

Audit Approach Memorandum
South Derbyshire District Council
For the year ended 31 March 2010

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To the Audit Sub-Committee of South Derbyshire District Council

The purpose of this plan is to highlight the key elements of the audit work to be undertaken on the financial statements of South Derbyshire District Council for the year ended 31 March 2010. This report has been written for the benefit of those charged with governance, in accordance with the requirements of International Standard on Auditing (UK & Ireland) 260, and the expectations of the Audit Commission.

We set out in this report our statutory responsibilities under the Code of Audit Practice, as they relate to our responsibility to provide an opinion on the Council's financial statements and our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources.

We have considered our independence and objectivity in respect of the audit and do not believe there are any matters which should be brought to your attention. This memorandum has been prepared on the basis of the limitations set out in 'The small print'.

We look forward to working with the Council over the next year.

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The following key matters have been identified from our detailed risk assessment for our audit of the 2009-10 accounts:

- Impact of the economic climate
- SORP 2009: Accounting for NNDR and Council Tax
- Fixed asset register
- Bad Debt Provision
- Estimated claims
- Presentation and format of the accounts
- Corporate Services partnering project
- New depot

1 Financial statements

1.1 Our approach

The Council's financial statements are an essential means by which it accounts for the stewardship of resources and its financial performance in the use of those resources. It is the responsibility of the Council to:

- ensure the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintain proper accounting records; and
- prepare financial statements which present fairly the financial position of the Council and its expenditure and income in accordance with the Statement of Recommended of Practice (SORP).

We are required to audit the financial statements and to give an opinion as to:

- whether they present fairly the financial position of the Council and its expenditure and income for the period in question;
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements; and
- whether the Annual Governance Statement (AGS) has been presented in accordance with relevant requirements and to report if it does not meet these requirements, or if the statement is misleading or inconsistent with our knowledge.

Our audit approach is based on an assessment of the audit risk relevant to the individual elements of the financial statements. We focus much of our audit effort on the areas that we deem to be of highest risk of material misstatement. Our work in other areas will typically be proportionately lower than for high risk areas.

As we have now completed our work on the 2008-09 statement of accounts, we have set out below our detailed risk assessment for our audit of the 2009-10 accounts. This risk assessment, summarised in the tables below, reflects both national developments and issues as well as local risks that have emerged during the course of our 2008-09 audit. We will keep our risk assessment under review, and if necessary, amend this plan.

We will report to you in our annual report to those charged with governance (ISA260) our findings and conclusions in respect of each of the risks that we have identified at the planning stage of the audit. We plan to present our ISA260 report to the Council's Audit Sub-Committee following the conclusion of our financial statements audit in September 2010.

1.2 Key national audit matters

Issue	How we plan to respond
<p>The economic climate</p> <p>The economic client has changed significantly over the last twelve months, which has resulted in additional risks that all public sector bodies will need to consider during 2009-10 and beyond.</p> <p>In many cases the potential risks are likely to have an impact in relation to both the financial statements and the Council's ability to achieve value for money, as well as risks to financial management and financial health. Such risks include:</p> <ul style="list-style-type: none"> • reduction in capital receipts; • impairment of fixed assets due to the collapse of the property market • treasury management risks; • increased pensions deficit leading to additional costs from increased employer contributions; • increased demand for services, e.g. housing and benefits; and • increased costs of pay and price inflation. 	<p>We note that the Council's level of general reserves is currently healthy and, based on current forecasts, should remain so until 2011/12. However, as general reserves are projected to fall below the minimum level by 2012/13, with a negative balance by 2014, this potentially presents a significant risk to the Council. The risk is further enhanced as a result of the pressure on public finances at a national level, expectations for low council tax increases and access to traditional funding streams potentially being severely limited to the Council.</p> <p>We will continue to monitor the Council's financial position during 2009/10 as part of our Use of Resources assessment and will pay particular attention to future proposals for restoring financial balance to the Housing Revenue Account.</p> <p>We will also consider the impact the economic climate has had on the financial statements in when undertaking our audit procedures, particularly in relation to asset valuations and debtor recoverability.</p>
<p>SORP 2009 - Accounting for National Non Domestic Rates and Council Tax</p> <p>The 2009 SORP has introduced a number of changes in the accounting for national non domestic rates and council tax in the Council's financial statements. It now requires local authorities to account for transactions on an agency basis. i.e. the Council only discloses its own share of debtors and creditors of the Collection Fund. There is a risk that the Council does not correctly account for these changes.</p>	<p>We will discuss with the Council the new accounting requirements and will provide feedback on any changes in disclosures that are needed to comply with the SORP.</p>

