discussed the valuation approach and allocation approach undertaken with management. Through discussion with management and considering the findings of the External Auditor, the Committee is satisfied that the year-end valuations are reasonable and that the revaluation movements have been appropriately presented in the Group consolidated financial statements. |

| Matter | Judgements |
|---|---|
| **Depreciation and estimated useful lives of fixtures, fittings ad equipment**<br><br>The Group revised its estimate of the useful lives of fixtures, fittings and equipment. | During 2017, the Group revised its estimate of the useful lives of its fixtures, fittings and equipment. The details of this change in accounting estimate are outlined at the start of note 1 to the Group consolidated financial statements on page 108.<br><br>Management have reported in detail to the Committee in relation to the determination of useful lives of the Group's fixtures, fittings and equipment. The Committee has reviewed the key assumptions and estimates used by management. Through discussion with management and considering the findings of the External Auditor, the Committee is satisfied that they are reasonable and that the estimated useful lives have been determined appropriately.<br><br>Accordingly, the Committee is satisfied that the depreciation of fixtures, fittings and equipment is correctly stated in the Group consolidated financial statements. |
| **Carrying value of goodwill**<br><br>Detailed impairment reviews are undertaken on an annual basis to determine whether the carrying value of goodwill is impaired. | Goodwill amounted to €33.4 million at 31 December 2017 (2016: €33.8 million).<br><br>The carrying values of hotel cash-generating units (CGUs) to which goodwill has been allocated are required to be tested annually for impairment. Management undertook detailed impairment reviews on a hotel by hotel basis, taking account of the valuations prepared by the qualified professional valuation specialists and other factors. The assumptions utilised by management in conducting these analyses are disclosed in note 10 to the Group consolidated financial statements and include projected cash-flows for future revenue and costs, terminal value multiples and discount rates.<br><br>The Committee has reviewed the approach taken by management, as outlined in management's report to the Committee, in conducting these impairment reviews and in particular, the assumptions utilised by management. As part of their audit, the External Auditor assessed the Group's impairment calculations on a CGU by CGU basis.<br><br>Discussions were undertaken between management and the External Auditor as to the underlying assumptions. Following discussions with management and with the External Auditor, the Committee is satisfied that these are reasonable. As the recoverable amounts of the CGUs were determined to be higher than their carrying values at 31 December 2017, no impairment of goodwill was recognised.<br><br>Accordingly, the Committee has concluded that the carrying value of goodwill is appropriately stated at 31 December 2017 and that the disclosures included within note 10 of the Group consolidated financial statements are adequate. |
| **Carrying value of other indefinite-lived intangible assets**<br><br>Other indefinite-lived intangibles represent the value of the Group's leasehold interest in respect of The Gibson Hotel, which was acquired in 2016. | The carrying value of other indefinite-lived intangible assets at 31 December 2017 amounted to €20.5 million, which represents the value of the Group's leasehold interest in The Gibson Hotel, Dublin.<br><br>Management reviewed the useful life of this asset and concluded based on the existence of renewal rights and the intention of the Group to exercise such rights in the future, that the indefinite useful life remains appropriate. Following discussions with management and the External Auditor, the Committee is satisfied that this is reasonable.<br><br>Cash-generating units containing indefinite-lived intangible assets are required to be assessed annually for impairment. Management have undertaken a detailed impairment review which supports the carrying value of this intangible asset at 31 December 2017 on a value-in-use basis. The External Auditor has also reviewed the underlying assumptions and supporting calculations. Based on discussions with management and considering the External Auditor's findings, the Committee is satisfied that management's conclusions are reasonable i.e. that the carrying value of intangible assets was not impaired at 31 December 2017.<br><br>Accordingly, the Committee has concluded that the carrying value of intangible assets is appropriately stated at 31 December 2017 and that the disclosures included within nsote 10 of the Group consolidated financial statements are adequate. |

## EXTERNAL AUDIT

Our External Auditor, KPMG, was appointed in 2014 and reappointed in 2016, when the Company became an EU Public Interest Entity (EU PIE) following its admission to the main markets of the Irish and London Stock Exchanges. Our audit partner since 2014 is Sean O'Keefe. The Group has no current plans to tender for this service, though the Group is cognisant of the EU Audit Regulation and Directive requirements on auditor rotation, which are monitored on an ongoing basis.

