

# Midlothian Council

## Interim Audit Report 2011-12

July 2012

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Audit Committee  
Tuesday 18 September 2012  
Item No. 7

# 1. Executive Summary

## Introduction

This report provides an update on our response to key risks from the results of interim audit work carried out to date. As part of our interim audit we have reviewed the effectiveness of Midlothian Council's core financial systems and followed up the progress in implementing recommendations agreed in prior year audit reports.

## Key Findings

Overall, we found the systems of internal financial control reviewed to be operating at a good standard. We were able to place reliance over controls tested for operating expenses and we found that controls were designed effectively within other systems that we identified as higher risk, including council tax, housing rent and arrangements for cash and bank. We identify areas for improvement within the Action Plans in **Appendices A and B** relating to:

- internal control arrangements for starters and leavers to the Payroll system
- developing a register of interests for council employees
- maintaining the independence of internal audit
- improvements to the information technology control environment.

We have agreed an action plan with the Head of Finance and HR. to implement the recommendations .

## Use of this report

This report has been prepared to advise you of the matters arising from our interim work and should not be used for any other purpose or be given to third parties without our prior written consent. Our report is part of a continuing dialogue between the Council and ourselves and should not be relied upon to detect all errors, systems or control weaknesses or opportunities for improvements in management arrangements that might exist.

The Council should assess the wider implications of our conclusions and recommendations before deciding whether to accept or implement them, seeking your own advice as appropriate.

## Acknowledgements

We would like to record our appreciation for the assistance and cooperation provided to us during our interim audit by Midlothian Council staff.

Grant Thornton UK LLP  
July 2012

## 2. Our accounts audit approach

### Introduction

This report is intended to provide additional detail regarding our audit approach, as set out in our Audit Approach Memorandum issued in January 2012, as well as an update on our response to key risks from the results of interim audit work carried out to date.

### Our responsibilities

We are required to conduct our work in accordance with Audit Scotland's Code of Audit Practice and the International Standards on Auditing (ISAs).

Accounting standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. We therefore focus our control review on the higher risk areas of the financial statements. We are also required to assess whether controls have been implemented as intended and have done this through a combination of inquiry and observation procedures, and, where appropriate, systems walkthrough tests.

As this is the first year of our audit, we completed additional testing to document each financial system and the internal controls in place.

**Table 1: The Scope of our Review of Core Financial Systems**

Key Financial System:	Audit Approach:
Housing Revenue	Systems walkthrough
Property, Plant and Equipment	Compliance testing <sup>1</sup>
Employee Remuneration	Compliance testing
Operating expenses	Compliance testing
Cash and Bank	Systems walkthrough
Council Tax	Systems walkthrough

### Note:

1

Area identified as an area for compliance testing but controls testing will be performed during final audit as the transactions are a year end process.

# 3. Core Financial Controls: Key Findings

## Introduction

All councils are required to establish and maintain effective arrangements for the proper governance of their affairs and the stewardship of resources at their disposal. The implementation and maintenance of sound systems of internal control are essential elements of robust corporate governance arrangements within an organisation. Following our initial assessment of the design and implementation of internal systems of financial control, we conducted testing on those areas that we considered to be the highest risk of material misstatement.

Overall, we found the systems of internal financial control reviewed to be a good standard with controls operating effectively. We did, however, identify a number of areas with scope for improvement which, if addressed, would further strengthen the Council's internal financial control regime. **Table 2** summarises the outcome of our audit work. The detailed findings are summarised in the following pages, and any recommendations are made within **Appendix A**.

Table 2: Assessment of the Control Environment	
Key Financial System:	Audit Assessment:
Property, Plant and Equipment	
Employee Remuneration	
Operating expenses	

Key:

	Area reviewed and no significant deficiencies highlighted.
	Area identified for improvement, refer to results of interim audit work.
	Area identified with a systems weakness which we regard as critical to operational or financial performance

## 3. Core Financial Systems

### Introduction

We have set out recommendations identified by our work in Appendix A to this report, and we report by exception below.

### Employee Remuneration

Employee remuneration is one of the key areas of expenditure for the Council. Around 43% of total expenditure in 2011-12 related to staff costs. The Council use internal controls such as policies and procedures to manage the risks relating to payroll.