Issue**How we plan to respond****Asset valuations**

FRS 11 requires the Council to formally assess its assets for indicators of impairment and assess the impact of these on the carrying value of its assets.

There is a risk that assets are not recorded in the financial statements at appropriate values, that reflect current market conditions. There is also the risk that the Council does not undertake this assessment on a timely basis to enable it to update its asset register to reflect any changes in value at the balance sheet date.

We will work with the Council to ensure that a formal assessment of impairment is undertaken to enable us to review and comment upon its appropriateness at our interim audit. We will review the Council's closedown timetable to ensure that adequate provision is made to take account of changes in asset values, so these can be accurately reflected in the draft financial statements.

1.3 Key local audit matters**Issue****How we plan to respond****Fixed Asset Register (FAR)**

During the course of our audit procedures in 2008-09, we noted that the FAR presented for audit did not directly reconcile to the Tangible Fixed Asset note presented in the Statement of Accounts. This was due to:

- the asset management system being a live system, which had been amended between the accounts figures being extracted and reports being produced for audit; and
- software issues, that were being investigated by the Council and discussed with the software provider.

There is a risk that the Council has not accurately recorded its tangible fixed assets within its Statement of Accounts as a result of not producing the relevant reports from the asset management system at the appropriate time.

We will liaise with the Council to ensure that the Council extract detailed reports, are extracted from the asset management system, breaking down each asset category when the notes to the accounts are prepared.

We will also ensure that the Council has continued to investigate the reconciliation differences identified from the first year implementation of the new asset management system.

Issue**Bad Debt Provision**

Our 2008-09 audit identified that the Council has not recently undertaken a formal review of current debt collection rates against the percentages used to calculate bad debt provisions, to ensure that they still reflect a best estimate of recoverability. Consequently there is a risk of overstatement of debtors.

How we plan to respond

We will assess the Council's review of the percentage rates applied each year to calculate bad debt provisions, against current collection patterns, to ensure the percentages remain appropriate.

In addition, we will also review the recently introduced quarterly monitoring of the provision.

Estimated Claims

Our 2008-09 audit identified that figures in the financial statements relating to subsidy income and payments due to the National Non Domestic Rates pool had been calculated on an estimated basis. The impact on the Collection Fund disclosure for Council Tax Benefit income was £38,000 and for National Non Domestic Rates was £14,000, which were not adjusted for.

We will review whether the Council has included a formal review process for final claims and returns in the accounts production process for 2009-10.

Following submission of the final claims, it is best practice for Council's to review any movement from estimates and assess the impact on the accounts.

Presentation and format of accounts

Our review of the draft 2008-09 accounts identified a limited number of disclosure and presentational adjustments.

We will provide feedback to the Council's finance team on where the format and presentation of the accounts can be improved.

We would be happy to undertake an early review of any suggested format for the Council's accounts at our interim audit.

Issue**How we plan to respond**

Corporate Services Partnering Project

The Council is currently in negotiation with two short listed bidders to outsource a range of corporate services, including the finance function. A decision on the preferred supplier is due to be made in March/April 2010, with the intention of beginning the implementation of the project in the summer of 2010.

We will continue to discuss with officers the implications of the new arrangements, as negotiations progress and are concluded.

Specifically in relation to the 2009/10 audit, we have been advised by officers that the changes should not impact on our ability to access audit evidence or key members of staff ,even though the new arrangement are expected to be implemented around the time of the final audit. We will continue to discuss this with officers. We will also consider whether adequate disclosure of the contractual obligation has been made in the 2010 Statement of Accounts.

