



## Planning report to the Audit Committee for the year ending 31 March 2020

Issued on 18 November 2020 for the meeting on 25 November 2020

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# Director introduction

## The key messages in this report:

I have pleasure in presenting our planning report to the Audit Committee for the 2020 audit. I would like to draw your attention to the key messages of this paper:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

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### **COVID 19**

The Local Government accounts timetable has been delayed in 2020 due to the impact of COVID – 19. Draft accounts were submitted in line with the revised 31 August date however, whilst the audit is underway, as reported at the previous meeting of the committee we do not currently expect to complete the audit by the revised deadline of 30 November. The implementation of IFRS 16 has also been delayed into the 21/22 Code due to COVID-19.

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### **Scope of Our Work**

Our audit work will be carried out in accordance with the requirements of the Code of Audit Practice ('the Audit Code') and supporting guidance published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General.

The Audit Code sets the overall scope of the audit which includes an audit of the accounts of the Council and work to satisfy ourselves that the Council has made proper arrangements to secure Value for Money (VfM) in its use of resources. There have not been any changes to the Audit Code itself and therefore the scope of our work is broadly similar to the scope of work set in the prior year.

Our responsibilities as auditor, and the responsibilities of the Council are set out in 'PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies' published by Public Sector Audit Appointments Limited.

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# Director introduction

## The key messages in this report (continued):

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

### **Areas of focus in our work on the accounts**

We summarise below the areas of significant risk we have identified to date.

- Valuation of properties – there is significant judgement over the inputs to the valuation. For the 19/20 statement of accounts, the Royal Institute of Chartered Surveyors issued guidance that COVID-19 introduced a material uncertainty over the valuations completed for years ending 31<sup>st</sup> March 2020. Consequently we anticipate including a emphasis of matter paragraph in our audit opinion in respect of these valuations.
- Cut-off of service line expenditure –there is a risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position. There is a risk that the Council may materially misstate expenditure through manipulating the year end position in order to report a more favourable outturn.
- Management override of controls – auditing standards presume there is a risk that the accounts may be fraudulently misstated by management overriding controls. Key areas of focus are: bias in the preparation of accounting estimates; inappropriate journal entries; and transactions which have no economic substance.

At the planning stage we have not identified the valuation of pension liabilities as a significant risk but we will keep this under review during the audit process once we receive the actuary's report, and as we are aware that there are ongoing legal cases that could potentially impact the level of the liability and could lead to us identifying this as a significant audit risk.

