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**Appendix 2**



# Audit Findings

*Year ending 31 March 2018*

This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.

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Devon Pension Fund

Audit Committee: 27 July 2018



# Contents



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on 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 testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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# Headlines

## Introduction

The table below summarises the key issues arising from the statutory audit of Devon Pension Fund ('the Pension Fund') and the preparation of the Pension Fund's financial statements for the year ended 31 March 2018 for those charged with governance.

This Audit Findings Report summarises the audit work undertaken as at 23 July 2018. Our audit is still in progress and we will provide a verbal update to the Council's Audit Committee (as Those Charged With Governance for the Pension Fund) on 27 July 2018.

<p><b>Financial Statements</b></p>	<p>Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion:</p> <ul style="list-style-type: none"> <li>the Pension Fund's financial statements give a true and fair view of the financial position of the Pension Fund and its income and expenditure for the year, and have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting.</li> </ul>	<p>Our audit work was completed on site during June and July 2018. Our findings are summarised in section two of this report. The financial statements were prepared to a high standard and we did not identify any adjustments to the financial statements that have resulted in an adjustment to the Fund's reported financial position.</p> <p>Audit adjustments are detailed in Appendix B.</p> <p>We did identify some internal control issues relating to Member Data and this is reported in more detail on page 10.</p> <p>The recommendations for management as a result of our audit work are included in Appendix A.</p> <p>Subject to outstanding information being provided and our final queries being resolved, we anticipate issuing an unqualified audit opinion following the County Council's Audit Committee meeting on 27 July 2018, as detailed in Appendix D. These outstanding items include:</p> <ul style="list-style-type: none"> <li>- receipt of the management representation letter;</li> <li>- review of the final set of financial statements;</li> <li>- review of controls reports for some external Fund Managers which have not yet been provided to us;</li> <li>- review of the Pension Fund's Annual Report to ensure it is consistent with the financial statements;</li> <li>- review of subsequent events to the date of our opinion; and</li> <li>- final file review by a review partner; this is an additional quality assurance arrangement Grant Thornton has for key audit assignments.</li> </ul>
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## Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

# Summary

## Overview of the scope of our audit

This Audit Findings presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management. As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

## Audit approach

Our audit approach was based on a thorough understanding of the Pension Fund's business and is risk based, and in particular included:

- An evaluation of the Pension Fund's internal controls environment, including its IT systems and controls;
- Controls testing of the contributions, benefits payments and member data systems; and
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks

## Conclusion

As noted earlier, we have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion.

## Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

The table below sets out our assessment of materiality for Devon Pension Fund.

	Amount (£)	Qualitative and other factors considered
Materiality for the financial statements	£40m	This was 1% of the expected net assets of the Pension Fund.
Performance materiality	£30m	This is 75% of the above materiality.
Trivial matters	£2m	This is 5% of the above materiality.
Materiality for specific transactions, balances or disclosures	£156k	We have set a lower materiality for management costs as this is likely to be of interest to users of the financial statements. This was 1% of the investment management costs for the Pension Fund.

# Going concern

## Our responsibility

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

## Going concern commentary

### Management's assessment process

Management have considered the implications of the most recent triennial revaluation and the impact of the increase in employers' contributions to address the overall funding deficit.

Management have also considered benefits payments due in the short term and their affordability, taking into account the regular contributions received and the level of investments available to the Pension Fund.

### Auditor commentary

- We agree with management's conclusion that the Pension Fund's financial statements should be prepared on a going concern basis.

### Work performed

Detail audit work performed on management's assessment

### Auditor commentary

- We did not identify the going concern of Devon Pension Fund a material uncertainty when we undertook our initial planning.
- Future funding contributions are set by an independent actuary and deficit recovery contributions are planned in order to eliminate the funding gap. At the latest triennial revaluation the actuary calculated the funding level to be 84% and in 2017/18 deficit recovery contributions of £38m were received by the Pension Fund.
- Year on year benefits payable are in line with the contributions received and there are no short term liquidity issues.

