

FINANCIAL STATEMENTS / REPORT OF THE AUDIT COMMITTEE

The Audit Committee met six times during the year. In May, the Committee reviewed the Half Year Report for the period to 31 March 2018 and recommended its approval to the Board. The external Auditor's plan for their audit of the year end financial statements was also received and discussed, and reviews of the Company's internal controls and the service levels provided by the Company's Custodian and Depositary were undertaken. In September, the Committee considered its terms of reference and reviewed the controls reports issued by the Company's outsourced service providers, including those issued by the Company's Administrator, Depositary, Custodian and Investment Manager. In November, the Committee reviewed the year end financial statements and discussed the findings of the external audit with KPMG. More details are provided below. Additional meetings of the Committee were held to consider the implications of the introduction of Key Information Documents, to review the services and performance of the Custodian and Depositary and to approve the final versions of the financial statements.

Role of the Audit Committee

The Audit Committee's main functions are:

- To monitor the internal financial control and risk management systems on which the Company is reliant.
- To consider whether there is a need for the Company to have its own internal audit function.
- To monitor the integrity of the half year and annual financial statements of the Company by reviewing and challenging, where necessary, the actions and judgements of the Investment Manager and the Administrator.
- To meet the independent Auditor of the Company to review their proposed audit programme of work and the subsequent Audit Report and to assess the effectiveness of the audit process, the nature of the non-audit work and the levels of fees paid in respect of both audit and non-audit work.
- To make recommendations to the Board in relation to the appointment, re-appointment or removal of the Auditor, and to negotiate their remuneration and terms of engagement on audit and non-audit work.
- To monitor and review annually the external Auditor's independence, objectivity, effectiveness, resources and qualifications.

The Audit Committee operates within defined terms of reference, which are available on the Company's website.

Composition of the Audit Committee

The Audit Committee comprises the whole Board, being independent Directors. All members of the Committee have recent and relevant financial experience and two are Chartered Accountants.

Significant Issues

In planning its own work, and reviewing the audit plan of the Auditor, the Audit Committee takes account of the most significant issues and risks, both operational and financial, likely to impact on the Company's financial statements.

The valuation of the investment portfolio is a significant risk factor. However, 97.4% of the portfolio at the year end can be verified against daily market prices and observable price movements. The remaining 2.6% uses methodologies based on observable inputs.

A further significant risk control issue is to ensure that the investment portfolio accounted for in the financial statements reflects physical ownership of the relevant securities. The Company uses the services of an independent Custodian (JPMorgan Chase Bank, NA) to hold the assets of the Company. The investment portfolio is reconciled regularly by the Administrator to the Custodian's records, and the year-end reconciliation was reviewed by the Auditor. The systems and controls operated by the Custodian are also monitored by the Depositary, J.P. Morgan Europe Limited, whose responsibilities include oversight of the safekeeping of the Company's assets. The Audit Committee meets with the Depositary as necessary, principally to review the work of the Depositary, but also to consider the effectiveness of the internal controls at the Custodian.

Financial statements issued by the Company need to be fair, balanced and understandable. The Audit Committee has reviewed the Annual Report as a whole and made a recommendation to the Board. Several sections of the Annual Accounts are not subject to formal statutory audit, including the Strategic Report and Investment Manager's Review; the checking process for the financial information in these sections was considered by the Audit Committee, and by the Auditor.

The Company's Half Year Report was approved by the Audit Committee prior to publication, and was also reviewed by the Auditor.

The Audit Committee has assessed whether it is appropriate to prepare the Company's financial statements on a going concern basis, and made its recommendation to the Board. The Board's conclusions are set out in the Report of the Directors. The Audit Committee's remit includes consideration of a statement by the Directors on the long-term viability of the Company. That statement can be found on pages 48 and 49.

As explained below, the Audit Committee has considered carefully the internal control systems. The Company relies heavily on third-party suppliers; the Audit Committee monitors the services and control levels of all of its suppliers on an ongoing basis.

The Committee reviewed special dividends received in the year to determine their allocation to the revenue or capital account in the Statement of Comprehensive Income.

Given the nature of the Company's investments, substantial funds can be received from corporate actions at investee companies. The implementation of the corporate actions can be complex and challenging. The Committee reviews such corporate actions, and takes advice where necessary.

The Company suffers withholding tax on many of its dividends received, some of which is irrecoverable. The Audit Committee and the Investment Manager aim to ensure that any recoverable withholding tax is received in a timely manner. However, such recovery can be difficult in some jurisdictions, and the Company has incurred professional service fees in this area.

The Audit Committee expressed concern to Link Fund Solutions that, for the second year running, the service providers' report on IT controls only covered controls existent on one day rather than throughout the period under review.

The Audit Committee also considered the reports and controls required relating to the additional fixed-term debt assumed by the Company during the year.

Internal Controls

The Board, through the Audit Committee, is responsible for ensuring that suitable internal control systems to prevent and detect fraud and error are designed and implemented by the third-party service providers to the Company and is also responsible for reviewing the effectiveness of such controls. The Board confirms that there is an ongoing process for identifying, evaluating and managing the principal risks faced by the Company in line with the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014 and the FRC's Guidance on Audit Committees published in April 2016. This process has been in place for the year under review and up to the date of approval of this report, and accords with the guidance. In particular, it has reviewed and updated the process for identifying and evaluating the significant risks affecting the Company and policies by which these risks are managed. The risks of any failure of such controls are identified in a Risk Matrix and a schedule of Key Risks, which are regularly reviewed by the Board and which identify the likelihood and severity of the impact of such risks and the controls in place to minimise the probability of such risks occurring. Where reliance is made on third parties to manage identified risks, those risks are matched to appropriate controls reported in the relevant third-party service provider's annual report on controls. The principal risks identified by the Board are set out in the Strategic Report on pages 10 to 12.