### New starters

We test the controls in place over joiners to the payroll system to ensure that genuine employees are added at the right pay scale, and that this is reviewed by an authorised signatory, typically the relevant Line Manager. We selected a sample of 25 new starts but found that in five cases (20% of the sample selected) we were unable to obtain the new start form for new members of staff during 2011-12. Of those we did obtain, 6 had been signed by someone who was not authorised to do so at the time of our testing.

We conducted further testing to ensure that the employees without starter forms exist and were placed on the payroll system at the correct rate. No errors were highlighted during this work.

At the time of our review, the Payroll and HR service was undergoing a period of change and reorganisation. These changes will require a period of time to bed in but in the meantime we will use our final audit work to carry out additional testing to gain assurance on the system and the expenditure reported within the annual accounts.

**Refer to audit recommendation 1**

### Leavers

We completed similar testing on staff leavers to ensure that people who are no longer employed by the Council are removed from the payroll. In a sample of 25, we were unable to obtain the leavers form for 4 members of staff (16% of sample selected). A further 4 authorised signatories on the leavers forms tested were not on the authorised signatories list.

**Refer to audit recommendation 2**

We used further testing to ensure that all leavers were removed from the payroll system at the correct leaving date. No errors were identified during this work.

## 4. Information Technology Controls

### Information Technology Control Environment

As part of our work to document and review the control environment, our IT Audit Manager conducted a risk-based, high level review of Information System controls.

We reviewed security and access arrangements for information technology.

**Appendix B** makes a number of recommendations. The key issues arising are summarised below.

### Disaster Recovery Arrangements

The Council has its primary server room located in Midlothian House and a secondary one in Fairfield House. The distance between both locations is approximately 30 yards. Backup tapes are kept in a safe in the ground floor of Fairfield House. The proximity between the main and secondary server rooms presents a risk that both rooms might be affected by a disaster. We understand that the Council has considered, and accepted this risk. We do, however, recommend that the Council considers relocating the secondary server room and backup storage site to a more remote location.

**Refer to IT audit recommendation 1**

The Council has duplicate IT capacity for the main applications split between both server rooms. Therefore, in the event of losing one server room, applications such as Integra (Finance) or Open Revenues (Council tax) could be run from the other server room. Additionally, the Council has produced a number of business continuity plans for the Integra, ITrent (Payroll) and Open Revenues applications among others. These plans detail different disaster scenarios and contain instructions to recover the applications in the event of a major issue affecting the IT infrastructure.

We understand that these plans were reviewed by a member of IT staff to confirm the validity and completeness of the recovery procedures detailed on them. However, these plans have not been subject to further testing.

**Refer to IT audit recommendation 2**

We also understand that there is an electric generator that covers the main server room at Midlothian House in the event of a power outage. However, this generator does not cover the secondary server room in Fairfield House.

**Refer to IT audit recommendation 3**

### Access Rights

There is a facility in the Council Intranet to run reports detailing new starters and leavers. System Administrators of applications or Helpdesk staff can run these reports to identify any leavers that have not been reported through the formal channels and disable their access rights. We did, however, note that there is no formal protocol to ensure that this is carried out regularly, and we noted that a number of Systems Administrators did not have access to the function.

**Refer to IT audit recommendation 4**

We also noted that there is no regular protocol to review the network security log on a regular basis. This process should involve the definition of the events to be monitored, such as failed logon attempts or changes to user access rights. Any unusual activity on the network should be investigated and documented.

**Refer to audit recommendation 5**

## 5. Governance review

### Introduction

The Code of Audit Practice gives us a responsibility to review the council's corporate governance arrangements. The council is responsible for putting in place arrangements for the conduct of its affairs, including compliance with applicable guidance, and monitoring the adequacy and effectiveness of these arrangements in practice. The Council's Audit Committee has a key role in monitoring these arrangements, and we look forward to working with the new committee in due course. Our recommendations are summarised in [Appendix A](#).

### Internal Audit

During our interim review, we completed our detailed review of the Council's internal audit function against the good practice within CIPFA's Code of Practice for Local Government Internal Auditors.