### Concluding comments

### Auditor commentary

- We anticipate we will provide the Pension Fund with an unmodified audit report as detailed in Appendix D.
- We have nothing to report regarding management's conclusion that the Pension Fund's financial statements should be prepared on a going concern basis.

# Significant audit risks

Significant risks are those risks that have a higher risk of material misstatement and require special consideration. Significant risks often relate to material, non-routine transactions or judgemental matters.

## Risks identified in our Audit Plan

## Commentary

1

### Improper revenue recognition

Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.

This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.

### Auditor commentary

Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:

- there is little incentive to manipulate revenue recognition;
- opportunities to manipulate revenue recognition are very limited;
- The culture and ethical frameworks of local authorities, including Devon County Council as the administering authority, mean that all forms of fraud are seen as unacceptable.

Therefore we do not consider this to be a significant risk for Devon Pension Fund.

Our audit work has not identified any issues in respect of revenue recognition.

2

### Management override of controls

Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management override of controls is present in all entities.

We identified management override of controls as a risk requiring special audit consideration.

### Auditor commentary

We have undertaken the following work in relation to this risk:

- gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness;
- obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness;
- evaluated the rationale for any changes in accounting policies or significant unusual transactions; and
- reviewed any significant related party transactions outside the normal course of business.

Our audit work has not identified any issues in respect of management override of controls.

# Significant audit risks

## Risks identified in our Audit Plan

## Commentary

### 3 The valuation of Level 3 investments is incorrect Auditor commentary

Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.

We identified the valuation of level 3 investments as a risk requiring special audit consideration.

We have undertaken the following work in relation to this risk:

- gained an understanding of the Fund's process for valuing Level 3 investments and evaluated the design of the associated controls;
- challenged management regarding the categorisation of Level 3 investments;
- reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments;
- considered of the competence, expertise and objectivity of the management experts used;
- reviewed the qualifications of the experts used to value the Level 3 investments at the year end and gained an understanding of how the valuation of these investments had been reached;
- assessed the potential impact of two 'emphasis of matter' paragraphs from the external auditors in two of the sets of financial statements that supported the Level 3 investments on the values attached to those investments; and
- for all of the Level 3 investments, tested the valuation by obtaining and reviewing the audited accounts at the latest date for individual investments and agreeing these to the fund manager reports at that date; we also reconciled those values to the values at 31 March 2018 to the figures provided by the Pension Fund's custodian.

Our audit work did not identify any issues in respect the valuation of Level 3 investments.

## Reasonably possible audit risks

A risk is "reasonably possible" when the likelihood of it occurring is more than remote. Designating a risk as reasonably possible does not mean that the audit team expects to find material errors or fraud. However, it does cause the audit plan to reflect the possibility that material errors or fraud could be present.

Risks identified in our Audit Plan	Commentary
<p><b>4 Contributions</b> Contributions from employers and employees' represents a significant percentage of the Fund's revenue. We therefore identified occurrence and accuracy of contributions as a risk requiring particular audit attention.</p>	<p><b>Auditor commentary</b></p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>evaluated the Fund's accounting policy for the recognition of contributions for appropriateness;</li> <li>gained an understanding of the Fund's system for accounting for contribution income and evaluated the design of the associated controls;</li> <li>tested a sample of contributions (including deficit recovery contributions) to source data to gain assurance over their accuracy and occurrence; and</li> <li>rationalised contributions received with reference to changes in member body payrolls and the number of contributing pensioners to ensure that any unusual trends are satisfactorily explained.</li> </ul> <p>Our audit work has not identified any issues in respect of pension contributions.</p>
<p><b>5 Pension Benefits Payable</b> Pension benefits payable represents a significant percentage of the Fund's expenditure.</p> <p>We identified completeness of pension benefits payable as a risk requiring particular audit attention.</p>	<p><b>Auditor commentary</b></p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>evaluated the Fund's accounting policy for the recognition of pension benefits expenditure for appropriateness;</li> <li>gained an understanding of the Fund's system for accounting for pension benefits expenditure and evaluated the design of the associated controls;</li> <li>tested a sample of individual pensions in payment by reference to member files;</li> <li>rationalised pensions paid with reference to changes in pensioner numbers and increases applied in year to ensure that any unusual trends are satisfactorily explained.</li> </ul> <p>Our audit work has not identified any issues in respect of benefits payable.</p>



