



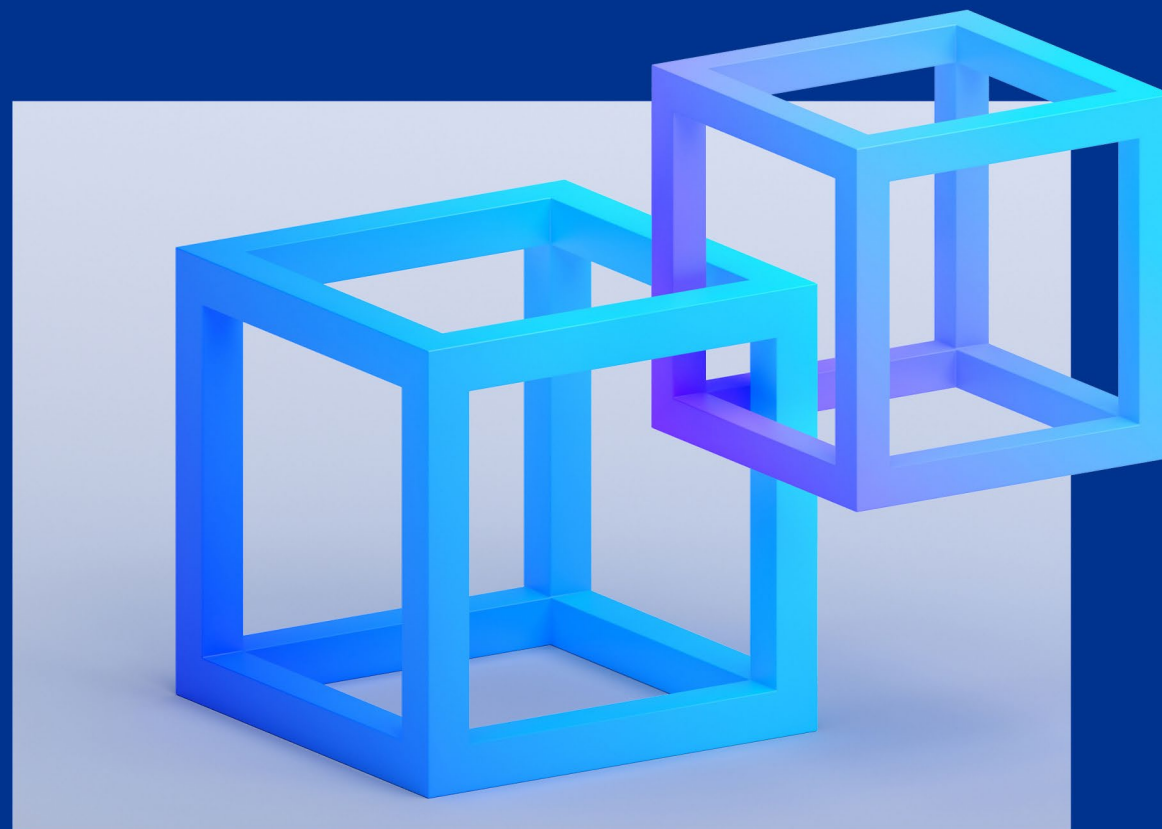
# Scottish National Investment Bank plc

Report to the Audit Committee

Audit plan and strategy for the year ending 31 March 2025

Report date: 15 November 2024

Meeting date: 25 November 2024



# Important notice

## **This report is presented under the terms of the Audit Scotland letter of appointment.**

Circulation of this report is restricted.

The content of this report is based solely on the procedures necessary for our audit.

## **Purpose of this report**

This Report has been prepared in connection with our audit of the consolidated financial statements of Scottish National Investment Bank plc (the 'Company') (and its subsidiaries (the 'Group')), prepared in accordance with International Financial Reporting Standards ('IFRSs') as at and for the year ended 31 March 2025. This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ('the Code').

This report is for the benefit of Scottish National Investment Bank plc ('SNIB') and is made available to Audit Scotland, the Auditor General and the Scottish Government, as a body (together 'the Beneficiaries'). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, although we are aware that others may read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

## **Restrictions on distribution**

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

# Introduction

## To the Audit Committee of Scottish National Investment Bank plc

I am pleased to have the opportunity to meet with you on 25 November 2024 to discuss our audit of the consolidated financial statements of Scottish National Investment Bank plc (SNIB), as at and for the year ending 31 March 2025.