New Depot

The Council is looking to procure a new depot as part of a wider capital transaction with a developer. The current proposal would result in the developer purchasing Council land in exchange for a new depot and a cash payment. As the transaction would be phased over a number of years, the recognition and treatment of each phase in the financial statements is more complex and increases the risk of misstatement.

We will continue to monitor progress of this project throughout the year and will include procedures in our financial statement audit to confirm the level of commitment the Council has at 31 March 2010 and whether this is appropriately reflect in statement of accounts.

1.4 International Financial Reporting Standards

CIPFA has confirmed that local authorities will be required to follow International Financial Reporting Standards from 1 April 2010. Financial data for 2009-10 will require restatement in order to provide comparative data in the financial statements.

There is a risk that the Council has not put adequate plans in place to manage this transition and collate the required information to prepare the restatement entries.

We will continue to work with the Council's finance team to ensure that arrangements are in place to prepare an IFRS transition plan and we will monitor progress against this plan throughout 2009-10 and into 2010-11. We will discuss with the Council the required accounting treatments under IFRS, where this will not compromise our independence, through sharing our experiences of IFRS transition from other public sector bodies and the commercial sector

The Use of Resources assessment considers how well organisations are managing and using their resources to deliver value for money in delivering better and sustainable outcomes for local people.

2 Use of Resources

2.1 Use of Resources assessment 2009/10

The Use of Resources assessment is undertaken by auditors as part of our responsibilities under the Code of Audit Practice. The assessment considers how well organisations are managing and using their resources to deliver value for money in delivering better and sustainable outcomes for local people.

Under this area of our responsibilities we are required to arrive at a score of 1 to 4, based on underlying Key Lines of Enquiry ("KLOEs"), for each of the following three themes:

Theme	Description
Managing finances	<ul style="list-style-type: none"> finances deliver strategic priorities sound understanding of costs financial reporting
Governing the business	<ul style="list-style-type: none"> effective procurement data quality governance internal control
Managing resources	<ul style="list-style-type: none"> natural resources workforce asset management

2.2 Value for money conclusion

The Code requires us to issue a conclusion on whether the Council has put in place proper arrangements to securing economy, efficiency and effectiveness in its use of resources, having regard to a standard set of relevant criteria, issued by the Audit Commission.

This is known as the value for money conclusion. In meeting this responsibility we will review evidence that is relevant to the Council's corporate performance management and financial management arrangements.

Where relevant work has been undertaken by other regulator we will look to place reliance on their reported results to inform this work. We will also follow up audit work from previous years to assess progress in implementing agreed recommendations.

3 Grant claims

3.1 Introduction and approach

In addition to our Code of Audit Practice responsibilities, we are required, acting as agents of the Audit Commission, to certify the Council's grant claims and returns, in accordance with the following arrangements:

- claims below £100,000 are not subject to certification;
- claims between £100,000 and £500,000 are subject to a reduced, 'light-touch' certification; and
- claims over £500,000 will be subject to a certification approach determined by the auditor's assessment of the control environment and management preparation of the specific claims.

The Council receives a significant amount of grant funding every year. We expect the following grants to require certification for 2009-10:

Reference/Name of Grant	Expected Council submission date *	Expected auditor submission date*
BEN01 Housing and council tax benefits scheme	31 May 2010	30 November 2010
CFB06 Pooling of housing capital receipts	03 July 2010	30 September 2010
HOU01 HRA subsidy return	30 September 2010	31 December 2010
HOU02 HRA subsidy base data	31 August 2010	10 October 2010
HOU21 Disabled facilities	30 June 2010	31 October 2010
LA01 National non-domestic rates return	26 June 2010	25 September 2010

