

Harrow Council

Report to the Governance, Audit  
and Risk Management Committee  
on the 2011/12 Audit

Planning Report

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# Executive summary

We have pleasure in setting out in this document details of our proposed audit plan for Harrow Council for the year ending 31 March 2012. The FRC has made it clear, in its 'Update for Audit Committees – November 2010', that it expects audit committees to focus activity on assessing and communicating risks and uncertainties and reliance on estimates, assumptions and forecasts. Whilst the guidance was issued to assist company directors serving on audit committees, this should be considered best practice for the Governance Audit and Risk Management (GARM) Committee.. This report will describe the work we undertake in order to support this activity.

Audit scope		
<p><b>Our audit scope is unchanged from last year</b></p>	<p>Our audit will be carried out in accordance with the Audit Commission's Code of Audit Practice 2008. There are no changes to scope compared to last year. Our primary audit responsibilities are also summarised in the "Briefing on Audit Matters" paper which was circulated to you as an appendix to our final report on the 2010/11 audit.</p> <p>In summary, under the Audit Commission's Code of Audit Practice we have responsibilities in two main areas:</p> <ul style="list-style-type: none"> <li>• the financial statements and the Annual Governance Statement</li> <li>• aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.</li> </ul> <p>The audit of the Council's Local Government Pension Scheme is dealt with in a separate audit plan and not in this one.</p> <p>In our fee letter presented in April 2011, we proposed an audit fee of £330,608 (2011: £367,342) for the audit of the Council's financial statements, the assurance report on the whole of government accounts return and the value for money conclusion which is equal to the scale fee set by the Audit Commission. Further information on fees is provided in Appendix 1.</p>	<p>Section 1 App 2</p>

Key audit risks		
<p><b>We summarise the key audit risks identified at this stage in our planning work</b></p>	<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. Revaluation of properties. The valuation is inherently sensitive to judgements on key assumptions.</li> <li>2. Valuation of the pension liability. This continues to be an audit risk in view of the size of the liability and complexity of judgements in this area and the sensitivity to small changes in assumptions.</li> <li>3. Presumed risk of fraud in revenue recognition, specifically around the recognition of grant income. This is a continuing audit risk in view of the need for judgements on recognition to be made on a grant-by-grant basis.</li> <li>4. Management override of controls. This is a presumed area of risk within auditing standards.</li> <li>5. Capital mis-coding remains a risk until the new controls introduced to strengthen processes relating to the approvals, recording and reporting of capital have been tested. Issues arose as a result of systematic mis-coding noted in 2009/10 audit.</li> </ol>	<p>Section 2</p>

# Executive summary (continued)

<b>Materiality and prior year uncorrected misstatements and disclosure deficiencies</b>		
<p>Based on budgeted expenditure we have set materiality at £5.3m and will report all adjustments in excess of £220k to you</p>	<p>For the 2012 financial statements, we have determined materiality of £5.3m (2011: £6.1m). We will report to the audit committee on all unadjusted misstatements greater than £265k, (2011, £305k) and other adjustments that are qualitatively material.</p> <p>We take this opportunity to remind you of the misstatements identified in the prior period. Identified uncorrected misstatements reduced cost of services by £695k and increased net assets by £695k.</p> <p>Whilst there were no major disclosure deficiencies in the prior year financial statements, we propose to work with management in advance of the year end audit to ensure that the presentation of the second set of IFRS financial statements incorporates best practice from across the sector.</p> <p>Further details of the 2011 uncorrected misstatements and disclosure deficiencies are included in Appendix 1 for reference.</p> <p>In addition, for your information, we would like to report that at the end of the prior period audit process, adjustments with a net credit to the Income and Expenditure Statement of £5.1m were recorded following discussion and agreement with management.</p>	<p>Section 1 App 1</p>