This report outlines our preliminary risk assessment and planned audit approach. We note that at the time of writing, we are in the early stages of planning our audit and will communicate any significant changes to the Audit Committee at the year end. Our risk assessment procedures remain alert to changes in the organisation and environment and we will communicate any significant changes to the planned audit approach subsequently. I provide this report to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

## Scope definition

Audit Scotland has appointed KPMG LLP as auditor of SNIB in accordance with the Public Finance and Accountability (Scotland) Act 2000.

In addition to responsibilities under our appointment by Audit Scotland, SNIB has appointed us as auditor of its two subsidiaries – Scottish Investments Limited and Scottish Investments Services Limited. We will provide separate planning independence confirmation for the subsidiary audits at a later date.

We will also perform work in accordance with the wider responsibilities embodied in the Code of Audit Practice approved by the Commission and the Auditor General (see pages 24-28)

## The engagement team

I am delighted to have taken over from Phil Merchant as engagement partner on the audit. I will be responsible for the audit opinion. I have over 13 years of experience with KPMG in the financial services industry and this will be my first year signing the audit opinion.

Other key members of the engagement team include Megan Fuller (Director) and Stephen Fisher (Senior Manager) with 10 and 17 years of experience respectively in the financial services industry.

Yours sincerely,



Hannah Walsh

15 November 2024

## How we deliver audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define 'audit quality' as being the outcome when audits are:

- Executed consistently, in line with the requirements and intent of applicable professional standards within a strong system of quality controls and
- All of our related activities are undertaken in an environment of the utmost level of objectivity, independence, ethics and integrity.

We depend on well planned timing of our audit work to avoid compromising the quality of the audit. This is also heavily dependent on receiving information from management and those charged with governance in a timely manner. As you are aware, we will not issue our audit opinion until we have completed all relevant procedures, including audit documentation.

### Restrictions on distribution

This report is intended solely for the information of those charged with governance of the Group and the report is provided on the basis that it should not be distributed to other parties; that it will not be quoted or referred to, in whole or in part, without our prior written consent; and that we accept no responsibility to any third party in relation to it.

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# Overview of planned scope including materiality



## Our materiality levels

We determined materiality for the consolidated financial statements at a level which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. We used a benchmark of total assets which we consider to be appropriate given the sector in which the entity operates, its ownership and financing structure, and the focus of users.

We considered the qualitative factors noted above when determining materiality for the financial statements as a whole.

To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of materiality (£11,180k or 75% of materiality) driven by our expectations of a normal level of undetected or uncorrected misstatements in the period. We also adjust this level further downwards for items that may be of specific interest to users for qualitative reasons, such as directors' remuneration.

### We will report misstatements to the audit committee including:

- Corrected and uncorrected audit misstatements above £745k (parent company £730k).
- Errors and omissions in disclosure (corrected and uncorrected) and the effect that they, individually and in aggregate, may have on our opinion.
- Other misstatements we include due to the nature of the item.

## Control environment

The impact of the group control environment on our audit is reflected in our planned audit procedures. Our planned audit procedures reflect findings raised in the previous year and management's response to those findings.

We will continue to assess the impact of the current economic conditions on processes and controls, which may result in subsequent changes in our audit approach.

We will execute a substantive audit approach as the most effective and efficient method of addressing the identified risks of material misstatement. We will test the design and implementation of controls over journal entries and investment valuation processes.

## Group Materiality

	Group
Materiality for the consolidated financial statements as a whole	<b>£14.9m</b> (2024: £12.9m 2.5% of total assets)
Materiality at 1 component in-scope for the Group audit (SIL-audited by group auditor). We will audit to the lower of component and statutory materiality	<b>£1.49m</b> (2024: £12.64m)
Misstatements reported to the audit committee	<b>£745k</b> (2024: £645k)

## Company Materiality

**£14.6m**

2.5% of Company total assets £582m

(2024: £12.9m)



# Overview of planned scope including materiality (cont.)



## Timing of our audit and communications

We will maintain communication led by the engagement partner, director and senior manager throughout the audit. We set out below the form, timing and general content of our planned communications:

- Audit committee meeting on 25 November 2024 where we present our initial audit plan;
- Status meetings with management throughout the duration of our audit where we communicate progress on the audit plan, any misstatements, control deficiencies and significant issues; and
- Audit committee meeting at the completion stage of the audit where we communicate the findings of our work, any audit misstatements and significant control deficiencies.