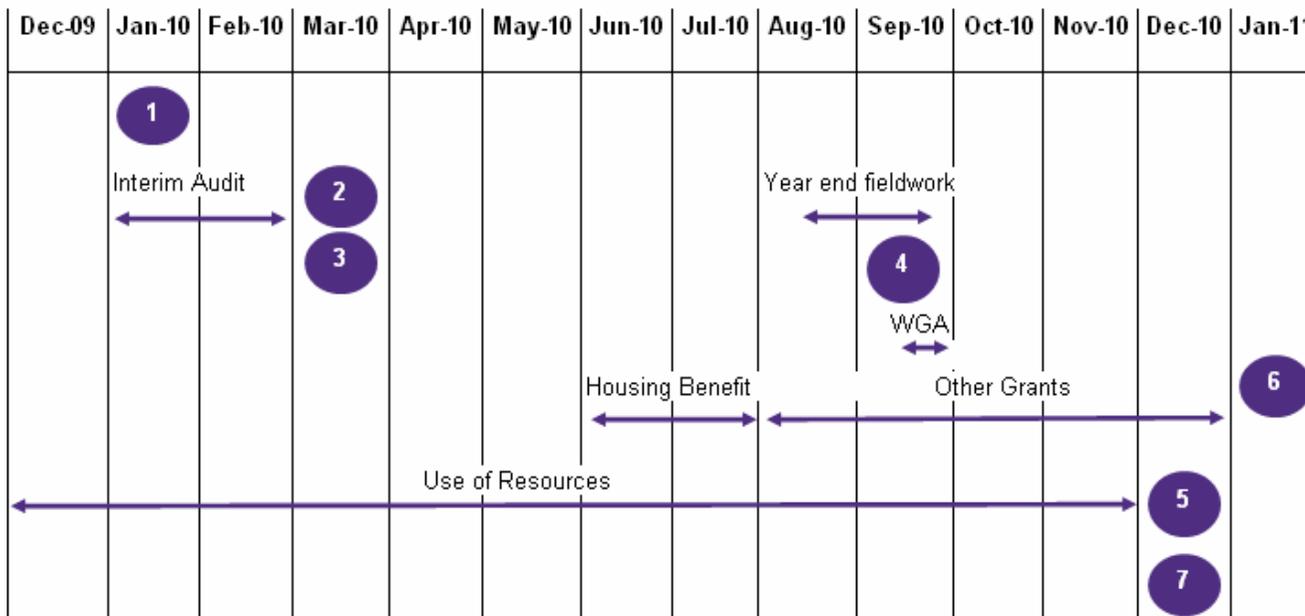
* Based on 2008-09 dates

4 Logistics

4.1 Timetables and milestones

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we closely with your team to achieve the proposed timetable set out below:

Deliverables timeline for SDDC



- Reports to be issued**
- 1 Audit Approach Memorandum
 - 2 Audit Strategy Document
 - 3 Audit requirements checklist
 - 4 ISA 260 Report
 - 5 Use of Resources Report
 - 6 Grants Report
 - 7 Annual Audit Letter

4.2 Engagement team

Our engagement team for the audit will include:

Name	Role	Contact details
Jon Roberts	Engagement partner	T: 0121 212 4000 E: jon.roberts@gtuk.com
Kyla Bellingall	Audit manager	T: 0121 232 5359 E: kyla.bellingall@gtuk.com
Ian Barber	Performance manager	T: 0121 232 5357 E: ian.m.barber@gtuk.com
Richard Moist	Assistant manager	T: 0121 232 5397 E: richard.moist@gtuk.com

The core audit team will be supported by other specialist and support staff, as necessary, during the course of the audit.

4.3 Fees

We proposed our audit fee for 2009-10 in a separate fee letter to the Council dated 30 April 2009, which was agreed with management. The agreed fee of £96,000 is in accordance with Audit Commission national fee guidance.

We have proposed this fee on the basis that:

- draft statutory accounts are presented to us by 30 June 2010 for audit, subject only to routine adjustments;
- supporting schedules for all figures in the accounts are supplied on the first day of the final audit visit, in accordance with our working papers requests documents;
- all books and records are made available to us;

- your staff are available to help us locate information and to provide prompt explanations;
- we will have access to all relevant officers as agreed; and
- all deadlines agreed with us are met.

Our ability to deliver to the agreed timetable and fee will depend upon this. If there are any variances to the above plan, we will discuss them with you and agree any additional fees before costs are incurred, wherever possible.

Any work outside the scope of this proposal will be billed separately after discussion with you.

