

## London Borough of Harrow Pension Fund

Report to the Governance, Audit and  
Risk Management Committee on the  
2011/12 Local Government Pension  
Fund Audit

Final Report

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# Executive summary

We have pleasure in setting out in this document our report to the Governance, Audit and Risk Management Committee "GARM" for the year ended 31 March 2012 for discussion at the meeting scheduled for 24 September 2012. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2012.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Status	Description	Detail
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## Completion of the audit

**On satisfactory completion of the outstanding items we anticipate issuing an unmodified audit opinion**

We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan.

We have substantially completed our audit in accordance with our Audit Plan, which was presented to you prior to the commencement of the audit, subject to the satisfactory completion of the matters set out below:

- Completion of the technical review processes.
- Receipt of signed management representation letter (see appendix 1).
- Update of post balance sheet event review to date of signing.

We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters.

At the date of this report and subject to the satisfactory completion of the outstanding matters referred to above, there are no matters in relation to the Local Government Pension Fund that would result in the issuance of a modified audit opinion.

## Key findings on audit risks

**We have addressed the risks identified in our planning report**

We discuss within Section 1 the results of our work in relation to key audit risks which have been identified as being significant to the 2011/12 accounts, and which were presented in our Audit Plan to the GARM in March 2012, as follows:

### Key risks

1. **Contributions:** The risk surrounding identification, calculation and payment of contributions, due to the complexities surrounding admitted bodies, has been addressed through our testing. No issues were noted.
2. **Benefits:** Complexities in the calculation of both benefits in retirement and ill health and death benefits have been reviewed during our testing with no issues identified.
3. **Investments:** The private equity investment reports have been reviewed during our testing with no issues identified. Derivative financial instruments have also been successfully revalued on a sample basis.
4. **Management override of controls:** all testing was completed with satisfactory results.

# Executive summary (continued)

## Identified misstatements

### No factual uncorrected misstatements have been identified

Audit materiality was set at £6.3 million (2010/11 £6.1 million). This is an increase from the £5.3m set out in our audit plan, when preparing the planning report the final net asset statement was not available and so the materiality level included a level of estimation.

We report all unadjusted misstatements greater than £319,000 (2010/11: £230,000) to you, as well as any misstatements that are qualitatively material.

There are no identified factual uncorrected misstatements above this level and no qualitatively material misstatements that we wish to bring to your attention, subject to completion of the above procedures.

## Accounting and internal control systems

### Suggestions from prior year have been addressed

We previously reported to you in our report on the 2010/11 audit that we identified two areas for improvement in relation to the internal control system. These improvements related to the use of the bank account and the inclusion of tolerance ranges in the Statement of Investment Principles. We are pleased to confirm that our recommendations regarding the bank account and tolerance ranges in the Statement of Investment Principles have been addressed. We have raised one suggestion during the course of this years audit relating to the authorisation of journal entries.

Section 2

## Current accounting and regulatory issues

We have included within this report accounting and regulatory issues that affect the pension fund industry, particularly focus areas of the Pensions Regulator (TPR). Although the London Borough of Harrow Pension Fund is not regulated by TPR these are guidelines for improving process and represent best practice in the industry.

Section 3

# 1. Key audit risks

The results of our audit work on key audit risks are set out below:

## Contributions

### Audit risk

Unlike the position in the private sector, we are not required to issue a separate statement on contributions for the Fund. Nevertheless, in view of the complexity arising from the participation of different employers within the Fund, we have included the identification, calculation and payment of contributions as an area of significant risk.

### Deloitte response

We have performed the following testing to address the significant risks around contributions:

- 1 Reviewed the design and confirmed the implementation of controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly.
- 1 Recalculated contributions for a sample of individual members to ensure they were calculated in accordance with the schedule of rates.
- 1 Performed analytical review procedures to gain assurance over the contributions received in the year, the results of which fell within our tolerance level.
- 1 Reconciled the membership movements in the year to the Financial Statements, ensuring that these included members from the admitted bodies.

All testing was completed with satisfactory results.