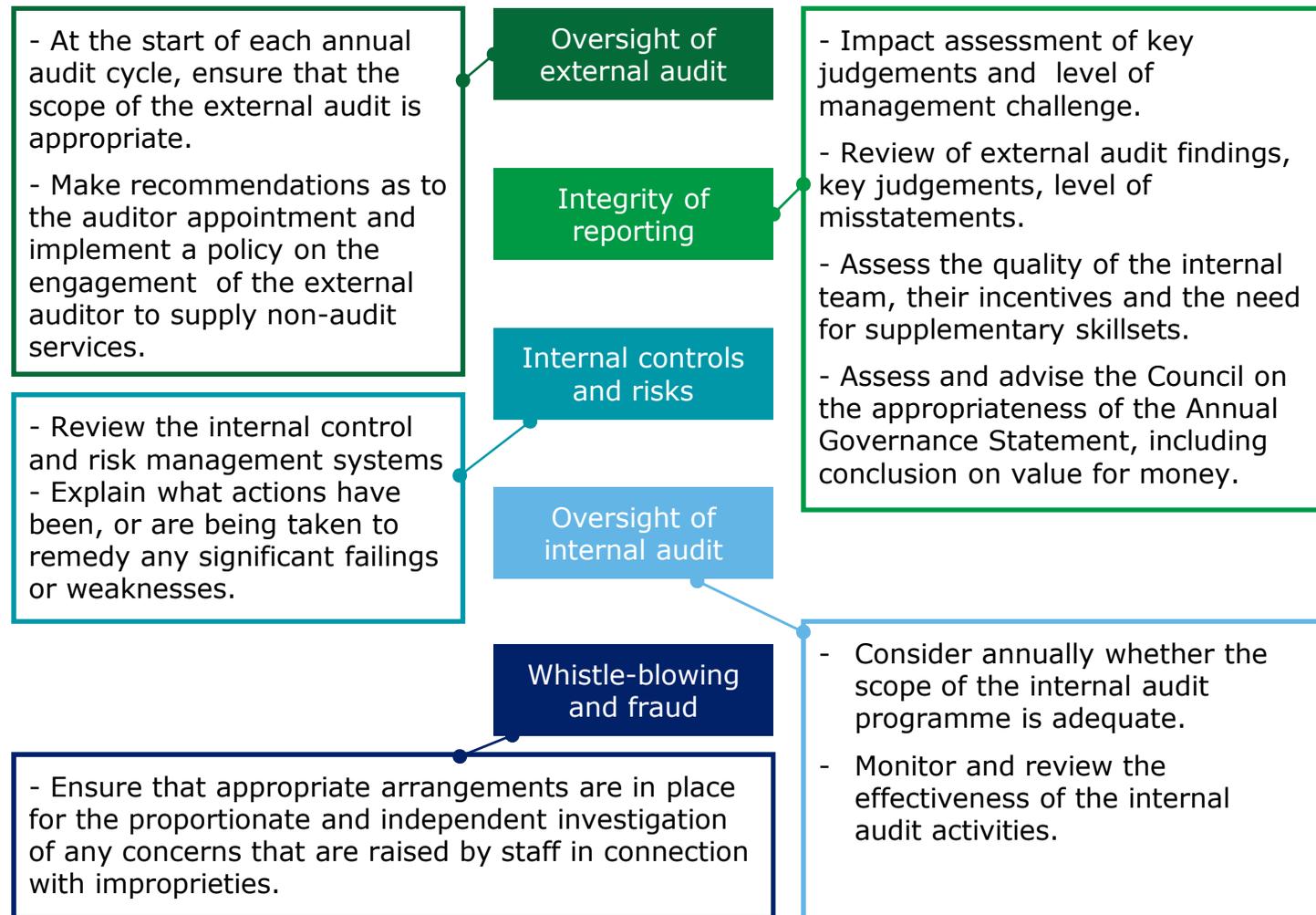
# Responsibilities of the Audit Committee

## Helping you fulfil your responsibilities

Why do we interact with the Audit Committee?