<b>Internal control</b>		
<p>Evaluation of the design and testing of the implementation of key controls relevant to the audit will inform the design of our substantive testing</p>	<p>To assist us in planning our work, we will evaluate the design and test the implementation of key controls relevant to the audit, including controls which mitigate the significant risks of material misstatement we have identified.</p> <p>Once we have assessed whether controls are designed and implemented appropriately, we will obtain our assurance from substantive testing procedures rather than performing further detailed testing on controls. We have selected this approach as the most efficient.</p> <p>We continue to liaise with the Council's internal auditors to maximise our combined effectiveness and to inform our own audit risk assessment. We have received and reviewed the internal reports already concluded during the year, and will review the audit plan for 2012/13 before it is concluded. As noted below, in section 2, we plan to use the work that Internal Audit has performed around the capital accounting control environment.</p>	<p>N/a</p>

# Executive summary (continued)

Other matters for those charged with governance		
<p>We confirm we are independent of the Council. We remind the Committee of the Briefing circulated in September 2011 which dealt with other matters we are required to communicate.</p>	<p>We have communicated to you separately in our publication entitled "Briefing on audit matters" those additional items which we are required to report upon in accordance with International Standards on Auditing (UK &amp; Ireland). The document also provides detail of the safeguards and procedures we have in place to ensure our independence and objectivity. This was circulated with our report on the 2011 audit to the September 2011 meeting of the Committee.</p> <p>We confirm we are independent of Harrow Council and will reconfirm our independence and objectivity to the audit committee for the year ending 31 March 2012 in our final report to the audit committee.</p>	<p>N/a</p>
New accounting and legal pronouncements		
<p>We do not anticipate that changes introduced by the 2011/12 edition of the Code will impact significantly on the accounts</p>	<p>The 2011/12 edition of the CIPFA Code of Practice on Local Authority Accounting makes a number of amendments to the 2010/11 edition. The majority of changes are clarifications of (rather than revisions to) past accounting, presentation and disclosure guidance. We included more detail in relation to the changes in our report presented the Committee in September 2011.</p> <p>Other developments reported to the Committee in September 2011 remain on the horizon and we will ensure that both management and the Committee are made aware of these in more detail before implementation is required.</p>	<p>N/a</p>
Communications		
<p>We expect the timing of communications to be largely consistent with the prior year</p>	<p>Section 5 sets out the form, timing and expected general content of our communications to you.</p>	<p>Section 5</p>

# 1. Scope of work and approach

## 1.1 Auditing standards

We will conduct our 2011/12 audit in accordance with the Audit Commission's Code of Audit Practice 2008 and other guidance issued by the Audit Commission.

We have responsibilities in two main areas:

- the financial statements and the statement on corporate governance; and
- aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also asked to provide an assurance statement on the Council's consolidation pack for Whole of Government Accounts purposes and to carry out procedures under instruction from the Audit Commission to certify grant claims and other returns on behalf of the Audit Commission.

## 1.2 The financial statements and statement on corporate governance

We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISA (UK and Ireland)") as adopted by the UK Auditing Practices Board ("APB"). The audit opinion on the accounts we intend to issue will reflect the financial reporting framework adopted by Harrow Council, being the Code of Practice on Local Authority Accounting ("the Code") which is based on International Financial Reporting Standards ("IFRS").

For the 2011/12 financial statements we have determined a materiality of £5.3m based on budgeted gross expenditure. We will review and update this as applicable on the basis of the actual position recorded in the 2011/12 financial statements. This figure takes into account our knowledge of the Council, our assessment of audit risks and the reporting requirements for the financial statements. 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 and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

## 1.3 The value for money conclusion

The Audit Commission has advised that in 2012 the auditors' statutory value for money ("VFM") conclusion will again be based on the following two criteria specified by the Commission:

<b>Specified criteria for auditors' VFM conclusion</b>	<b>Focus of the criteria for 2012</b>
<b>The organisation has proper arrangements in place for securing financial resilience.</b>	The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
<b>The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.</b>	The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

## 1.4 The whole of government accounts

Whole of Government Accounts (WGA) are commercial-style accounts covering all the public sector and include some 1,700 separate bodies. Auditors appointed by the Audit Commission have a statutory duty under the Code of Audit Practice to review and report on the Council's whole of government accounts return. Our report is issued to the National Audit Office ("NAO") for the purposes of their audit of the Whole of Government Accounts.