# Reasonably possible audit risks

## Risks identified in our Audit Plan

6

### The valuation of Level 2 investments is incorrect

While level 2 investments do not carry the same level of inherent risks associated with level 3 investments, there is still an element of judgement involved in their valuation as their very nature is such that they cannot be valued directly.

We identified valuation of level 2 investments as a risk requiring particular audit attention.

## Commentary

### Auditor commentary




We have undertaken the following work in relation to this risk:

- gained an understanding of the Fund's process for valuing Level 2 investments and evaluate the design of the associated controls;
- evaluated the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments;
- challenged management regarding the categorisation of Level 3 investments; and
- reviewed the reconciliation of information provided by the individual fund managers, the custodian and the Pension Scheme's own records and sought explanations for significant variances.

We asked management to change two investments (sterling deposits and foreign currency deposits) from Level Two to Level One and the financial statements were amended accordingly. Further information is included in Appendix B.

Our audit work did not identify any other issues in respect the valuation of Level 2 investments.

# Accounting policies

Accounting area	Summary of policy	Comments	Assessment
<b>Revenue recognition</b>	Contributions are accounted for on an accrual basis, not simply when payments are received.	<p>We have no issues to report over the:</p> <ul style="list-style-type: none"> <li>• Appropriateness of the policy under the relevant accounting framework</li> <li>• Adequacy of disclosure of accounting policy</li> </ul>	 Green
<b>Judgements and estimates</b>	<p>Key estimates and judgements include:</p> <ul style="list-style-type: none"> <li>• Valuation of level 3 investments</li> <li>• The assumptions within the triennial valuation and the impact this has on the Pension Fund.</li> </ul>	<p>We have no issues to report over the:</p> <ul style="list-style-type: none"> <li>• Appropriateness of the policy under the relevant accounting framework</li> <li>• Extent of judgements involved</li> <li>• Adequacy of disclosure of accounting policies</li> </ul>	 Green
<b>Other critical policies</b>		<p>We have reviewed the Pension Fund's policies against the requirements of the CIPFA Code of Practice. The Pension Fund's accounting policies are appropriate and consistent with previous years.</p>	 Green

## Assessment

- Marginal accounting policy which could potentially be open to challenge by regulators (Red)
- Accounting policy appropriate but scope for improved disclosure (Amber)
- Accounting policy appropriate and disclosures sufficient (Green)

## Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

	Issue	Commentary
1	<b>Matters in relation to fraud</b>	We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures.
2	<b>Matters in relation to related parties</b>	We are not aware of any related parties or related party transactions which have not been disclosed.
3	<b>Matters in relation to laws and regulations</b>	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
4	<b>Written representations</b>	A standard letter of representation has been requested from the Pension Fund which is included in the Audit Committee papers.
5	<b>Confirmation requests from third parties</b>	We requested from management permission to send confirmation requests to banks, fund managers and other organisations with whom the Pension Fund had short term investments. This permission was granted and the requests were sent. Most were returned with positive confirmation, however where requests were not received we undertook alternative procedures including agreement of loan repayments after the year end. There are no issues we wish to draw to the Audit Committee's attention.
6	<b>Disclosures</b>	Our review found no material omissions in the financial statements.
7	<b>Significant difficulties</b>	The financial statements were prepared to a high standard and we have provided letters of assurance to the auditors of other bodies connected with the Pension Fund. We will work with the Council and Pension Fund to identify ways in which the audit can be undertaken more efficiently in future years,
8	<b>Matters on which we report by exception</b>	We are required to give a separate opinion for the Pension Fund Annual Report on whether the financial statements included therein are consistent with the audited financial statements. We have yet to complete this work and will provide an update to the Audit Committee on 27 July 2018.