Terms of Reference and a bespoke Audit Manual are in place to outline the role and approach of the internal audit team. We found that the service operates a risk based audit plan which takes account of corporate and service level risk registers and discussions with senior management. A cyclical approach is adopted to ensure that the council's corporate risks are regularly reviewed. The reports are clear, concise and constructive, and target timescales are set for their release and agreement.

We did, however, note that the Audit and Risk Manager continues to fulfil operational roles within the Council, including overseeing the risk management and insurance functions.

[Refer to audit recommendation 3](#)

### Register of Interests and Related Party Transactions

The International Standard on Auditing (ISA) 550, recognises that the risks of misstatement are higher when related parties are involved. The recently updated standard requires us to explicitly consider related party relationships and transactions and form an understanding of controls relevant to related parties.

As part of our review of the governance arrangements we noted that there is an updated Register of Interests for all members of the Council. The Employee Code of Conduct provides guidance on potential conflicts of interest, including those affecting close family members or people living in the same household. The Code of Conduct asks employees to inform their line manager of any potential conflicts. There is, however, scope for the Council to maintain a register of staff interests to ensure that an accurate list is in place of all interests within the Council.

[Refer to audit recommendation 4](#)

## 6. Performance

### Introduction

In accordance with our Audit Approach Memorandum, we worked with scrutiny partners to develop a Shared Risk Assessment for Midlothian Council. We have also followed up the Council's progress against a number of Audit Scotland's national performance reports. In this section we summarise our findings.

### Assurance and Improvement Plan

Under the National Scrutiny Plan for Local Government 2011-12, Scotland's scrutiny agencies work together to develop a shared risk assessment and Assurance and Improvement Plan (AIP) for each council area. During 2011-12, the Local Area Network (LAN) has followed up the progress made by the Council, both in areas identified during the Best Value audit and against specific areas of risk or uncertainty identified by scrutiny partners. The AIP Update 2012-15 highlights one significant concern relating to Housing Services. The LAN also highlight areas of uncertainty in relation to the proposed shared service for Education with East Lothian Council.

The LAN also acknowledged the Council's commitment to continuous improvement, and the plans in place to embed self-evaluation. We have not identified any additional areas of work to add to our Audit Strategy as a result of the Shared Risk Assessment process, although we will continue to monitor the Council's plans to respond to the financial climate.

### Audit Scotland's National Reports

We are asked to follow up Audit Scotland's national performance reports to ensure that the Council is aware of the issues and recommendations that they make. We consider the Council's responses to the reports around 6-12 months following publication. In Midlothian although, as we note below, we found that the Council has taken account of the national issues highlighted by Audit Scotland's work, we note that there is no formal mechanism to ensure that national reports are taken to the appropriate committee.

[Refer to audit recommendation 5](#)

### Transport for Health and Social Care

Audit Scotland produced a report on Transport for Health and Social Care in August 2011. The availability of transport is an essential part of making health and social care services work effectively together. The report found that services are generally fragmented and public sector partners are not working together effectively to deliver transport for their users, or make the best use of available resources.

In Midlothian, the council and its partners had identified transport as an area for potential improvement and efficiency savings before the publication of the report. The work in this area is being led by NHS Lothian's Strategic Transport Group. The national report has therefore supported work which was already underway at the Council. We will continue to monitor the partnership's progress in this area, particularly in relation to any success in improving outcomes for service users.

### Community Health Partnerships

In June 2011, Audit Scotland published a report on Community Health Partnerships (CHPs). CHPs were set up in 2004 with a challenging agenda. They were expected to provide certain community-based health services, bridge the gap between primary and secondary healthcare services, and improve joint working between health and social care. However, Audit Scotland found that these responsibilities did not come with the necessary authority to implement the significant changes required. As a result, the added value of the partnerships was not clear, and the report called for a fundamental review of partnership arrangements to ensure they focus on meeting individuals' needs.

Midlothian Council's Audit Committee considered the report in June 2011. It asked for a further report on Midlothian's profile to be presented to a future committee. We note that the Audit Committee has not yet received an update.

**Refer to audit recommendation 6**

### Scotland's Public Finances

In August 2011, Audit Scotland prepared a follow-up report on Scotland's Public Finances, which outlined the progress that public bodies have made in managing their reduced budgets.