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# 1. Key audit risks (continued)

Benefits	
<b>Audit risk</b>	<p>Changes were made to the Fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and ill health and death benefits which are in addition to the annual increases required by the 1997 Regulation and Pension (Increases) Act 1971.</p> <p>On 8 July 2010 the Government announced its intention to move to the Consumer Price Index (CPI) as the measure of inflation for pension increase purpose. This change came into effect for the 2011/2012 increases.</p>
<b>Deloitte response</b>	<p>The following tests were performed to address the risk around benefits:</p> <ul style="list-style-type: none"><li>• Reviewed the design and confirmed the implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits through discussion with the pensions team and testing that controls were in force during the year under review.</li><li>• Tested a sample of new pensioner calculations and other benefits paid in the year. The sample was tested through agreement to supporting documentation, and review of the calculation, by reference to the qualifying service, scheme rules and benefit choices made by the member.</li><li>• Reviewed the actuarial valuation indicating the impact of the change to CPI discussed above, whilst having little impact on the current year this change will impact the future increases and therefore level of benefits being paid out of the scheme.</li><li>• Performed analytical review procedures over the pension payments made in the year based on prior year audited numbers adjusted for changes in pensioner numbers.</li></ul> <p>All testing was completed with satisfactory results.</p>

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## Investments

### Audit risk

The Fund makes some use of private equity investments 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 key audit risk.

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

### Deloitte response

The following tests were performed to address the significant risk around investments:

- Reviewed the design and implementation of controls present at the Fund for ensuring investments are valued correctly.
- Reconciled the total value of the investments held by the Fund as reported in the Net Assets Statement to independent confirmations received directly from the investment managers.
- Performed an analytical review on the performance of the portfolio.
- Carried out sample testing on sales and purchases made in the year.
- Reviewed the year end portfolio for compliance with the Statement of Investment Principles (SIP).
- Obtained an understanding of the valuation of private equity investments through discussion with the investment manager. The private equity investment manager valuation was obtained for the quarter to 31 December 2011 and this was compared to the audited financial statements for the year ended 31 December 2011 to determine the investment manager's ability to forecast valuations. The percentage difference was extrapolated to the valuation as at 31 March 2012 to determine the possibility of a material misstatement.
- Engaged our internal experts to review the use of derivatives and to recalculate the value of a sample of open contracts.

All testing was completed with satisfactory results.

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# 1. Key audit risks (continued)

## Management override of controls

### Audit risk

We are required by ISA 240 'The auditors' responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of management override of the system of internal control.

### Deloitte response

The following tests were performed to address the risk of management override of controls:

- 1 Reviewed analysis and supporting documentation for journal entries, key estimates and judgements.
- 1 Performed substantive testing on journal entries to confirm that they have a genuine, supportable rationale.
- 1 Reviewed ledgers for unusual items and on a test basis investigated the rationale of any such postings.
- 1 Reviewed significant management estimates and judgements such as year end accruals and provisions and consider whether they are reasonable.
- 1 Made enquiries of those charged with governance as part of our planning and detailed audit processes.

All testing was completed with satisfactory results.

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## 2. Accounting and internal control systems

### Current year control observation

#### Authorising journals

<b>Observation</b>	There is no policy for authorising journals before they are posted.
<b>Recommendation</b>	The Officers should consider implementing a review process to ensure that all journal entries are reviewed and authorised before they are posted to the general ledger.
<b>Management response</b>	Agreed. From August 2012, a paper file has been maintained of all journals processed into SAP for the pension fund. All journals will be authorised in writing by the Treasury and Pension Fund Manager prior to posting to SAP by another member of the Corporate Finance team.