We plan to perform our audit work as follows:

- Planning and risk assessment will be completed prior to year end, allowing us to perform interim procedures over income and journal entries;
- As in the prior year, we expect to commence our risk assessment and testing on unlisted investments earlier in the cycle to allow us to provide an interim update to the Audit Committee in May; and
- Remaining substantive procedures will be performed from April to June.

The year end timetable, including signing of financial statements has been discussed but is yet to be agreed with management.

## Key changes to our audit

Key changes to our audit arising from changes in your business and its environment include

- *Impact of the restructuring of the Group during the year* – during the period under audit, all investment holdings have been transferred from a subsidiary, SIL, into SNIB plc. Management have provided a pre-transaction accounting and tax impact summary of the restructuring event. We note that the investments have been transferred at a valuation date of 31 August 2024. We are considering management's assessment of the accounting impact of the transfer, and work surrounding asset valuation at that point during the year. Our risk assessment is ongoing but we have highlighted a new risk on our audit risk map for the parent company to reflect this area.
- *Unit of account* – management are required to assess how a market participant would transact for each individual investment. We will consider management's assessment and how this has been applied. Note we have held discussions on this with management over the course of the year and await their documented analysis to consider.

## Wider scope

The Code of Audit Practice has four areas used to define the wider audit scope. These are financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes.

Our audit will take the above areas into account in its execution.

## Revenue recognition – rebuttal of fraud risk

Professional standards require us to presume, unless rebutted, that the fraud risk from revenue recognition is a significant risk. We do not believe there is a fraud risk related to revenue recognition because the calculation of revenue is non-complex and non-judgmental.

## Impacts of climate risk and new ESG/climate change disclosures

We will evaluate management's assessment of the potential financial implications of climate risk on the financial statements, including estimates and disclosures.

As part of our procedures on other information, we will obtain and read your ESG/climate change disclosures. We will consider whether there is a material inconsistency between this information included in the annual report and the financial statements with our knowledge obtained in the audit.

## Reporting on regularity of expenditure and income

We will perform procedures to support our opinion on the regularity of expenditure and income in the financial statements as noted in the audit report.

# Overview of planned scope including materiality (cont.)



## Our fees

We are discussing our audit fees including those surrounding the investments ownership changes in the period with management, the Audit Committee and Audit Scotland. Upon completion of those discussions, we will share our finalised fee proposal with the Committee in writing.

## Using the work of others and areas requiring specialised skill

We outline below where, in our planned audit response to audit risks, we expect to use the work of others or require specialised skill/knowledge to perform planned audit procedures and evaluate results. If circumstances arise during the audit that cause us to widen the scope or to involve additional specialists, we will communicate this at the completion stage.

Others	Extent of planned involvement or use of work
<b>KPMG Tax specialist</b>	Tax specialists will be engaged to support the audit of the current tax computation.
<b>KPMG iRadar Valuation Specialist</b>	Testing the valuation of a risk-based selection of unlisted debt investments by reperforming management's calculation/independently reprojecting the calculations.
<b>KPMG Credit Risk Assurance (CRA) – Credit rating specialist</b>	Credit Risk Assurance (CRA) team will support us in assessing the credit rating applied by management for a risk-based selection of unlisted debt investments.
<b>KPMG Data &amp; Analytics (D&amp;A) specialist</b>	D&A team will be engaged to support analysis of journal entries analysis based on high-risk criteria.

# Significant risks and Other audit risks



Our preliminary risk assessment draws upon our historic knowledge of the business, the industry and the wider economic environment in which the group operates.

We also use our regular meetings with senior management to update our understanding.

The risk map shows the identified significant risks and other areas of audit risks, subject to the completion of our risk assessment procedures. Administrative expenses were highlighted as an other area of audit risk in the prior year. At planning, this balance is no longer material to the Group and as such not considered a risk of material misstatement. Interest income recognised to-date is driving operating profit for the Group, and is included as an other area of audit risk.

Our audit report will include details of our findings in relation to significant financial statement audit risks and key audit matters.

## Significant risks

Management override of control is a significant risk that professional standards require us to assess in all cases.

Valuation of unlisted investments is considered to be a significant risk due to significant estimation uncertainty around the valuations and further complexity in relation to macroeconomic factors.