# 1. Scope of work and approach (continued)

## 1.5 Certification of grant claims

Under Section 28 of the Audit Commission Act 1998, the Commission is responsible for making arrangements for certifying claims and returns in respect of grants or subsidies made or paid by any Minister of the Crown or a Public Authority to a Local Authority. The Commission, rather than its appointed auditors, has the responsibility for making certification arrangements. The appointed auditor carries out work on individual claims as an agent of the Commission under certification arrangements made by the Commission which comprise certification instructions which the auditor must follow.

## 1.6 Liaison with internal audit

The audit team, following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function, review the findings of internal audit and adjust the audit approach as is deemed appropriate. This normally takes a number of forms:

- assessment of the control environment;
- discussion of the work plan for internal audit; and
- where internal audit identifies specific material deficiencies in the control environment, we consider adjusting our testing so that the audit risk is covered by our work.

During 2011/12 the internal audit department will be performing work to assess the application and effectiveness of the new capital controls and we will take into account the findings when planning our own work in relation to the capital mis-coding audit risk explained in section 2, below.

## 1.7 Fees

We propose an audit fee of £330,608 (2011 £367,372) for the audit of the accounts, the assurance report on the whole of government accounts and the value for money conclusion for the Council, which is equal to the scale fee set by the Audit Commission.

The 10% reduction reflects:

- no inflationary increase from 2010/11;
- lower ongoing costs following the first year adoption of International Financial Reporting Standards (IFRS) in 2010/11; and
- the new approach to value for money (VFM) work following the abolition of the Comprehensive Area Assessment.

This excludes the fee for the audit of the Local Government Pension Scheme, which is dealt with in a separate report to this Committee, and fees for the certification of grant claims. The total estimated and proposed amount for all these services for 2012 is analysed in Appendix 1.

An analysis of the fees charged will be included in our Final Report to those charged with governance.



## 2. Key audit risks

Based upon our initial assessment, we will concentrate specific effort on the significant audit risks set out below:

### Revaluation of properties

<b>The valuation of properties is sensitive to judgements on key assumptions</b>	<p>The Council holds a substantial portfolio of properties, subject to a rolling revaluation programme that requires the application of specialist valuation assumptions.</p> <p>The current and recent economic volatility has affected property values, generally, and the Council has recorded significant gains and losses over the last few years. Current market sentiment suggests yields could soften and the expected increases in rental values may not come to fruition. These factors could lead to further falls in fair values during 2011/12.</p>
<b>Deloitte response</b>	<p>We will review the arrangements in place for updating market values and assess their compliance with the new Code of Practice. This will include an assessment of the qualifications and experience of the in-house specialists that carry out the valuations.</p> <p>Once again, included in our audit team are valuation specialists from Drivers Jonas Deloitte. They will assist us in reviewing the reasonableness of key assumptions.</p>

### Valuation of the pension liability

<b>The valuation of the pension liability continues to be an audit risk in view of its size and the complexity of judgements in this area</b>	<p>The pension liability relating to the pension scheme is substantial so that its calculation is sensitive to comparatively small changes in assumptions made about future changes in salaries, price and pensions, mortality and other key variables. Some of these assumptions draw on market prices and other economic indices and these have become more volatile during the current economic environment.</p>
<b>Deloitte response</b>	<p>We will consider the qualifications, relevant expertise and independence of the actuary engaged by the Council and the instructions and sources of information provided to the actuary. We will include a specialist from our team of actuaries within our engagement team to assist in the review of assumptions used to calculate the pension liability and related in year transactions and the reasonableness of the resulting accounting entries.</p>