### Prior year control observations

During the course of our 2010/2011 audit we identified two areas for improvement in the internal control systems which are detailed below:

#### Statement of Investment Principles (SIP)

<b>Observation</b>	Although the Statement of Investment Principles reflected the Authority's latest investment strategy, the SIP did not include control ranges around the strategic asset allocations and the policy on rebalancing these. As a consequence, the investment holdings at year end are not in line with the Statement of Investment Principles.
<b>Recommendation</b>	This issue was highlighted last year but has yet to be implemented. Therefore we recommend that the Statement of Investment Principles is updated to include control ranges around the strategic asset allocations. We are satisfied that non-compliance with the Statement of Investment Principles has been adequately disclosed within the Pension Fund's Annual Report.
<b>Management response</b>	During the year the Pension Fund Investment Panel ("PFIP") agreed ranges around the strategic allocation, which have been complied with. A rebalancing policy was also agreed. At each PFIP meeting, actual versus strategic asset allocations and ranges are considered. Officers have delegated authority to rebalance the equity and bond allocations should they be out of range. The SIP will be updated following the completion of the strategic review later in 2011 to include asset allocation ranges and the rebalancing policy.
<b>2011/2012 update</b>	A new Statement of Investment principles was signed on 14 February and the new SIP contains tolerance ranges.

## 2. Accounting and internal control systems (continued)

### Use of bank account

<b>Observation</b>	<p>The Pension Fund currently operates its cash flows through the main London Borough of Harrow bank account. Therefore when contributions are 'made' there is no physical movement of cash, i.e. a journal entry is booked between the expense to the Authority and the contributions to the Pension Fund.</p> <p>The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, regulation 6 introduced a new requirement for each pension fund to have, by 1 April 2011, a bank account which is separate from any which the administering authority has in its capacity as a local authority. This change is being adopted because it will enable pension fund monies to be clearly ring-fenced from other monies of the local authority, and thus reflects a longstanding Audit Commission view on best practice.</p>
<b>Recommendation</b>	<p>Although as at 1 April 11, the Fund is complying with the requirement to have its own bank account, the Pension Fund still operates its cash flows through the main London Borough of Harrow bank account. Whilst complying with the specific requirement to have its own bank account this does not follow the intent of the requirement which is to ensure that monies are clearly ring fenced from other monies of the local authority.</p> <p>This process should be amended so that all cash flows operate directly from the Pension Fund bank account.</p>
<b>Management response</b>	<p>Harrow are now compliant with the regulations concerning pension fund bank accounts. During 2011-12 all pension fund cash movements were processed through Harrow Council bank accounts as discussed in the Report, with monthly (or more frequent) settlements. This approach changed from April 2012 and all contributions from employers other than Harrow Council are now directly banked into the pension fund current account. The IT project to run pension fund BACS transactions for pensions and lump sums against the pension fund bank account has been completed and has been in operation since June 2012.</p> <p>The small value of cheques that are still processed through the Harrow Council account on cost efficiency grounds and contributions from Harrow Council and expenses paid by Harrow Council remain subject to a monthly aggregation and settlement. No further changes are planned to these processes..</p>
<b>2011/2012 update</b>	<p>During our audit we noted that this recommendation has been addressed and now the cash flows are ringfenced from those of the Council.</p>

# 3. Current Accounting and Regulatory Issues

## Upcoming financial reporting developments

For reference, the following developments in the pension industry may impact the governance arrangements and financial statements of the London Borough of Harrow Pension Fund. Whilst we appreciate that the Local Government Pension Scheme is not regulated by the Pensions Regulator, we consider their guidance to be indicative of what is currently considered to be best practice in the pensions sector.

### The new LGPS 2014 project

On 22 December 2011 an agreement reached by the Local Government Association (LGA) and local government unions on how to take forward the future reform of the Local Government Pension Scheme (LGPS) in England and Wales was accepted by the Government. The agreement consists of:

- A set of principles covering:
  - the design of a new LGPS
  - the future management and cost of the scheme
  - Governance of the LGPS
    - A timetable for implementing the new scheme by April 2014
    - A project outline for managing the process of agreeing, by April 2012, the 'big ticket' elements of the new scheme

During April 2012, following the acceptance by UNISON and GMB on how to take forward the reform of the Local Government Pension Scheme (LGPS) in England and Wales, a project has been set up to reach agreement on the elements of the new scheme together with the management and governance of the scheme going forward.