The following are the key components which the Company has in place to provide effective internal control:

- The Board has agreed clearly defined investment criteria, which specify levels of authority and exposure limits. Reports on compliance with these criteria are regularly reviewed by the Board.
- The Board has a procedure to ensure that the Company can continue to be approved as an investment company by complying with sections 1158/1159 of the Corporation Tax Act 2010.
- The Investment Manager and Administrator prepare forecasts and management accounts which allow the Board to assess the Company's activities and to review its performance.
- The contractual agreements with the Investment Manager and other third-party service providers, and adherence to them, are regularly reviewed.
- The services and controls at the Investment Manager and at other third-party suppliers are reviewed at least annually.
- The Audit Committee receives and reviews assurance reports on the controls of all third-party service providers, including the Custodian and Administrator, undertaken by professional service providers.
- The Audit Committee seeks to ensure that the Company is recovering withholding tax on overseas dividends to the fullest extent possible.
- The Investment Manager's Compliance Officer continually reviews the Investment Manager's operations. The Investment Manager also employs a compliance consultant. Compliance reports are submitted to the Committee at least annually.

Internal control systems are designed to meet the Company's particular needs and the risks to which it is exposed. They do not eliminate the risk of failure to achieve business objectives and, by their nature, can only provide reasonable and not absolute assurance against mis-statement or loss.

As the Company has no employees, it does not have a whistle-blowing policy and procedure in place. The Company delegates its main functions to third-party providers, each of whom report on their policies and procedures to the Audit Committee. During the year, the Audit Committee has ensured that all third party service providers have appropriate GDPR (Data Protection) policies in place and has reviewed the Company's own policies as applied to the Directors.

The Audit Committee believes that the Company does not require an internal audit function, principally because the Company delegates its day-to-day operations to third parties, which are monitored by the Committee, and which provide control reports on their operations at least annually.

External Audit Process

The Audit Committee meets at least twice a year with the Auditor. The Auditor provides a planning report in advance of the annual audit, a report on the annual audit, and a report on their review of the half year financial statements. The Audit Committee has an opportunity to question and challenge the Auditor in respect of each of these reports.

In addition, the Audit Committee Chairman discusses the audit plan and results of the audit with the external Auditor prior to the relevant Audit Committee meeting. After each audit, the Audit Committee reviews the audit process and considers its effectiveness. The review of the 2018 audit concluded that the audit process had worked well, and that the significant issues had been adequately addressed.

At least once a year, the Audit Committee has an opportunity to discuss any aspect of the Auditor's work with the Auditor in the absence of the Investment Manager and administrators.

Auditor Assessment and Independence

The Audit Committee has reviewed KPMG's independence policies and procedures, including quality assurance procedures. It was considered that those policies and procedures remained fit for purpose. Philip Merchant has been the Audit Partner allocated to the Company since the appointment of KPMG at the 2016 AGM. The audit of the financial statements for the year ended 30 September 2018 is therefore his second as Audit Partner. The Committee has also taken into consideration the standing, skills and experience of the audit firm and the audit team and is satisfied that KPMG is both independent and effective in carrying out their responsibilities.

The Audit Committee has discussed the findings of the FRC's recent 2018 Audit Quality Report on the quality of audits performed by KPMG and has satisfied itself that none of the shortcomings identified are relevant to the audit of the Company.

Fees Payable to the Auditor

Total fees payable to the Auditor were £33,000 (2017: £33,000). Of the total fees, the fees for audit services were £25,000 (2017: £25,000).

The Audit Committee has approved and implemented a policy on the engagement of the Auditor to supply non-audit services, taking into account the recommendations of the FRC, and does not believe there to be any impediment to the Auditor's objectivity and independence. All non-audit work to be carried out by the Auditor must be approved by the Audit Committee in advance. The cost of non-audit services provided by the Auditor for the financial year ended 30 September 2018 was £8,000 (2017: £8,000). This comprised: £6,000 in relation to the half year review and £2,000 in relation to review reports and filings required in respect of the Debenture and fixed-term debt.

These non-audit services are assurance related, and the Audit Committee firmly believes that KPMG have been best placed to provide them on a cost effective basis to the benefit of shareholders. The fees for non-audit services are considered not material in the context of the accounts as a whole.

The Audit Committee is satisfied that KPMG remains independent. The Audit Committee confirms that the non-audit work undertaken by the Company's Auditor satisfies, and does not compromise, the tests of the Auditor's independence, objectivity, effectiveness, resources and qualification. Given the assurance nature of the fees, the cost of these services are considered by the Audit Committee to be proportionate in relation to the fees for audit services.

Re-appointment of the Auditor

Taking into account the performance and effectiveness of the Auditor and the confirmation of their independence, the Committee recommends that KPMG LLP be re-appointed as Auditor to the Company.

Audit Tender

The audit was put out to competitive tender in 2016, following which KPMG were appointed as the Company's Auditor in respect of the financial year ended 30 September 2017. In accordance with the CMA Order, a competitive audit tender must be carried out at least every ten years. The Company is therefore required to carry out a tender no later than in respect of the financial year ending 30 September 2027.

CMA Order

British Empire Trust has complied throughout the year ended 30 September 2018 with the provisions of the Statutory Audit Services Order 2014, issued by the Competition and Markets Authority ('CMA Order').

Calum Thomson

Audit Committee Chairman

9 November 2018