

London Borough of Harrow Council

Report to the Governance, Audit and Risk  
Management Committee

Audit Plan for the 2011/12 Pension Fund Annual  
Report Audit

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# Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for the London Borough of Harrow Pension Fund for the year ending 31 March 2012.

Audit scope		
<b>Our audit scope is unchanged from last year</b>	<p>Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.</p> <p>Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund.</p> <p>The pension fund accounts remain part of the accounts of the Authority as a whole. The LGPS Regulations require administering authorities to prepare an annual report for the pension fund, which should incorporate the annual accounts. Our audit report on the Authority accounts will continue to cover the pension fund section of that document. In addition, we are asked by the Commission to issue an audit report for inclusion in the annual pension fund report.</p>	Section 1

Key audit risks		
<b>We summarise the key audit risks identified at this stage</b>	<p>The key audit risks which we have identified as part of our overall audit strategy are:</p> <ol style="list-style-type: none"><li>1. In view of the complexity arising from the participation of different admitted bodies within the fund, together with the fact that members may pay different rates depending on their pensionable pay, we have included the calculation and payment of contributions as areas of audit risk.</li><li>2. As there are a number of complexities to the calculation of both benefits in retirement and benefits paid on ill health and death, we have identified benefits payable as an area of specific risk.</li><li>3. Previously, the pension fund has invested in private equity and derivative financial instruments. Such investments can give rise to complexities in accounting, disclosure and measurement; accordingly we will treat the appropriateness of the accounting for these investments as a risk.</li><li>4. Management override of key controls. This is a presumed area of risk within auditing standards.</li></ol>	Section 2

Timetable		
<b>Our work will be carried out at the same time as our audit of the Authority</b>	<p>The timetable is set out in Section 5. The fieldwork will be carried out at the same time as our work on the Authority's financial statements in order for us to have completed the audit of the financial statements in time for inclusion in the Authority's annual report.</p>	Section 5

# Executive summary (continued)

## Materiality and prior year uncorrected misstatements and disclosure deficiencies

<p><b>Planning materiality set at £5.3m</b></p> <p><b>Reporting threshold set at £0.22m</b></p>	<p>We calculate materiality on the basis of the net assets of the fund, but have restricted this to the materiality established for the audit of the Authority's financial statements as a whole.</p> <p>We estimate materiality for the year to be £5.3 million (2011: £6.1 million). We will report to the Governance, Audit and Risk Management ("GARM") Committee on all unadjusted misstatements greater than £0.26 million (2011: £0.23 million). Further details on the basis used for the calculation of materiality are given in our audit plan for the audit of the Authority's financial statements.</p>	
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## Prior year uncorrected misstatements and disclosure deficiencies

<p><b>No prior year issues</b></p>	<p>There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2010/11 accounts.</p>	
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## Independence

<p><b>We reconfirm our independence</b></p>	<p>Deloitte have developed important safeguards and procedures in order to ensure our independence and objectivity.</p> <p>These are set out in the "Independence policies and procedures" section included at Appendix 1.</p> <p>We will reconfirm our independence and objectivity for the year ending 31 March 2012 in our final report to the GARM Committee. We have discussed our relationships with the Authority in our separate audit plan for the audit of the Authority's financial statements.</p>	<p>Appendix 1</p>
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## Fee

<p><b>Fee in line with prior year</b></p>	<p>We propose a fee of £35,000 excluding VAT (PY: £35,000) which is in line with the fee scale advised by the Audit Commission.</p>	
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## Engagement team

	<p>Paul Schofield will lead the audit and will be supported by David Hobson who will be the day to day contact on the engagement.</p>	
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## Matters for those charged with governance

<p><b>Briefing on audit matters</b></p>	<p>We have attached at Appendix 1 our "Briefing on audit matters" which includes those additional items which we are required to report upon in accordance with International Standards on Auditing (UK &amp; Ireland). We will report to you at the final audit stage any matters arising in relation to those requirements.</p>	<p>Appendix 1</p>
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# 1. Scope of work and approach

## Overall scope and approach

### **Audit objectives are explained in more detail in our “Briefing on audit matters” document attached as Appendix 1.**

Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.

Local LGPS funds administered by administering authorities are not statutory bodies in their own right. Therefore, it is not possible for separate audit appointments to be made for LGPS audits. We are therefore appointed to the audit of the LGPS through the existing Audit Commission appointment arrangements.

Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund.

Our audit objectives are set out in our “Briefing on audit matters” document attached as Appendix 1.

The audit opinion we intend to issue as part of our audit report on the Authority’s financial statements will reflect the financial reporting framework adopted by the pension fund. This is the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the “Code of Practice”).