As noted on page 5, we are in the process of performing risk assessment over the accounting and tax impact of the novation of investment holdings from SIL to SNIB plc. The inclusion on the risk map reflects our preliminary assessment that there is a significant risk for the parent company in relation to the impacts of the intra-group transfer of investments. We will share a detailed risk description and our audit approach once finalised.

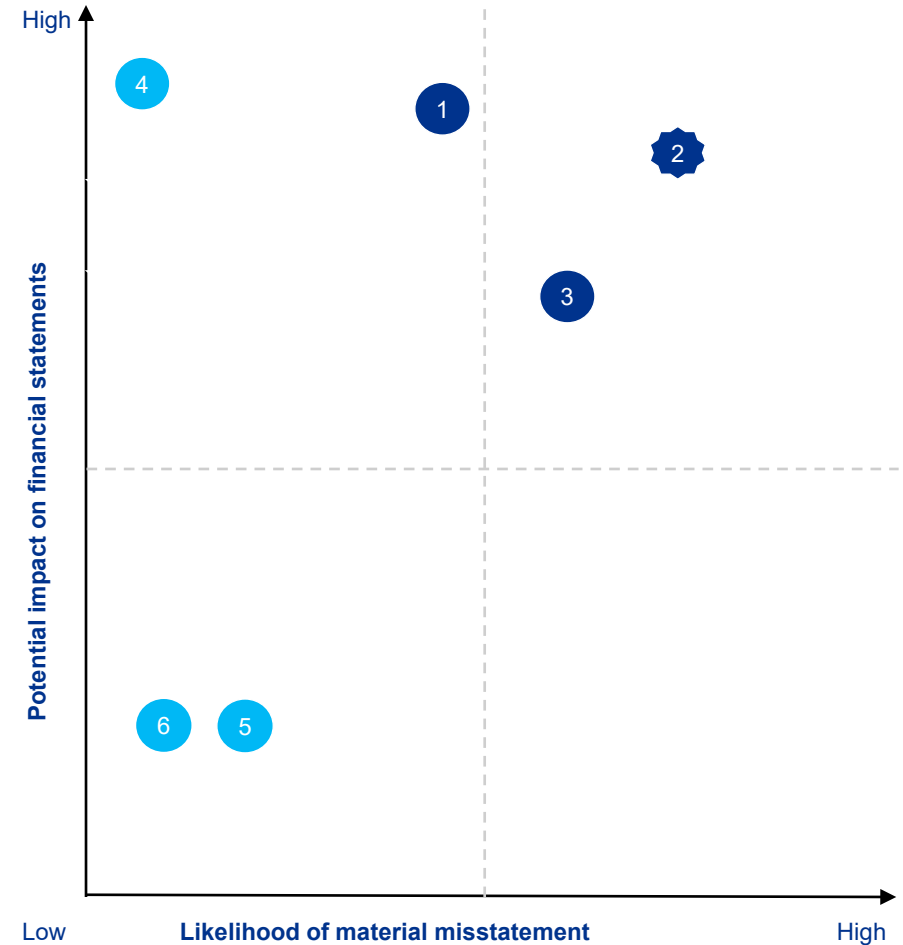
### Significant risks

1. Management override of controls
2. Valuation of unlisted investments (Key audit matter)
3. New: Accounting for intra-Group transfer of investment holdings (Company only)

### Other areas of audit risks

4. Going concern
5. New: Interest income
6. Cash

- Key:**
- # Significant financial statement audit risks
  - # Higher assessed risk or Other audit risk
  - Change compared to prior year
  - # Key audit matter and significant financial statement audit risk
  - # Key audit matter



# Significant risks



## 1 Management Override of Controls(a)

Fraud risk related to unpredictable way management override of controls may occur

Change vs prior year



### Significant audit risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management of any company is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- Other than potential for management bias on investment estimates, we have not identified any specific additional risks of management override relating to this audit.



### Planned response

- Our audit methodology incorporates the risk of management override as a default significant risk.
- In line with our methodology, we will test the design and implementation of controls over journal entries and post-closing adjustments, as well as the design and implementation of relevant controls within the unlisted valuation process. As reported in prior year, we identified a control deficiency whereby amendments could be made to existing journals within Access Financials after approvals for posting to the ledger with no further review or approval documented. We will perform inquiries and a walkthrough of the process to assess if the deficiency remains. If the deficiency remains open, in line with the prior year we will perform a detailed risk assessment to understand the types of transactions affected and design our audit response.
- We will set high risk criteria for specific journals to test substantively. If any journals meet these criteria, we will examine supporting documentation for each entry.
- We will assess the appropriateness of changes to the methods and underlying assumptions used to prepare accounting estimates.
- We will assess the appropriateness of the accounting for significant transactions that are outside the Group's normal course of business, or are otherwise unusual as applicable. At planning, we understand that there has been an intra-Group asset transfer that would qualify as a significant transaction.