# Independence and ethics

## **Independence and ethics**

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix C.

## **Audit and Non-audit services**

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Pension Fund. No non-audit services were identified.

# Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

## Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year.

Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £' 000	Impact on total net expenditure £'000
1 There were no adjustments that affected the Pension Fund's primary financial statements.			
<b>Overall impact</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>

## Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure change	Detail	Adjusted?
<b>Investment categorisation</b>	Foreign currency deposits and short term Sterling deposits totalling £62m were reclassified from Level 2 to Level 1 investments.	✓
<b>Investment categorisation</b>	There were a small number differences between the comparative figures in the draft financial statements for 2017/18 and the audited financial statements for 2016/17.	✓

# Audit Adjustments

## Impact of unadjusted misstatements

No adjustments were identified during the 2017/18 audit which have not been made within the final set of financial statements.

There are no unadjusted errors from previous years.

# Fees

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services.

## Audit Fees

	Proposed fee	Final fee
Pension Fund Audit	28,603	28,603
<b>Total audit fees (excluding VAT)</b>	<b>£28,603</b>	<b>£28,603</b>

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA)

# Audit opinion

We anticipate we will provide the Pension Fund with an unmodified audit report

## Independent auditor's report to the members of Devon County Council on the pension fund financial statements

### Opinion

We have audited the pension fund financial statements of Devon County Council (the 'Authority') for the year ended 31 March 2018 [set out on pages 117 to 166] which comprise the Fund Account, the Net Asset Statement and notes to the pension fund financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18.

In our opinion the pension fund financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2018 and of the amount and disposition at that date of the fund's assets and liabilities;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the pension fund of the Authority in accordance with the ethical requirements that are relevant to our audit of the pension fund financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Who we are reporting to

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the County Treasurer's use of the going concern basis of accounting in the preparation of the pension fund financial statements is not appropriate; or
- the County Treasurer has not disclosed in the pension fund financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the pension fund financial statements are authorised for issue.

## Other Information

The County Treasurer responsible for the other information. The other information comprises the information included in the Statement of Accounts and Annual Governance Statement set out on pages 1 to 178, other than the pension fund financial statements, our auditor's report thereon and our auditor's report on the Authority's financial statements. Our opinion on the pension fund financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the pension fund financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the pension fund financial statements or our knowledge of the pension fund of the Authority obtained in the course of our work or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the pension fund financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.



**Opinion on other matter required by the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice)**

In our opinion, based on the work undertaken in the course of the audit of the pension fund financial statements the other information published together with the pension fund financial statements in the Statement of Accounts and Annual Governance Statement, for the financial year for which the pension fund financial statements are prepared is consistent with the pension fund financial statements.

**Matters on which we are required to report by exception**

Under the Code of Audit Practice we are required to report to you if:

- we have reported a matter in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Local Audit and Accountability Act 2014.

We have nothing to report in respect of the above matters.

**Responsibilities of the Authority, the County Treasurer and Those Charged with Governance for the financial statements**

As explained more fully in the Statement of Responsibilities for the Statement of Accounts set out on page 122, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the County Treasurer. The County Treasurer is responsible for the preparation of the Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18, which give a true and fair view, and for such internal control as the County Treasurer determines is necessary to enable the preparation of pension fund financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the pension fund financial statements, the County Treasurer is responsible for assessing the pension fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the pension fund lacks funding for its continued existence or when policy decisions have been made that affect the services provided by the pension fund.

The Audit Committee Those Charged with Governance.

**Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the pension fund financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these pension fund financial statements.

A further description of our responsibilities for the audit of the pension fund financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

Jon Roberts  
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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July 2018



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