For pension fund statements, we have initially considered the net assets of the fund as the benchmark for our materiality assessment as this benchmark is deemed to be a key driver of business value, is a critical component of the financial statements and is a focus for users of those statements. However, we have restricted our estimate of materiality to the amount set for the Authority’s financial statements as a whole, which is £5.3 million. Our separate audit plan for the audit of the Authority’s financial statements includes further information on how we derived this estimate. The concept of materiality and its application to the audit approach are set out in our Briefing on audit matters document. The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements.

The Audit Commission has also determined that auditors should give an opinion in accordance with auditing standards on the financial statements included in the pension fund annual report. This entails the following additional work over and above giving an opinion on the pension fund accounts included in the statement of accounts:

- Comparing the accounts to be included in the pension fund annual report with those included in the statement of accounts.
- Reading the other information published within the pension fund annual report for consistency with the pension fund accounts.
- Where the pension fund annual report is not available until after the auditor reports on the financial statements, undertaking appropriate procedures to confirm that there are no material post-balance sheet events arising after giving the opinion on the pension fund accounts included in the financial statements.
- The financial statements included in the pension fund annual report are prepared on the basis of the same proper practices - the Code of Practice - as the financial statements included in the statement of accounts.
- Consider whether the annual report has been prepared in accordance with the Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

## 2. Key audit risks

Based upon our initial assessment we will concentrate specific audit effort in 2011/12 on the following areas:

### Contributions

#### **Tiered contribution rates increase complexity**

Unlike the position in the private sector, we are not required to issue a statement about contributions in respect of the LGPS. However, this remains a material income stream for the pension fund and in view of the complexity introduced by the participation of more than one employer in the fund, and a benefit structure with tiered contribution rates, we have identified this as a specific risk.

#### **Deloitte response**

We will perform the following procedures to ascertain whether employer and employee contributions have been calculated, scheduled and paid in accordance with the schedule:

- Review the design and confirm the implementation of key controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly.
- Recalculate contributions for a sample of individual members to ensure they are calculated in accordance with the schedule of rates.
- Perform analytical review procedures to gain assurance over the total contributions received in the year.
- Reconcile the membership movements in the year to the Financial Statements, ensuring that these include members from the admitted bodies.

We note that the Authority is not responsible for the calculation of contributions and will therefore perform such tests with the assistance of the other scheduled and admitted bodies.

### Benefits

#### **There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits.**

Changes were made to the local government pension fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and benefits paid on ill health and death.

In respect of benefits in retirement, benefits are accumulated on two different bases for service pre and post 1 April 2008. The calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement. Also individuals now enjoy greater flexibility in their choice of the mix of pension and lump sum.

In respect of ill health and death benefits, the calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement. Some employers may not have retained all the necessary records.

The Government has also completed the process to amend the revaluation and index factors for statutory minimum uplift from the Retail Price Index to the Consumer Price Index. This change has further increased the complexity of benefit calculations.

#### **Deloitte response**

We will perform the following procedures to ascertain whether benefits payable have been calculated correctly in accordance with the fund rules.

- Review the design and confirm the implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits.
- Test a sample of new pensioner calculations and other benefits paid by tracing to supporting documentation and reviewing the calculation, to ensure it is in line with the scheme rules.
- Perform analytical review procedures over the pensions paid in the year based on prior year audited numbers adjusted for changes in pensioner numbers and any pension increases.

## 2. Key audit risks (continued)

### Financial instruments

**Private equity and derivatives are complex to value**

The pension fund makes some use of investments in private equity and derivative financial instruments.

Private equity funds are complex to value and include an element of judgement on the part of the investment manager. Given that these funds form a material balance within the pension fund accounts, we have identified the valuation of these funds as a specific risk.

The fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements.

**Deloitte response**

For the private equity investments we will seek to understand the approach adopted in the valuation of such investments and inspect supporting documentation such as cash flow reports, quarterly investment advisor reports and audited financial statements. We will tailor further procedures depending on the outcome of that work and our assessment of the risk of material error taking into account the fund's investment holding at the year end.

We will update our understanding of the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Code of Audit Practice on Local Authority Accounting. The use of expert advice may be required for testing these balances.

### Management override of controls

**Audit guidance includes a presumed risk of management override of key controls.**

Auditing standards recognise that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports. They include a presumption of a risk of management override of key controls.

**Deloitte response**

We will focus our work on testing of journals, significant accounting estimates and any unusual transactions, including those with related parties.