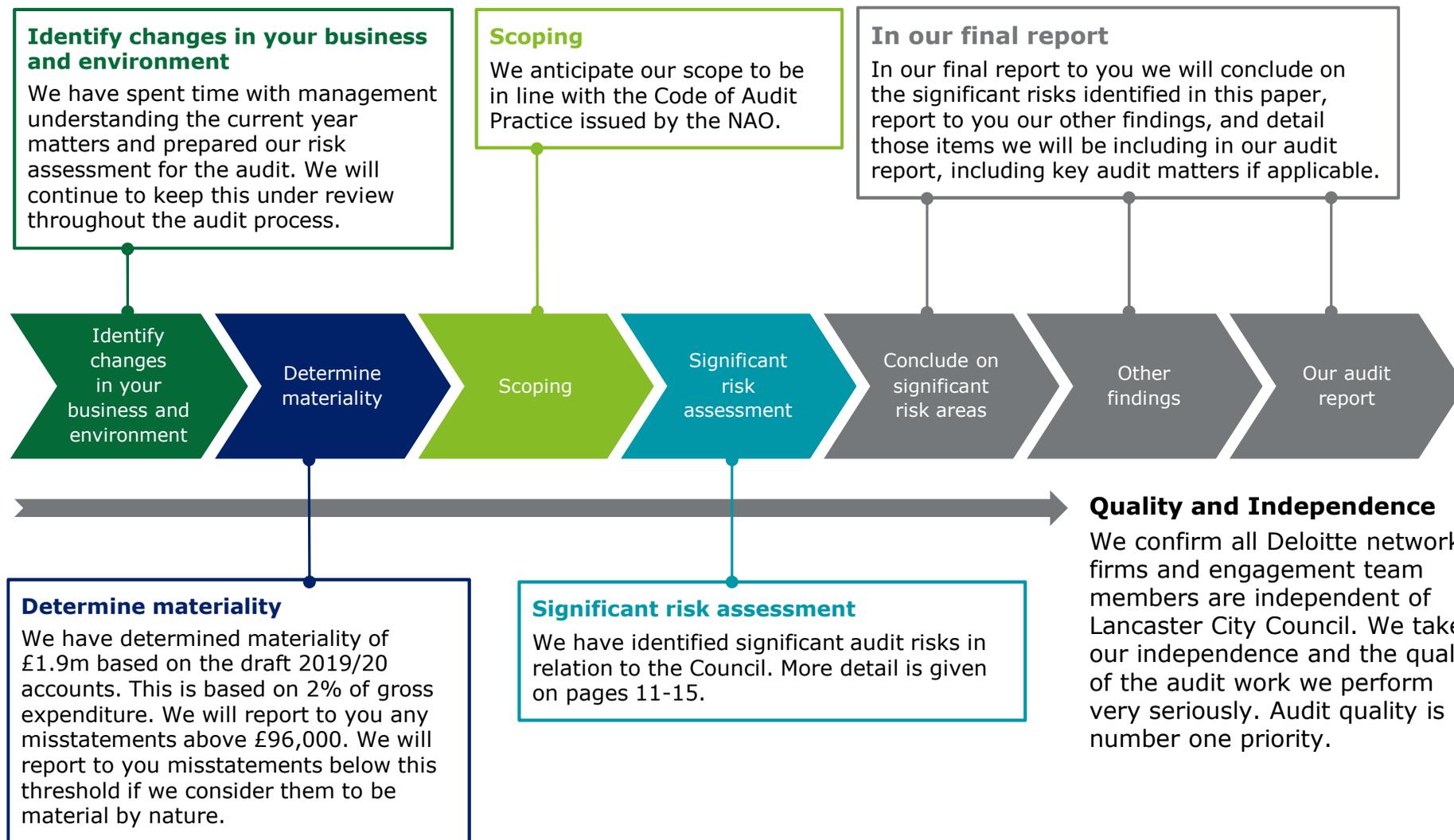


As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.



# Our audit explained

## We tailor our audit to your business and your strategy



# Scope of work and approach

## We have four key areas of responsibility under the Audit Code

### Financial statements

We will conduct our audit in accordance with the Code of Audit Practice and supporting guidance issued by the National Audit Office ('NAO') and International Standards on Auditing (UK) ('ISA (UK)') as adopted by the UK Auditing Practices Board ('APB').

The Council will prepare its accounts under the Code of Practice on Local Authority Accounting ('the Code') issued by CIPFA and LASAAC.

We report on whether the financial statements:

- Give a true and fair view of the financial position and income and expenditure; and
- Are prepared in line with the Code of Practice on Local Authority Accounting ('the Code').

### Opinion on other matters

We are required to report on whether other information published with the audited financial statements is consistent with the financial statements.

Other information includes information included in the Statement of Accounts, in particular the Narrative Report. It also includes the Annual Governance Statement which the Council is required to publish alongside the Statement of Accounts.

In reading the information given with financial statements, we take into account our knowledge of the Council, including that gained through work in relation to the Council's arrangements for securing value for money through economy, efficiency and effectiveness in its use of resources.

### Whole of Government Accounts

The National Audit Office have issued guidance in respect of the Whole of Government Accounts. Based upon this guidance we expect that Lancaster City Council will be below the threshold for detailed testing. We will confirm this through our audit work and in our final report to Those Charged With Governance

### Value for Money conclusion

We are required to provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We carry out a risk assessment to identify any risks that, in our judgement, have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. The risk assessment enables us to determine the nature and extent of further work which may be required.

We also consider the impact of findings from other inspectorates, review agencies and other relevant bodies on their risk assessment, where they are relevant and available.

**Our responsibilities as auditor, and the responsibilities of the Council, are set out in 'PSAA Statement of Responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies' published by PSAA.**

# Scope of work and approach

## Our approach

### Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

### Approach to controls testing

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").

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.

### Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council complete the Code checklist during drafting of their financial statements.