4.4 Billing and payment schedule

Our billing and payment schedule, which reflects when we will carry out the work, will be as follows:

Billing date	Period	£ excluding VAT
March 2010	25%	24,000
June 2010	25%	24,000
September 2010	25%	24,000
December 2010	25%	24,000
Total	100%	96,000

4.5 Information required

We will issue a client arrangements letter to the Council setting out the specific information and working papers requirements for our audit. We will issue this to the Council by 31 March 2010.

'The small print' sets out the basis on which we undertake your audit.

5 The small print

Engagement terms

The purpose of this memorandum is to highlight the key elements in the proposed strategy for the audit of the Council for the year ended 31 March 2010.

The document is also used to report to management in order to meet the mandatory requirements of International Standard on Auditing (UK and Ireland) 260.

Ethical standards

We have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

Communication of adverse or unexpected findings

We will communicate any adverse or unexpected findings affecting the audit on a timely basis with the appropriate person within the business. Such communication will be made either informally or via an audit progress memorandum.

The actual or potential resolution of significant audit and accounting issues will be discussed and agreed with the division, company and group management and documented for the Audit Sub-Committee's consideration.

Audit quality assurance

We are committed to achieving and maintaining the highest quality of service. If you have any comments on our service, please contact Jon Roberts as engagement lead, in the first instance. Alternatively you may wish to contact the Audit Commission's Head

of Operations (Central) on 0121 733 7173, or Grant Thornton's National Head of Government Audit, Sarah Howard on 0113 245 5514.

We would be happy to discuss further the firm's approach to quality assurance.

Independence

We are not aware of any relationships that may affect the independence and objectivity of the audit team, which we are required by auditing and ethical standards to communicate to you. We comply with the ethical standards issued by the APB and with the Audit Commission's requirements in respect of independence and objectivity as summarised below.

Auditors appointed by the Audit Commission are subject to the Code of Audit Practice (the Code) which includes the requirement to comply with ISAs when auditing the financial statements. Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. Standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standard defines 'those charged with governance'

as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Sub-Committee. The auditor reserves the right, however, to communicate directly with the Executive matters which are considered to be of sufficient importance.

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Council invites us to carry out risk-based work in a particular area, which cannot

ISAK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected

otherwise be justified to support our audit conclusions, it will be clearly differentiated as non Code work in the plan.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Partner;
- audit staff are expected not to accept appointments as lay school inspectors;
- firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned;
- auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies, and disposal of consultancy practices and auditors' independence;
- auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission;
- auditors are expected to comply with the Commission's policy for both the Partner and the second in command (Senior Manager/Manager) to be changed on each audit at least once every five years with effect from 1 April 2003 (subject to agreed transitional arrangements);
- audit suppliers are required to obtain the Commission's written approval prior to changing

any Audit Partner/Director in respect of each audited body; and

- the Commission must be notified of any change of second in command within one month of making the change. Where a new Partner/Director or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Communication with those charged with Governance

Communication with those charged with governance is an essential element of the audit. We will discuss with the Audit Sub-Committee the scope of our work in advance. We propose that we meet with them following the conclusion of our procedures in order to communicate the matters arising

We would also be interested to hear if there are other matters that the Audit Sub-Committee would like us to address and to understand more fully the Committee's expectations and requirements from the audit process.

Responsibilities of the Council

The Council's financial statements are an essential means by which it accounts for the stewardship of resources and its financial performance in the use of those resources. It is the responsibility of the Council to:

- ensure the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintain proper accounting records; and
- prepare financial statements which present fairly the financial position of the Council and its expenditure and income in accordance with the Statement of Recommended of Practice (SORP).

Our audit approach

This plan sets out the work to be undertaken for the audit of the 2009-10 financial statements. The plan is based on the Audit Commission's risk-based approach to audit planning. It reflects:

- our Code of Audit Practice responsibilities;
- current national risks relevant to the Council's local circumstances; and
- our assessment of the Council's local risks and improvement priorities, based on outcomes of our recent audit of its 2008-09 financial statements.