### Risk of fraud in revenue recognition

<b>A continuing risk in view of the need for judgements on recognition made on a grant-by-grant basis</b>	<p>Clarified International Standards on Auditing establish a presumption of a risk of fraud in revenue recognition. Accounting for grant income can be complex as the timing for recognising income in the accounts will depend on the scheme rules for each grant. It may also be necessary to take into account past practice by the Council and grant funder.</p> <p>There have not been any changes to accounting practice in this area, but CIPFA have clarified that the existing guidance for capital grants applies equally to revenue grants.</p>
<b>Deloitte response</b>	<p>We will test that recognition of income properly reflects the grant scheme rules, that entitlement is in agreement with the draft or final grant claim and that the grant control account balance has been properly reconciled. We raised a control recommendation in our prior year audit for all grants to be centrally maintained in addition to S106 grants being assessed as capital or revenue at inception to ensure accounted for correctly within SAP.</p> <p>All areas of revenue will be tested in the course of our audit, should we have any concerns around the recognition we will perform additional testing where necessary.</p>



## 2. Key audit risks (continued)

### Management override of controls

**Audit guidance includes a presumed risk of management override of key controls** Auditing standards recognise that management may be in a position to override controls that are in place to present inaccurate or even fraudulent financial reporting. They include a presumption of a risk of management override of key controls in all audits. This is particularly relevant to our approach in a time of ongoing budgetary pressures.

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

In testing journals, we will make use of computer assisted audit techniques to analyse the whole population of journals and to identify those which had features which can be indicators of possible fraud and to focus our testing on these.

Our consideration of key accounting estimates will focus on the areas of significant judgement identified separately as areas of audit risk above.

We consider through our detailed planning procedures and subsequent performance of substantive procedures whether there are any transactions where the business rationale was not clear. In the event that we do identify any such transaction, we will design and perform focused procedures.

### Capital mis-coding

**As a result of the changes and improvements to the control environment, this remains an audit risk** In our 2010 audit of the financial statements we, along with management, noted a weakness in relation to the management, control and monitoring of certain capital projects within Children's Services – this led to us issuing a qualified VFM opinion with the 2009/10 financial statements and a delay in their issuance whilst the matter was investigated by management, with assistance from third parties. The VFM opinion in our 2010/11 accounts was not qualified as a result of the actions taken by management in the short-term to resolve the issues.

A risk remains for the 2011/12 as a result of the significant changes made to the control environment.

**Deloitte response** In planning our audit we will perform testing around the design and implementation of the new controls to confirm that the control weakness has been addressed. We will liaise with internal audit in performing this work as they have been monitoring the process since the issue first arose. We will assess the work performed by internal audit in testing the application and effectiveness of the new procedures when planning our own work to ensure no duplication of work.

We will also perform detailed substantive work in relation to capital spend against budget, challenging overspends and supporting these to approvals.

# 3. Consideration of fraud

## 4.1 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 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:

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

## 4.2 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 your auditor, 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.

## 4.3 Fraud inquiries

We will make the following inquiries regarding fraud:

Management	Internal Audit	GARM committee
<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</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 the GARM committee 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</p> <p>Whether the GARM committee have knowledge of any actual, suspected or alleged fraud affecting the entity</p>

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

# 3. Consideration of fraud (continued)

## 4.4 Process and documentation

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

## 4.5 Concerns

As set out in Section 2 above we have identified the risk of fraud in revenue recognition and management override of controls as a key audit risk for your organisation. The previous issues around capital mis-coding remain a risk for 2011/12 as the capital control environment has been subject to significant change/improvement during the year.