Further information is available at:

<http://www.lgps.org.uk/lge/core/page.do?pagelid=15431012>

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### 3. Current Accounting and Regulatory Issues (continued)

#### Assurance reporting on Pension Trustees

A discussion document by the Institute of Chartered Accountants of England and Wales (“ICAEW”) was released in December 2011 as a Pension Trustee Supplement to ICAEW AAF 02/07. The AAF 02/07 framework sets out high-level guidance for practitioners who provide assurance reports on services and operations provided by expert third parties.

The control objectives stated in the exposure draft is split into six areas as follows:

- a) accepting business;
- b) officers and key persons and Pension Regulator compliance;
- c) administrative and accounting;
- d) other compliance;
- e) risk management; and
- f) Information Technology.

The Pensions Regulator is intending to require all Independent Trustees to obtain an independent assurance report from a practitioner with regard to, amongst other things, the soundness of administrative and accounting procedures before they can be considered for acceptance on to the Trustee Register. It was also proposed that an annual assurance report would be required to remain on the Trustee Register.

The Regulator has indicated that trustees who offer pensions trustee services generally (including Pension Trustees who do not wish to be on the Trustee Register) may find it useful to evaluate the soundness of their administrative and accounting processes by voluntarily following the same reporting model. This is because the guidance in the Supplement and the assurance reporting framework envisaged may help the service providers consider the importance of accepting responsibility for their own internal controls including their design, implementation and operation and to provide a written report evaluating the effectiveness of its control procedures for the relevant period.

Not all of the Pension Trustee’s business activities need be considered when evaluating whether their control procedures meet the specific control objectives. It is sufficient for the control procedures to be considered to the extent they are relevant to the control objectives that relate to the Pension Trustee’s own business operations providing pensions trustee services.

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## 4. Other matters for communication

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below

<b>Independence</b>	<p>We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised.</p> <p>If the GARM wishes to discuss matters relating to our independence, we would be happy to arrange this.</p>
<b>Non-audit services</b>	<p>We are not aware of any inconsistencies between APB Revised Ethical Standards for Auditors and the Authority's policy for the supply of non-audit services or of any apparent breach of that policy.</p> <p>An analysis of professional fees earned by Deloitte LLP in the period from 1 April 2011 to 31 March 2012 will be provided to the GARM in a separate report on the Authority's audit.</p> <p>Fees payable to the auditors for the audit of the pension scheme annual report of the London Borough of Harrow Pension Fund (excluding VAT) were £35,000 (2010/11 £35,000).</p> <p>Our fee is consistent with the scale fee determined by the Audit Commission.</p>
<b>International Standards on Auditing (UK and Ireland)</b>	<p>We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.</p>
<b>Liaison with internal audit</b>	<p>The audit team, following an assessment of the independence and competence of the internal auditor, reviewed the findings of internal audits to inform the risk assessment and considered the impact on our audit approach.</p> <p>No adjustments were made to the audit approach as a result of our review of the work of internal audit.</p>
<b>Written representations</b>	<p>A copy of the representation letter to be signed on behalf of the Authority is attached at Appendix 1.</p>
<b>Relationships</b>	<p>There are no relationships (including the provision of non-audit services) we have with the London Borough of Harrow Pension Fund, its Members, senior Officers and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence, together with the related safeguards that are in place.</p>

# 5. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audited bodies by summarising where, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body begin and end, and what is expected of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our audit plan has been prepared on the basis of, and our audit work carried out in accordance with the Code and the Statement of Responsibilities, copies of which have been provided to the Council by the Audit Commission.

The audit may include the performance of national studies developed by the Audit Commission, where the auditors are required to follow the methodologies and use the comparative data provided by the Commission. Responsibility for the adequacy and appropriateness of these methodologies and the data rests with the Audit Commission. The audit may also include reviews such as this report which address locally determined risks and issues the scope of which is agreed with management in advance of the work. In this case it is for management to determine whether the scope is adequate and appropriate to their needs.

While our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Pension Fund's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditor's report.

We view this report as part of our service to you for Corporate Governance purposes and it is to you alone that we owe a responsibility for its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent.