# 3. Consideration of fraud

## 3.1 Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We are aware that management has the following processes in place in relation to the prevention and detection of fraud which include:

- Anti-fraud and corruption policy
- Codes of conduct
- Whistle-blowing procedures

## 3.2 Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

## 3.3 Fraud inquiries

We will make the following inquiries regarding fraud:

Management	Internal Audit	Those charged with governance
<p>Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments;</p> <p>Management's process for identifying and responding to the risks of fraud in the entity;</p> <p>Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;</p> <p>Management's communication, if any, to employees regarding its views on business practices and ethical behaviour; and</p> <p>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.</p>	<p>Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.</p>	<p>How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks; and</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.</p>



## 3. Consideration of fraud (continued)

We will make inquiries of others within the Authority as appropriate. We will also inquire into matters arising from your whistling blowing procedures.

### 3.4 Process and documentation

We will gather this information through meetings and review of relevant documentation, including meeting minutes.

### 3.5 Representations

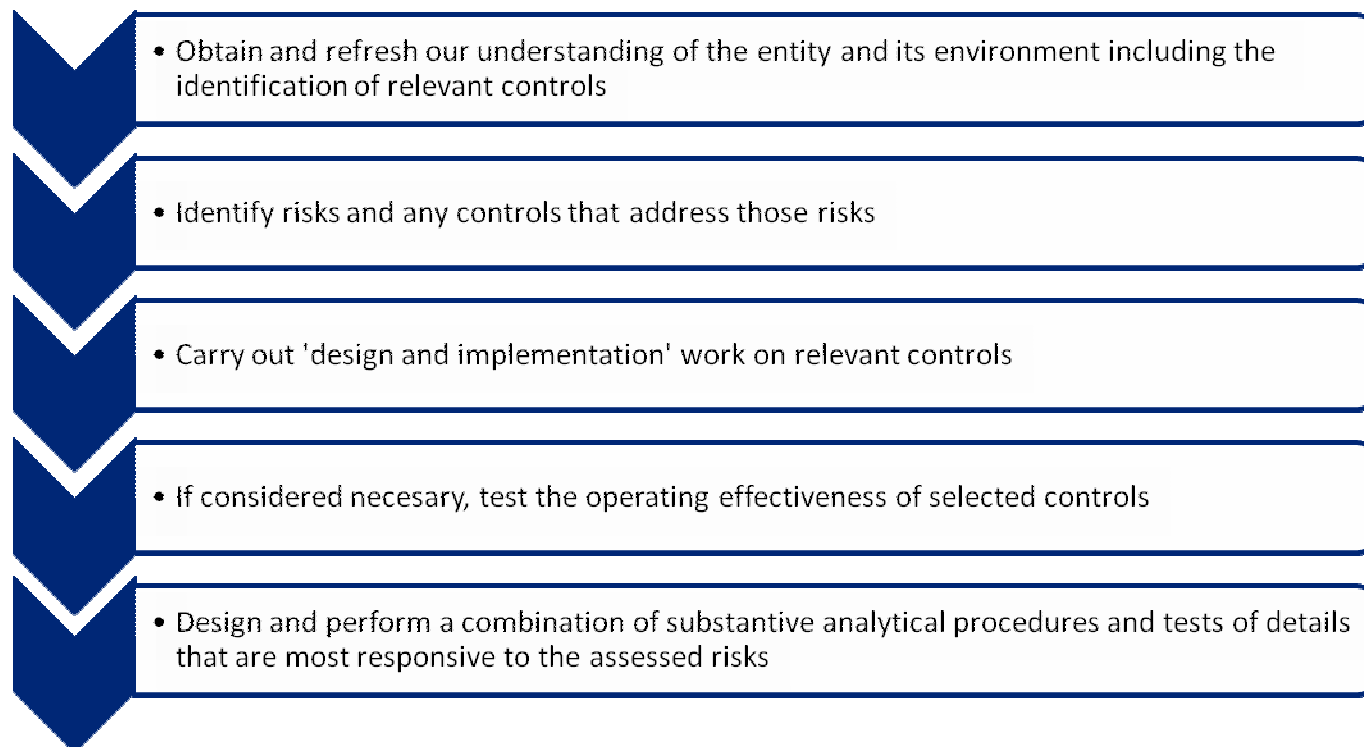
We will ask for you and management to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - officers;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

## 4. Internal control

### Obtaining an understanding of internal control relevant to the audit

As set out in "Briefing on audit matters" (Appendix 1), our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I"). Our audit approach consists of the following:



The results of our work in obtaining an understanding of controls will be collated and the impact on the extent of substantive audit testing required will be considered. At this stage, we do not propose to carry out tests on the operating effectiveness of controls and will obtain our assurance wholly from substantive testing procedures. We have selected this approach as the most efficient.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Authority, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

## 5. Timetable

		2012								
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
<b>Management</b>	Prepare plan based on discussions with management		■							
	Early discussion of Authority's approach to risks areas		■							
	Performance of detailed audit planning fieldwork			■						
	Audit fieldwork/audit issues meetings							■		
	Review of pension fund annual report							■	■	
	Preparation of our report on the 2011/12 audit								■	
<b>Pensions Committee</b>	Audit plan			■						
	Report to the GARM Committee on the 2011/12 accounts audit									■

Our work during these visits will be closely co-ordinated with the work carried out on other parts of main audit of Harrow Council.

## 6. Responsibility statement

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body and this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

This report should be read in conjunction with the “Briefing on audit matters” attached at Appendix 1 and sets out those audit matters of governance interest which came to our attention during the audit to date. Our audit was not designed to identify all matters that may be relevant to members and this report is not necessarily a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Members of Harrow Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

**Deloitte LLP**  
Chartered Accountants

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January 2012

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# Appendix 1: Briefing on audit matters

## Published for those charged with governance



This document is intended to assist those charged with governance to understand the major aspects of our audit approach, including explaining the key concepts behind the Deloitte Audit methodology including audit objectives and materiality.

Further, it describes the safeguards developed by Deloitte to counter threats to our independence and objectivity.

This document will only be reissued if significant changes to any of those matters highlighted above occur.

We will usually communicate our audit planning information and the findings from the audit separately. Where we issue separate reports these should be read in conjunction with this "Briefing on audit matters".

## Approach and scope of the audit

### Primary audit objectives

We conduct our audit in accordance with International Standards on Auditing (UK & Ireland) as adopted by the UK Auditing Practices Board ("APB"). Our statutory audit objectives are:

- To express an opinion in true and fair view terms to the members on the financial statements;
- To express an opinion as to whether the accounts have been properly prepared in accordance with the relevant financial reporting framework; and
- To form an opinion as to whether the financial statements contain the information specified in regulation 3 and the schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996;

### Other reporting objectives

Our reporting objectives are to:

- Present significant reporting findings to those charged with governance. This will highlight key judgements, important accounting policies and estimates and the application of new reporting requirements, as well as significant control observations.
- Provide timely and constructive letters of recommendation to management. This will include key business process improvements and significant controls weaknesses identified during our audit.

# Appendix 1: Briefing on audit matters (continued)

## **Materiality**

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.

"Materiality" is defined in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements" in the following terms:

"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

We determine materiality based on professional judgment in the context of our knowledge of the audited entity, including consideration of factors such as stakeholder expectations, sector developments, financial stability and reporting requirements for the financial statements. We use a different materiality for the examination of the summary contributions to that used for the financial statements as a whole.

We determine materiality to:

- Determine the nature, timing and extent of audit procedures.
- Evaluate the effect of misstatements.

The extent of our procedures is not based on materiality alone but the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

The materiality in relation to the audit of the pension scheme's financial statements will not necessarily coincide with the expectations of materiality of an individual member of the scheme in relation to his or her expected benefits. Our judgments about materiality are made in the context of the financial statements as a whole and the account balances and classes of transactions reported in those statements, rather than in the context of an individual member's designated assets, contributions or benefits.

## **Uncorrected misstatements**

In accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK and Ireland)") we will communicate to you all uncorrected misstatements (including disclosure deficiencies) identified during our audit, other than those which we believe are clearly trivial.

ISAs (UK and Ireland) do not place numeric limits on the meaning of 'clearly trivial'. The Audit Engagement Partner, management and those charged with governance will agree an appropriate limit for 'clearly trivial'. In our report we will report all individual identified uncorrected misstatements in excess of this limit and other identified errors in aggregate.

We will consider identified misstatements in qualitative as well as quantitative terms.

# Appendix 1: Briefing on audit matters (continued)

## Audit methodology

Our audit methodology takes into account the changing requirements of auditing standards and adopts a risk based approach. We utilise technology in an efficient way to provide maximum value to trustees and create value for management and those charged with governance whilst minimising a “box ticking” approach.

Our audit methodology is designed to give trustees the confidence that they deserve.

For controls considered to be ‘relevant to the audit’ we evaluate the design of the controls and determine whether they have been implemented (“D & I”). The controls that are determined to be relevant to the audit will include those:

- Where we plan to obtain assurance through the testing of operating effectiveness;
- Relating to identified risks (including the risk of fraud in revenue recognition, unless rebutted and the risk of management override of controls);
- Where we consider we are unable to obtain sufficient audit assurance through substantive procedures alone; and
- To enable us to identify and assess the risks of material misstatement of the financial statements and design and perform further audit procedures.