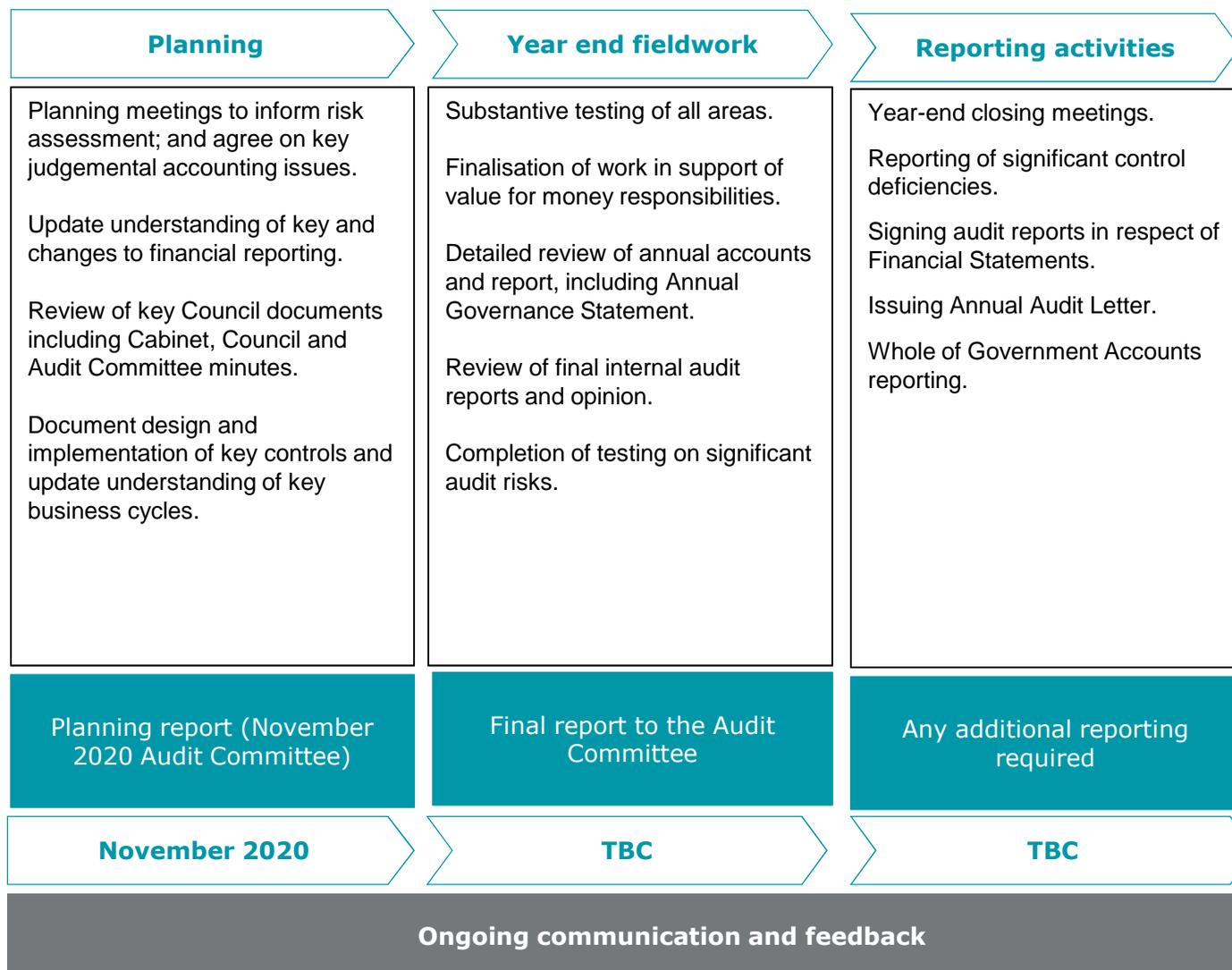
### Value for Money and other reporting

The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

# Continuous communication and reporting

## Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.