## 4.6 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 or group and involves:
  - management;
  - 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" circulated to you in September 2011, 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 and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

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

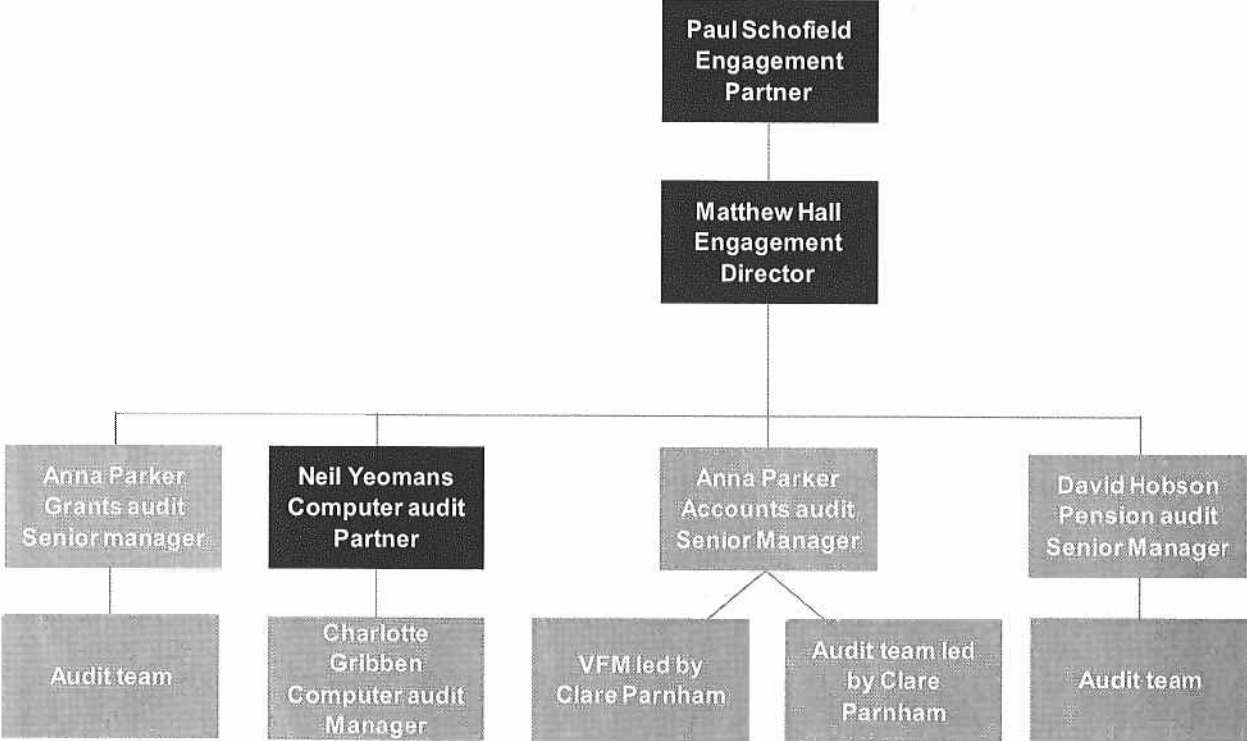
# 5. Communications timetable

Set out below is the approximate expected timing of our reporting and communication with Harrow Council.

Planning	Pre year end fieldwork	VFM conclusion	Year end fieldwork	Reporting	Post reporting activities
<p>Meetings with Harrow Council to discuss the audit plan and management response to the audit.</p> <p>Agreement to the audit plan and audit objectives.</p> <p>Finalisation of the audit plan and audit objectives.</p>	<p>Gain a detailed understanding of the systems and controls including the IT system.</p> <p>Review of the internal control system.</p> <p>Finalisation of the internal control system.</p> <p>Finalisation of the internal control system.</p>	<p>Finalisation of the VFM conclusion.</p>	<p>Performance of the audit plan and testing.</p> <p>Performance of specified procedures in relation to the audit of the WCA consolidation pack.</p> <p>Finalisation of the audit plan and testing.</p> <p>Finalisation of the audit plan and testing.</p>	<p>Review of the audit findings and discussion of the findings with the Audit and Risk Management Committee.</p> <p>Issuance of the audit report on the findings from the audit.</p> <p>Issuance of the audit report on the findings from the audit.</p>	<p>Audit feedback.</p> <p>Issuance of an audit letter and presentation to the Governing Body, Audit and Risk Management Committee.</p>
Nov 2011 - Jan 2012	Jan-Feb 2012	Feb-June 2012	July-Sept 2012	July-Sept 2012	Oct 2012-Dec 2012
Ongoing communication and feedback					