The budget reductions affect revenue and capital expenditure differently, with capital budgets taking the largest cuts in percentage terms. The level of budget reduction also varies significantly among spending areas. Scottish Government funding to the local government sector has fallen by 5%, in 2011-12, whereas the health sector funding has reduced by 0.3%.

Midlothian Council recognises the challenging financial environment it faces and is clear about the projected budget gap for the next three years. The Council's Business Transformation Programme (BTP) is the key approach in place to identify efficiency savings. We will continue to monitor the success of the BTP in delivering anticipated savings.

## 6. Looking forward

### Further work planned

We have additional work planned in advance of the financial statements audit, to inform our opinion and discharge our responsibilities against the Code. We outline some of the key areas of work below.

### Revised governance arrangements

We look forward to working with the new Council, and in particular, the new Audit Committee. We will also work with the Council's internal auditors to review the arrangements in place to support an Annual Governance Statement within the Annual Accounts.

### Asset Management

We will shortly complete a review of the Council's arrangements for asset management. Detailed functional Asset Management Plans will be a key source of information for rationalisation decision making processes. We will therefore review the Council's current asset base and monitor the progress to date of the first phase of the approved Corporate Asset Management Plan. This work will be reported in our final audit report.

### Maintaining Scotland's Roads

Audit Scotland has asked us to carry out a detailed follow up review of the progress the Council has made since the publication of the *Maintaining Scotland's Roads* national report in February 2011.

We continue to work with the Roads Services Manager to assess Midlothian Council's response to the recommendations within the national report. The Council received the report in April 2011 and supported the recommendations, including the development of asset management planning, and improved performance reporting. An additional £1 million per annum was allocated to the roads maintenance budget to arrest any further deterioration in the Midlothian roads network.

We anticipate that full results of this work will be reported by 31 July 2012.

# Appendices

## A. Audit Recommendations

Number	Finding	Recommendation	Priority H/M/L	Management response	Implementation Due
<b>Employee Remuneration</b>					
1	During internal control testing on employees joining the Council we noted that a number of new start forms could not be located. In a further six cases the new start forms were signed by someone who was not authorised to do so at the time of testing.	We recommend that the Council reviews the procedures in place to add employees to the payroll to ensure that appropriate authorisation and audit trail is provided.	Medium	Using a systems thinking approach, the existing recruitment process, including placing new starts on payroll, is currently being re-designed to ensure that processes are improved in terms of quality, speed and accuracy.	30 November 2012
2	During testing, we were unable to obtain the leavers form for four members of staff. A further four authorised signatories on the leavers forms tested were not on the authorised signatories list.	We recommend that the Council reviews the procedures in place for staff leavers to ensure that an appropriate audit trail is provided.	Medium	Using a systems thinking approach, the existing leavers process will be re-designed to ensure that processes are improved in terms of quality, speed and accuracy.	31 March 2013
<b>Internal audit</b>					
3	We understand that the Risk and Audit Manager has been asked to fulfil operational roles to support the Council's development, particularly in relation to risk management. Best practice guidance indicates that the internal audit function should have no operational duties within the Council.	Revised arrangements for operational responsibilities such as managing the Council's approach to risk, and the insurance function should be made before the Risk and Audit Manager retires in February 2013.	Medium	The Head of Finance and Human Resources is currently reviewing the organisational arrangements for Risk and Audit Services. This review is ongoing. I will consider separate internal options to Audit from operational duties.	31 December 2012

## A. Audit Recommendations (continued)

Number	Finding	Recommendation	Priority H/M/L	Management response	Implementation Due
<b>Governance</b>					
4	The Council does not have a Register of Interest for members of staff.	We recommend that all Council employees within a position of authority make annual declarations with regards to their interests, even if only to confirm that he/she has no interests.	High	There is specific reference in the Standing Orders to declarations by officers which requires them, as soon as it comes to their notice that the Council has entered into a contract in which they have a pecuniary interest, to give notice in writing in the manner provided by Section 68 of the Act of 1973. In addition the Code of Conduct for Employees, together with the Register for Gifts and Hospitality is considered to provide an adequate safeguard against conflict of interests and it is not proposed to seek annual declarations. The Code of Conduct and register will be re-publicised to employees in order to ensure appropriate awareness.	30 September 2012
<b>Performance</b>					
5	There is no procedure in place to ensure that national reports from Audit Scotland are reported to the Audit Committee, where appropriate.	We recommend that the Council formalises procedures for reporting national reports and issues to the appropriate committee.	Medium	Agreed and in place	Immediate effect.