# Materiality

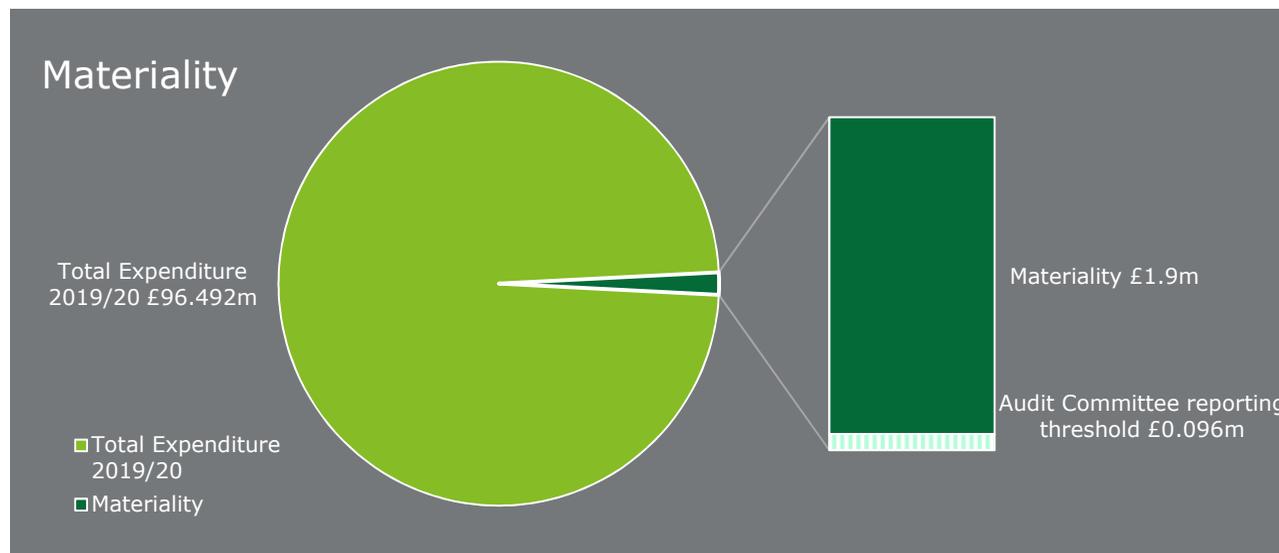
## Our approach to materiality

### Basis of our materiality benchmark

- The audit director has determined materiality as £1.9m, based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of Total Expenditure excluding expenditure on Taxation and Non-Specific Grant Expenditure based on the 2019/20 draft accounts as the benchmark for determining materiality.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of £0.096m.
- We will report to you misstatements below this threshold if we consider them to be material by nature.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

# Significant risks

## Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality; and
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements.

The next page summarises the significant risks that we will focus on during our audit.

We note however that some of the items included within note 4 of the accounts may not meet the definition as set out in IAS 1 and we invite management to critically consider this disclosure. We further suggest that management consider whether the impact of COVID-19 be included in this disclosure.

### Principal risk and uncertainties highlighted in the Annual Governance Statement

- Risk management and information governance

### IAS 1 Critical accounting estimates (note 4)

- Property Valuations
- Property, plant and equipment depreciation
- Pension liabilities
- Fair Value Measurement
- Provision for NNDR Appeals
- Provision for debtors
- Impact of Brexit on asset values and pension liability

### Changes in your business and environment

- Ongoing impact of COVID 19
- Local Government Reorganisation
- Internal Reconfiguration



# Significant risks

## Significant risk dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Management paper expected	Slide no.
Cut-off of service line expenditure			D+I			13
Property Valuations			D+I			14
Management Override of Controls			D+I			15

D+I: Assessing the design and implementation of key controls

 Low level of management judgement

 Moderate level of management judgement

 High level of management judgement

# Significant risks

## Risk 1 – Cut-off of service line expenditure

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**Risk identified**

Under UK auditing standards, there is a presumed risk of revenue recognition due to fraud. We have rebutted this risk, and instead believe that a fraud risk lies with the completeness of service line expenditure manifest through early cut off of expenditure. We identify this as expenditure excluding payroll costs, depreciation and amortisation and housing benefit expenditure as this is grant backed and for which it is judged there is no incentive for manipulation.

There is an inherent fraud risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position.

There is a risk that the Council may materially misstate expenditure through manipulating the year-end position in order to report a more favourable outturn.

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**Our response**

Our work in this area will include the following:

We will obtain an understanding of the design and implementation of the key controls in place in relation to ensuring appropriate cut-off of service line expenditure (excluding payroll, depreciation and amortisation, and expenditure which is grant backed);

We will perform focused testing in relation to the enforcement of cut-off of service line expenditure (excluding the areas set out above); and,

We will review and challenge the assumptions made in relation to year-end estimates and judgements to assess completeness and accuracy of recorded service line expenditure.