# 6. Client service team

We set out below our audit engagement team.



# 7. Responsibility statement

This report should be read in conjunction with the "Briefing on audit matters" circulated to you in September 2011 and sets out those audit matters of governance interest which have come to our attention during the planning of our audit to date. Our audit is not designed to identify all matters that may be relevant to the board and our final report on the audit will not necessarily be a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for the members, 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. It should not be made available to any other parties without our prior written consent.

## **Deloitte LLP**

Chartered Accountants

St Albans

16 January 2012



# Appendix 1: Prior year uncorrected misstatements and disclosure deficiencies

## Uncorrected misstatements

We are required to communicate to you the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. The following uncorrected misstatements were identified during the course of our prior year audit:

		(Credit)/ charge to current year CIES £'000	Increase/ (decrease) in net assets £'000	Increase/ (decrease) in collection fund £'000
<b>Judgemental misstatements</b>				
Debtor provisioning	[1]	(695)	695	-
<b>Total</b>		<u>(695)</u>	<u>695</u>	<u>-</u>

[1] Difference in judgement over the appropriate level of bad debt provision amounting to £2.3m:

- £695k in relation to rates, benefits and sundry debtors – impacting the main statements; and
- £1,644k in relation to NNDR and council tax – only impacting the collection fund.

## Disclosure deficiencies

Auditing standards require us to highlight significant disclosure deficiencies to enable audit committees to evaluate the impact of those matters on the financial statements. The table below highlights those areas of disclosure that we considered required consideration by the committee in the prior year:

Disclosure	Source of disclosure requirement	Quantitative or qualitative consideration
Notes disclosing the breakdown of short term debtors and creditors (5.19 and 5.22) have changed format between the previous SORP and the new IFRS Code. Amounts are allocated differently under the new Code, and prior year balances have been reanalysed in the notes under this format. The accounts do not include reconciliation between the old and new format.	SORP and Code presentation differences	Qualitative

We obtained written representations from management confirming that after considering these uncorrected items, both individually and in aggregate, in the context of the consolidated financial statements taken as a whole, no adjustments were required.

# Appendix 2: Analysis of audit and grant certification fees

We summarise below our proposed audit fees as discussed with officers:

	2011/12 £	2010/11 £
Fees payable to the auditor for the audit of the Council's accounts, assurance report on the whole of government return and value for money conclusion *	330,608	367,342
Fees payable to the auditor for the audit of the Council's pension scheme	35,000	35,000
	<hr/>	<hr/>
Fees payable to the auditors for the certification of grant claims **	110,000	110,000
	<hr/>	<hr/>
<b>Total fees for audit services provided to the Council (excl VAT)</b>	<b>475,608</b>	<b>512,342</b>

\* Included in the 2010/11 audit fee were items of a one of nature. At the time of writing this report there is ongoing work in relation to an objection to the 2008/09 accounts, not reflected in the 2011/12 fees stated above.

\*\* Our fees for grant certification work are billed on the basis of time spent by different grades of staff using scale fees advised by the Audit Commission. The level of fees charged in a given year is dependent on the grant schemes falling within the audit requirement, the scope of procedures agreed between the Audit Commission and the grant paying body and the quality of working papers provided to us and timeliness with which audit queries are resolved. The above figure is our current estimate for both 2012 and 2011.

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