KPMG attend each of our Committee meetings and, in October/November of each year, present to us a detailed document setting out their audit scope, materiality and assessment of key risk areas for the statutory audit. We review this in detail prior to the commencement of the audit process. A similar document is also prepared for the interim accounts review, usually at our May/June meeting. We meet with the External Auditor privately on a regular basis throughout the year, usually coinciding with the publication of our financial statements.

The Group also uses KPMG for the provision of non-audit services, usually relating to Group transactions or one-off areas of technical advice. The Committee monitors the provision of these services and are advised, in advance by management, of the rationale behind their proposed appointment and the business reasons for the work.

Tax advisory assignments carried out by KPMG in 2017 related to assessment of capital allowances, transfer pricing analysis, the acquisition of the Clayton Hotel Cardiff Lane and Clayton Hotel Liffey Valley, review of corporation tax returns, review of tax provisions, and various smaller acquisition-related and ad-hoc enquiries. Other non-audit services included financial due diligence in relation to the acquisition of Clayton Hotel Birmingham (formerly Hotel La Tour Birmingham), reporting for landlords on turnover rents, sustainability services and small number of other incidental matters.

The fees paid to KPMG for 2017 are set out on page 123 of the report. The ratio of non-audit to audit fees was 0.94:1.

We have evaluated KPMG on their work completed during 2017, based on our assessment of their work, feedback from management and review of their documentation. The Committee is satisfied with their effectiveness, objectivity and independence. The Committee also considered the External Auditor's internal processes for monitoring objectivity and independence, including peer partner review. We are satisfied that these processes have operated effectively.

## INTERNAL CONTROL AND RISK MANAGEMENT

While the Board has ultimate responsibility for risk management it has delegated this task to the Committee. The Committee has responsibility for the oversight of the Group's system of internal control along with the oversight of the Internal Audit function.

**Assessment of the risk management framework and internal controls**

Risk management and assessment of the principal risks facing the Group are a standing item for each Committee meeting. We review the Group's risk register at each meeting and consider reports from the Head of Risk and Compliance and also senior management's opinion on the status of these risks. Of particular interest to us is the emergence of new risks or where the profile of a particular risk has changed. Details on the Group's risk management framework is set out on pages 36 to 43.

The Group has an established internal control environment which is in place to assist in managing risks and to maintain appropriate controls over the Group's activities. During the year we considered enhancements to the internal control environment with the implementation of an upgraded accounting platform, the development of a shared service centre and our new procurement system. This project will continue in 2018. The Internal Audit function also reviews the effectiveness of these controls through its audit programme and we consider the internal audit reports at each of our meetings.

## INTERNAL AUDIT

The effectiveness, scope of work and operation of the Internal Audit function is a focus area for the Committee. At each Committee meeting we review the findings arising from the Group Internal Auditor's reviews. In particular, we consider any control weaknesses identified and the remedial action to be taken. Management's opinion on the matters raised is also considered. We meet with the Group Internal Auditor without management present at each Committee meeting.

During the year we considered the planned internal audit approach and the main audit focus areas as presented by the Group Internal Auditor. This provided the basis for developing the internal audit plan, which was reviewed and approved by the Committee. The ongoing completion of this plan is also reviewed regularly. At our June meeting we reviewed and updated the internal audit terms of reference and the role description of the Group Internal Auditor.

We identified that the Group faced increasing risks in relation to IT and data, particularly given the external environment and Group developments in this area. To address this, and following an assessment process by management and Internal Audit, we appointed an external partner, EY, to provide additional internal audit technical expertise in this area. A detailed IT risk assessment was completed and a programme of audits has been agreed. Updates on this area are provided to the Committee and the audits are ongoing.

## THE WORK OF THE COMMITTEE IN 2017

The Committee met seven times during 2017. Attendance at these meetings was:

| Member | No. of meetings |
|---|---|
| Robert Dix | 7/7 |
| Alf Smiddy | 7/7 |
| Margaret Sweeney | 7/7 |

All members of the Committee are considered by the board to be independent. The board considers that the Committee Chairman has sufficient recent and relevant financial experience for the role and that there is sufficient financial and commercial experience within the Committee as a whole.