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# Significant risks

## Risk 2 – Property Valuation

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**Risk identified**

The Council held £238.4m of property assets at 31 March 2019 which, as set out in the draft financial statements increased to £239.0m as at 31 March 2020. Included within this increase are net adjustments due to valuations of £1.187m. In addition the authority hold £28.3m of investment properties which increased by £18k due to revaluations in the year.

The Audit Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years.

Furthermore the Council completed the valuation as at the 1 April 2019. Any changes to factors used in the valuation process could materially affect the value of the Council's assets as at year-end.

The level of judgement required in arriving at asset valuations, coupled with both the issues detected in the prior year and the impact of Covid – 19 on valuations completed as at 31 March 2020 leads us to conclude that there is a risk that that the value of property assets, including investment property, may be materially misstated.

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**Our response**

We will test the design and implementation of key controls in place around the property valuation, and how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation;

We will review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;

We will use our valuation specialists, Deloitte Real Estate, to support our review and challenge the appropriateness of the Council's assumptions and judgements on its assets values.

We will test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts.

Using appropriate indices we will evaluate whether assets not revalued are stated at a value materially different to their fair value.

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# Significant risks

## Risk 3 – Management override of controls

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**Risk identified**

In accordance with ISA 240 (UK and Ireland) management override of controls is a significant risk for all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions. The key judgements in the financial statements include those which we have selected to be the significant audit risks, (completeness and cut-off of service line expenditure and the Council's property valuations) and any one-off and unusual transactions where management could show bias. These are inherently the areas in which management has the potential to use their judgement to influence the financial statements.

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**Our response**

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

We will test the design and implementation of key controls in place around journal entries and key management estimates;

We will risk assess journals and select items for detailed testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest;

We will review accounting estimates for biases that could result in material misstatements due to fraud; and,

We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

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# Value for Money

## Risk assessment process

We are required to provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

The Code and supporting auditor guidance note require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk – if we do not identify any significant risks, there is no requirement to carry out further work.

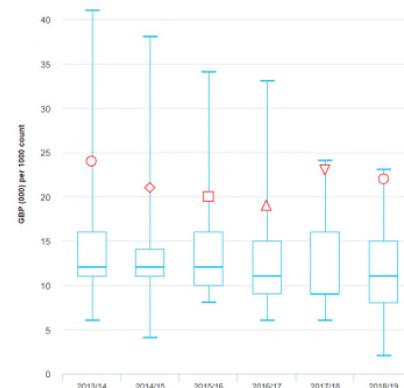
Our risk assessment procedures include:

- Reading the annual governance statement
- Considering local and sector developments and how they impact on the Council
- Reviewing the audit report from 2018/19
- Discussing issues such as the response to Covid - 19 with senior officers
- Reviewing reports issued by internal audit
- Reviewing other documentation of the Council including budget setting reports, financial and operational performance monitoring reports
- Understanding the arrangements in potential areas of significant risk
- Reviewing reports issued by regulators.

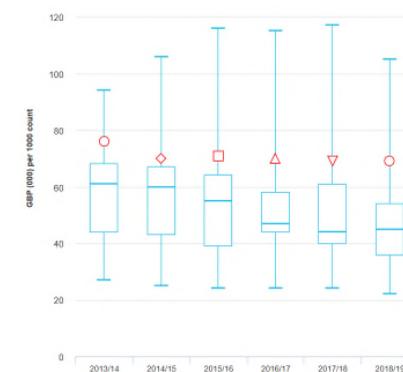
Whilst at this stage we have not identified any significant Value for Money risks certain areas of expenditure have been identified which we will investigate further as our evaluation of the risks develops. The metrics identified are;

- Total Expenditure on Council Tax Benefits and Housing Benefits Administration per head
- Total Expenditure on Culture and Sport per head

For each of these areas we will require management to provide an analysis of their understanding of the reason the Council is an outlier together with evidence that the level of spend can be considered commensurate with observed outcomes.



Council Tax Benefits and Housing Benefits Administration per Head



Expenditure on Culture and Sport per head

# Use of Auditor Powers under Local Audit and Accountability Act

## Objections to the financial statements

We are in receipt of two objections to the draft financial statements raised by electors.

Our work to date has confirmed that the objections are eligible under the terms of Auditor Guidance Note 03 and we are currently reviewing the substance of the objections to determine whether they should be accepted for further investigation.