## A. Audit Recommendations (continued)

Number	Finding	Recommendation	Priority H/M/L	Management response	Implementation Due
Performance					
6	We noted that the Audit Committee had asked for a further report on the Midlothian profile of Community Health Partnerships in June 2011, but to date this has not been provided.	The Council should ensure that the Community Health Partnership is reviewed, and the findings reported to the Audit Committee. The self assessment provided in the <i>Community Health Partnerships</i> national report may be useful in completing this review.	Medium	A report will be targeted for the Audit Committee on 18 September 2012.	18 September 2012.

## B. IT Audit Recommendations

Number	Finding	Recommendation	Priority H/M/L	Management response	Implementation Due
Disaster recovery					
1	<p>The Council has its primary server room located in Midlothian House and a secondary one in Fairfield House. The distance between both locations is approximately 30 yards. Backup tapes are kept in a safe in the ground floor of Fairfield House.</p> <p>We understand that the Council is already aware of the potential implications that the proximity between both server rooms entails and that the risk as such has been accepted.</p>	<p>We recommend that the Council considers relocating the secondary server room and backup storage site to a more remote location. This location should provide adequate environmental and security conditions for hosting IT equipment and backup media.</p>	Medium	<p>Relocation of the secondary server room and backup storage site to a more remote location.</p> <p>At this time this recommendation is likely to be difficult to achieve in the short term due to significant costs and investment required. Although as part of the wider Strategic review of the Council and the Effective working in Midlothian (EWIM) project a number of options are being explored in relation to Council property which could facilitate and provide opportunities for this recommendation to be implemented in the medium to long term. These recommendations will also be discussed at the Business Continuity group and a formal decision will be taken by the Council on the preferred approach to be taken.</p>	Tied to EWiM programme, so 31 July 2017

## B. IT Audit Recommendations Continued

Number	Finding	Recommendation	Priority H/M/L	Management response	Implementation Due
Disaster recovery					
2	The Council has produced a number of business continuity plans for their IT applications. These plans detail different disaster scenarios and contain instructions to recover the applications in the event of a major issue affecting the IT infrastructure. However, these plans have not been subject to further testing.	<p>The Council should produce a test strategy for the IT business continuity plans. This document should detail the plans in scope, the disaster scenarios to be tested, and the frequency for this test.</p> <p>An incremental testing approach should be followed to ensure the complexity of the IT components tested should be increased as the testing progresses. We recommend that the recovery of critical IT components is tested at least once a year.</p>	Medium	<p><b>Test strategy for the IT business continuity plans.</b> A Test strategy will be drawn up to assist with the Implementation and ongoing management of the IT Business continuity plans and associated testing. The strategy will detail the disaster scenarios to be tested, and the frequency for the tests to be performed.</p> <p><b>Incremental testing</b> approach should be followed. IT Services already adopt an Incremental testing approach for a number of key systems but due to the number of systems and the time and resource required the chosen systems are prioritised for testing and various walk through and scenarios are tested at that time and associated amendments and revisions are made to Supporting documentation.</p> <p><b>We recommend that the recovery of critical IT components</b> is tested at least once a year. Noted but please also refer to points 2 &amp; 3 above which confirms the current approach taken by IT Services. This will be reviewed and discussed with the Business continuity group.</p>	30 November 2012