## **Deloitte LLP**

Chartered Accountants  
St Albans  
September 2012

# Appendix 1: Draft representation letter

Deloitte LLP

*Our Ref:*     *DPH/PJS/2012*

*Date:*

Dear Sirs

## **London Borough of Harrow Pension Fund(the “Fund”)**

This representation letter is provided in connection with your audit of the financial statements of the fund for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the Fund, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011/2012, the financial transactions of the Pension Fund during the year ended 31 March 2012, and the amount and disposition of the fund’s asset and liabilities as at 31 March 2012, other than liabilities to pay pensions and other benefits after the end of the fund year.

We acknowledge as members of London Borough of Harrow Pension Fund our responsibilities for ensuring that the financial statements are prepared which give a true and fair view, for keeping records in respect of active members of the Fund and for making accurate representations to you.

We confirm, to the best of our knowledge and belief, the following representations.

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Fund have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of Officer and Committee member meetings, have been made available to you.
2. We acknowledge our responsibilities for the design, implementation and operation of internal control to prevent and detect fraud and error.
3. 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.
4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting the Fund involving:
  - (i). management;
  - (ii). employees who have significant roles in internal control; or
  - (iii). others where the fraud could have a material effect on the financial statements.
5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Fund’s financial statements communicated by members, former members, employers, regulators or others.
6. We are not aware of any actual or possible instances of non-compliance with laws and regulations, the effects of which should be considered when preparing financial statements.

# Appendix 1: Draft representation letter (continued)

7. Where required, the value at which assets and liabilities are recorded in the net asset statement is, in the opinion of the Authority, the fair value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Fund. Any significant changes in those values since the balance sheet date have been disclosed to you.
8. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements.  
  
We have made enquiries of any key Members and Officers or other individuals who are in a position to influence, or who are accountable for the stewardship of the Fund and confirm that we have disclosed in the financial statements all transactions relevant to the Fund and we are not aware of any other such matters required to be disclosed in the financial statements, whether under Statement of Recommended Practice – Financial Reports of Pension Schemes (revised May 2007) (“Pensions SORP 2007”) or other requirements.
9. We confirm that the financial statements have been prepared on the going concern basis. We do not intend to wind up the fund. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Fund’s ability to continue as a going concern. We confirm the completeness of the information provided regarding events and conditions relating to going concern at the date of approval of the financial statements, including our plans for future actions.
10. You have been informed of all changes to the Fund rules during the year and up to the current date.
11. We have not commissioned advisory reports which may affect the conduct of your work in relation to the Fund’s financial statements.
12. No claims in connection with litigation have been or are expected to be received.
13. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
14. There have been no events subsequent to 31 March 2012 which require adjustment of or disclosure in the financial statements or notes thereto.
15. There have been no irregularities involving management or employees who have a significant role in the accounting and internal control systems or that could have a material effect on the financial statements.
16. The pension fund accounts and related notes are free from material misstatements, including omissions.
17. The Fund has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.
18. The Fund has satisfactory title to all assets.



# Appendix 1: Draft representation letter (continued)

19. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.
20. No transactions have been made which are not in the interests of the members of the Fund during the Fund year or subsequently.
21. We confirm that:
- 1 all settlements and curtailments have been identified and properly accounted for;
  - 1 all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
  - 1 the actuarial assumptions underlying the valuation of the scheme liabilities (including the discount rate used) accord with the members' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business;
  - 1 the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
  - 1 the amounts included in the financial statements derived from the work of the actuary are appropriate.
22. All trades in complex financial instruments are in accordance with our risk management policies, have been conducted on an arm's length basis and have been appropriately recorded in the accounting records, including consideration of whether the complex financial instruments are held for hedging, asset/liability management or investment purposes. None of the terms of the trades have been amended by any side agreement and no documentation relating to complex financial instruments (including any embedded derivatives and written options) and other financial instruments has been withheld.
23. We confirm that the Pension Fund Annual Report is compliant with the requirements of Regulations 34(1)(e) of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance.
24. We confirm that the information that is contained within the Pension Fund Annual Report and Accounts for the year to 31 March 2012 is complete, accurate and consistent with the information that is contained within the Pension Fund Accounts.

We confirm that the above representations are made on the basis of adequate enquiries of other officials of the Fund (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

Signed on behalf of London Borough of Harrow Pension Fund

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