We have made enquiries of your S151 officer, Monitoring Officer and Solicitor and will make further enquiries as necessary to conclude whether to accept these objections.

Guidance upon the process to be followed by the Appointed Auditor in respect of objections can be found in Auditor Guidance Note 04 published by the National Audit Office.

# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes our audit plan, including key audit judgements and the planned scope.

### Use of this report

This report has been prepared for the 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.

### What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

We will update you if there are any significant changes to the audit plan.

**Deloitte LLP**

Newcastle | November 2020

# Fraud responsibilities and representations

## Responsibilities explained



### Your 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.



### Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- 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.
- As set out in the significant risks section of this document, we have identified the risk of fraud in expenditure and management override of controls as key audit risks for your organisation.



### Fraud 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 will request the following to be stated in the representation letter signed on behalf of the Council:

- 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:
  - (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.]
- 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.

# Fraud responsibilities and representations

## Inquiries

We will make the following inquiries regarding fraud:



### **Management:**

- 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.
- Management's process for identifying and responding to the risks of fraud in the entity.
- 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.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

### **Internal audit**



- 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.

### **Those charged with governance**



- 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.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

# Independence and fees



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

<b>Independence confirmation</b>	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2020 in our final report to the Audit Committee.
<b>Fees</b>	Our audit fees are set out on the following page. There are no non-audit fees.
<b>Non-audit services</b>	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
<b>Relationships</b>	We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

# Fees

The professional fees expected to be charged by Deloitte in the period from 1 April 2018 to 31 March 2020 are as follows:

	2019/20	2018/19
	£	£
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment	44,959	44,959
Overrun (as approved by PSAA)	-	37,534
<b>Total audit</b>	44,959	82,493
<b>Total fees</b>	44,959	82,493



# Our approach to quality

## AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our Audit Quality Monitoring and Measuring programme. In July 2019 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2018/19 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality. We have further transformed our internal review processes including a new focus for reviewing in progress audits, developing our Audit Quality Indicators ('AQI') which are monitored and reported to the firm's executive, and on enhanced remediation procedures.

Whilst we are pleased that overall our quality record, as measured by external inspections, has improved from 76% to 84%, we remain committed to continuous improvement and achieving as a minimum the 90% benchmark across all engagements. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions. We are also pleased to see the impact of our previous actions on impairment, group audits and contingent liability disclosures reflected in the audits under review and there being limited or no findings in those areas. These continue to be a focus in our training, internal coaching and internal review programmes.

We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website.  
<https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

### The AQR's 2018/19 Audit Quality Inspection Report on Deloitte LLP

"We assessed 84% of the firm's audits that we reviewed as requiring no more than limited improvements, compared with 76% in 2017/18. Of the FTSE 350 audits we reviewed this year, we assessed 75% as achieving this standard compared with 79% in 2017/18. We note that our inspection results show only modest improvements in audit quality."

"We had no significant findings arising from our firm-wide work on internal quality monitoring, engagement quality control reviews and independence and ethics."

#### **"Our key individual review findings related principally to the need to:**

- Exercise greater professional scepticism in the audit of potential prior year adjustments and related disclosures in the annual report and accounts.
- Strengthen the extent of challenge of key estimates and assumptions in key areas of judgement, including asset valuations and impairment testing.
- Improve the consistency of the quality of the firm's audit of revenue.
- Achieve greater consistency in the audit of provisions and liabilities."

#### **"The firm has enhanced its policies and procedures during the year in a number of areas, including the following:**

- Through the firm's global audit quality programmes, there has been an increased focus on consistency of audit work across the audit practice. For certain account balances, standardised approaches have been adopted, further use has been made of centres of excellence and delivery centres and new technologies embedded into the audit process to support and enable risk assessments, analytical procedures and project management activities.
- Further methodology updates and additional guidance and training for the audit practice covering group audits, accounting estimates, financial services (including the adoption of IFRS 9) provisions and contingencies and the evidencing of quality control procedures (including EQCR) on individual audits.
- Increased support for audit teams throughout the audit cycle including coaching programmes for teams and greater use of diagnostics to monitor progress.
- Continued focus on the approach to the testing of internal controls. The firm provided additional training and support to audit teams adopting a controls-based audit approach, increased focus on reporting to Audit Committees on internal controls and on the wording of auditor's reports."



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