## B. IT Audit Recommendations Continued

Number	Finding	Recommendation	Assessment	Management response	Implementation Due
Disaster recovery continued					
3	<p>We also understand that there is an electric generator that covers the main server room at Midlothian House in the event of a power outage, but this generator does not cover the secondary server room in Fairfield House.</p> <p>We also noted that the fire extinguisher in the Fairfield server room was last serviced in 2008. There is a risk that a fire may not be efficiently dealt with.</p>	<p>We recommend that both the primary and secondary server rooms should be serviced by an electric generator as this would greatly assist the recovery of IT operations in the event of a power outage.</p> <p>All fire extinguishers should be regularly serviced in line with health and safety guidelines.</p>	Medium	<p><b>Primary and Secondary server rooms</b> should be serviced by an electric generator. A number of options are currently being explored and a report will be prepared for the Business continuity group and a decision made on the best available options noting the financial constraints and pressures on the Council at this time. These recommendations will be raised and discussed at the business continuity group and appropriate actions will be agreed.</p> <p><b>Fire extinguisher</b> Call has been logged with campus maintenance for Fire Extinguisher to be replaced – 11/07/2012. Confirmation has now been received that new Fire extinguisher has been ordered 12/07/2012 John Blake. Awaiting confirmation when new extinguisher in place.</p>	<p>If approved by Business Continuity group, likely to be tied in with EWiM so 31 March 2017.</p> <p>30 September 2012</p>

## B. IT Audit Recommendations Continued

Number	Finding	Recommendation	Assessment	Management response	Implementation Due
Access Rights					
4	<p>There is a facility in the Council Intranet to run reports detailing new starters and leavers. System administrators can run these reports to identify any leavers that have not been reported through the formal channels and disable their access rights. Only members of the "workgroup-new-starters-leavers" group in Active Directory are able to run these reports. However, we noted that 11 System Administrators of the Integra, Open Revenues and Tribal K2 (Fixed Assets) applications were not included in that group and therefore, they would not be able to run these reports.</p>	<p>The list of members of the "workgroup-new-starters-leavers" group should be reviewed on a regular basis to ensure that it includes all system administrators within the Council.</p> <p>Members of this group should be reminded of running the leavers report at least on a weekly basis. System administrators should disable the access accounts in the applications under their remit for any employees on that report.</p>	Low	<p>This Active Directory group "workgroup-new-starters-leavers" has been reviewed and appropriate membership of this group verified for completeness and accuracy at this time.</p> <p>A wider communication will be sent out to all nominated IT Business System Administrators making them aware of the New Starts and Leavers reporting facility and for this to be reviewed on a weekly basis.</p> <p>The system administrators will be reminded of the requirement to disable access to these accounts within their Business Applications for any employees on the Leavers report. IT Services actively monitor these reports and disable Network Access for all Leavers as soon as notified.</p> <p>It also needs to be noted that the Leaver information is dependent upon the HR Leaver process and the associated quality and timeliness of the information being updated on the Primary system.</p>	30 September 2012

## B. IT Audit Recommendations Continued

Number	Finding	Recommendation	Assessment	Management response	Implementation Due
Access Rights continued					
5	We noted that there is no regular process to review the network security log on a regular basis. We understand that this is due to the size of this log and insufficient human resources. There is a risk that unauthorised activity on the network may go undetected.	<p>We recommend that the Council develops a protocol to review the network security log on a regular basis.</p> <p>This protocol should provide a definition of the events to be monitored (failed logon attempts or changes to user access rights) and the frequency for this review. Any unusual activity on the network should be reviewed and documented. The Council may consider the use of a software tool to assist IT staff in the analysis of this log.</p>	Low	Midlothian IT Services recognise the concerns highlighted by the report in relation to the Network Security log but at this time do not have sufficient funds to secure the required Software tools to help with the analysis and reporting of any such incidents. In response to this recommendation a report will be prepared to seek funding from the Councils Management team to procure and implement the required Software tools to help with the management and review of the Network Security log. The implementation date assumes funding granted. Noting that other controls and checks are also in place to minimise the impact of this type of incident.	29 June 2013

## B. IT Audit Recommendations Continued

Number	Finding	Recommendation	Assessment	Management response	Implementation Due
Access Rights					
6	We noted that the Head of IT Infrastructure and the Head Of Customer Services were members of the "Corporate IT Development" group in Active directory. However, these two members of staff do not work in the IT Development team. Members of this group have system administrator access to the database supporting the ITrent application (Payroll). There is a risk that unauthorised access to data managed by the ITrent application could be gained.	Membership of the "Corporate IT Development" group in Active Directory should be revalidated to ensure that it is granted to users that require it to fulfil their job duties.	Medium	The membership of this Active Directory group "Corporate IT Development" will be reviewed and appropriate membership validated and verified to ensure that unauthorised access to data managed by the Itrent Application is not compromised.	31 August 2012



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