Our audit strategy

We will be working closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently, with the minimum of disruption to the Council's staff.

Our audit strategy comprises:

- updating our understanding of the Council through discussions with management and Internal Audit;
- reviewing the Council's Internal Audit service, to determine whether it complies with the requirements of CIPFA's Code of Practice on Internal Audit and the extent to which we can take assurance from its work;
- reviewing the design and implementation of the internal financial control systems to the extent that they have a bearing on the highest risk areas of the financial statements;
- reviewing the adequacy of the Council's general controls in respect of its information technology (IT);
- assessing the audit risk and, based on that assessment and the assessment of the design of the internal control system, developing and implementing appropriate audit procedures;

- testing the operating effectiveness of the internal financial controls, where we consider it appropriate to rely on controls;
- reviewing the adequacy of material disclosures in the financial statements;
- maintaining regular contact with officers to discuss emerging issues and any new accounting or auditing requirements;
- verifying all material balance sheet accounts and performing analytical review of income and expenditure streams; and
- ensuring that the balances reported in the Council's Whole of Government Accounts (WGA) consolidation pack are consistent with the financial statements.

Materiality

We consider an item to be material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer present fairly the transactions, assets and liabilities of the Council.

Materiality is set at the planning stage of the audit to ensure that an appropriate level of work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than 2% of materiality will be recorded on a schedule of potential misstatements. These are assessed both individually and in aggregate, discussed with you and, if you decide not to adjust the financial statements for them, we will request that you confirm in your letter of representation to us your view that they are not material to the financial statements.

Even if an item or balance is of low value, below the level of materiality, it might be judged material because of its nature, for example any item that affects the disclosure of individuals' emoluments. Equally, an item of higher value may be judged not material if it does not distort the fair presentation of the financial statements.

Internal controls

We are required to evaluate the design of the Council's internal controls over risks, which could lead to material misstatement in the financial statements and determine whether they have been implemented effectively. Our emphasis will be on identifying and obtaining an understanding of control activities that address the areas where we consider material misstatements are more likely to occur.

We plan to carry out this work prior to the financial year end, i.e. undertake an interim audit visit in advance of when we carry out our audit of the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our audit, we identify any control weaknesses, we will report these to the Council.

In consequence, our work cannot necessarily be relied upon to disclose deficiencies or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

Use of the work of internal audit

We review Internal Audit's overall arrangements against the CIPFA Standards for Internal Audit to ensure that they are adequate to produce robust and reliable work. Where the arrangements are considered to be adequate, we can gain assurance from the overall work undertaken by Internal Audit and can conclude that, the service in itself, is contributing positively to the internal control environment and overall governance arrangements within the Council.

In accordance with professional standards and our audit approach, a comprehensive review of the Internal Audit service is only undertaken every three years, unless there is an indication that a more frequent review is required.

A full review the Council's Internal Audit service was completed in 2006-07. For 2009-10, our work will

involve reviewing the Council's progress in implementing the recommendations raised from our full assessment and ensuring that there have been no significant changes to the Internal Audit service.

In addition, where Internal Audit has completed specific work and detailed testing on an area that we have determined as representing an accounts risk to the Council's financial statements, we will review this work in detail, to establish whether we can place reliance upon the testing undertaken and the conclusions reached. Where we seek to place reliance on specific areas, we undertake re-performance work to ensure that we would have drawn the same conclusions from the testing undertaken and resultant findings. This approach ensures that we maximise the assurance gained from Internal Audit's work in addressing the risk factors we have identified from our overall review of the financial statements and minimises the duplication of audit work.

Audit of IT systems

Our audit approach requires a review of the Council's internal controls in the IT environment, as the Council uses computer systems for accounting applications that process a large number of transactions.

As in previous years, we will involve our information specialists to undertake this element of the audit.



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This proposal is made by Grant Thornton UK LLP and is in all respects subject to the negotiation, agreement and signing of a specific contract/letter of engagement.

The client names quoted within this proposal are disclosed on a confidential basis. All information in this proposal is released strictly for the purpose of this process and must not be disclosed to any other parties without express consent from Grant Thornton UK LLP