## Other requirements of International Standards on Auditing (UK and Ireland)

ISAs (UK and Ireland) require we communicate the following additional matters:

ISA (UK & Ireland)	Matter
ISQC 1	Quality control for firms that perform audits and review of financial statements, and other assurance and related services engagements
240	The auditor’s responsibilities relating to fraud in an audit of financial statements
250	Consideration of laws and regulations in an audit of financial statements
265	Communicating deficiencies in internal control to those charged with governance and management
450	Evaluation of misstatements identified during the audit
505	External confirmations
510	Initial audit engagements – opening balances
550	Related parties
560	Subsequent events
570	Going concern
600	Special considerations – audits of group financial statements (including the work of component auditors)
705	Modifications to the opinion in the independent auditor’s report
706	Emphasis of matter paragraphs and other matter paragraphs in the independent auditor’s report
710	Comparative information – corresponding figures and comparative financial statements
720	Section A: The auditor’s responsibilities relating to other information in documents containing audited financial statements

# Appendix 1: Briefing on audit matters (continued)

## Independence policies and procedures

Important safeguards and procedures have been developed by Deloitte to counter threats or perceived threats to our objectivity which include the items set out below.

### Safeguards and procedures

- Every opinion (not just statutory audit opinions) issued by Deloitte is subject to technical review by a member of our independent Professional Standards Review unit.
- Where appropriate, review and challenge of key decisions takes place by the Second Partner and by the Independent Review Partner, which goes beyond ISAs (UK and Ireland), and ensures the objectivity of our judgement is maintained.
- We report annually to those charged with governance our assessment of objectivity and independence. This report includes a summary of non-audit services provided together with fees receivable.
- There is formal consideration and review of the appropriateness of continuing the audit engagement before accepting reappointment.
- Periodic rotation takes place of the audit engagement partner and, where appropriate, the independent review partner and key partners involved in the audit in accordance with our policies and professional and regulatory requirements.
- In accordance with the Revised Ethical Standards issued by the APB, there is an assessment of the level of threat to objectivity and potential safeguards to combat these threats prior to acceptance of any non-audit engagement. This would include particular focus on threats arising from self-interest, self-review, management, advocacy, over-familiarity and intimidation.
- In the UK, statutory oversight and regulation of auditors is carried out by the Professional Oversight Board (POB) which is an operating body of the Financial Reporting Council. The Firm's policies and procedures are subject to external monitoring by both the Audit Inspection Unit (AIU), which is a division of POB, and the ICAEW's Quality Assurance Directorate (QAD). The AIU is charged with monitoring the quality of audits of economically significant entities and the QAD with monitoring statutory compliance of audits for all other entities. Both report to the ICAEW's Audit Registration Committee. The AIU also reports to POB and can inform the Financial Reporting Review Panel of concerns it has with the accounts of individual entities.



# Appendix 1: Briefing on audit matters (continued)

## **Independence policies**

Our detailed ethical policies' standards and independence policies are issued to all partners and employees who are required to confirm their compliance annually. We are also required to comply with the policies of other relevant professional and regulatory bodies.

Amongst other things, these policies:

- State that no Deloitte partner (or any immediate family member) is allowed to hold a financial interest in any of our UK audited entities;
- Require that professional staff may not work on assignments if they (or any immediate family member) have a financial interest in the audited entity or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the audited entity;
- State that no person in a position to influence the conduct and outcome of the audit (or any immediate family member) should enter into business relationships with UK audited entities or their affiliates;
- Prohibit any professional employee from obtaining gifts from audited entities unless the value is clearly insignificant; and
- Provide safeguards against potential conflicts of interest.

## **Remuneration and evaluation policies**

Partners are evaluated on roles and responsibilities they take within the firm including their technical ability and their ability to manage risk.

## **APB Revised Ethical Standards**

The Auditing Practices Board (APB) has issued five ethical standards for auditors that apply a 'threats' and 'safeguards' approach.

The five standards cover:

- Maintaining integrity, objectivity and independence;
- Financial, business, employment and personal relationships between auditors and their audited entities;
- Long association of audit partners and other audit team members with audit engagements;
- Audit fees, remuneration and evaluation of the audit team, litigation between auditors and their audited entities, and gifts and hospitality received from audited entities; and
- Non-audit services provided to audited entities.

Our policies and procedures comply with these standards.

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