# Significant risks (cont.)



## 2 Valuation of unlisted investments

Risk that the carrying value of unlisted investments is materially misstated

Change vs prior year



### Significant audit risk and key audit matter

- The Group's portfolio of unlisted investments makes up 94% (2024: 97%) of the total assets (based on the draft trial balance as at 30 September 2024). Unlisted investments are measured at fair value, which is established in accordance with the International Private Equity and Venture Capital Valuation Guidelines by using measurements of value such as prices of recent orderly transactions, earnings multiples and net assets.
- The valuation of unlisted investments has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.



### Planned response

- **Methodology choice:** In the context of observed industry best practice and the provisions of the International Private Equity and Venture Capital Valuation Guidelines, we will challenge the appropriateness of the valuation basis selected.
- **Our valuations experience:** We will challenge the directors on key judgements affecting investee company valuations, such as the choice of benchmark for earnings multiples where relevant, their consideration of milestones and analysis of progress against these, credit risk assessments and use of appropriate discount rates. We will compare key underlying financial data inputs to external sources, investee company audited accounts and management information as applicable and available. We will challenge the assumptions around sustainability of revenue or earnings based on the forecasts of the investee companies and whether these are achievable and we will obtain understanding of milestones completed during the year. We will also challenge the key assumptions of credit ratings and credit spreads used to determine discount rates, used in the discounted cash flow valuations that determine fair values of loans. Our work will include consideration of events which occur subsequent to the period end up until the date our audit report.
- **Comparing valuations:** Where a recent transaction is used to value a holding, we will obtain an understanding of the circumstances surrounding the transaction and vouch the price to supporting documentation. We will also assess whether subsequent changes or events such as market or entity specific factors would imply a change in value.
- **Assessing transparency:** We will consider the appropriateness, in accordance with relevant accounting standards, of the disclosures in respect of unlisted investments and the effect of changing one or more inputs to reasonably possible alternative valuation assumptions.

We will perform risk assessment procedures to determine the level of audit testing required over each asset in the portfolio. This will incorporate any risk assessment prepared by management as well as consideration of the nature and size of each investment in the context of the overall portfolio.

# Other areas of audit risks



4

## Going Concern

Ability of the business to continue as a going concern

Change vs prior year 



### Other audit risk

- Management's assessment of the Group's ability to continue as a going concern involves consideration of all factors affecting the group.
- There is a risk that management's assessment of the Group's ability to continue as a going concern does not appropriately consider the impact of all external factors, including plausible but severe downside scenarios on the income and carrying value of assets.
- The risk that disclosures in the financial statement and the annual report are not adequate with regard to the effect of key risks to the financial position, performance, business model and strategy.



### Planned response

- Evaluate how management's risk assessment process identifies business risks relating to events and conditions that may cast significant doubt on the ability to continue as a going concern.
- Evaluate any models management uses in its assessment and evaluate how the information system captures events and conditions that may cast significant doubt on ability to continue as a going concern.
- Evaluate whether management's assessment has failed to identify events or conditions that may cast significant doubt on going concern and whether the method used by management is appropriate.
- We will inspect a letter received by the Directors indicating the Scottish Government's intention to provide ongoing support and will assess the business reasons why the Scottish Government may or may not choose to provide this support.
- Assess management's going concern assessment including the plausible but severe downside scenarios particularly whether those downside scenarios reflect plausible external impacts on the business.
- Evaluate whether sufficient and appropriate audit evidence has been obtained to conclude whether a material uncertainty exists and the appropriateness of management's use (or otherwise) of the going concern basis of accounting.
- Evaluate whether there is adequate support for the assumptions underlying management's assessment, whether they are realistic and achievable and consistent with the external and/or internal environment and other matters identified in the audit.

# Other areas of audit risks (cont.)



## 5 Interest income

Income may be materially misstated

## 6 Cash

Cash balances may be materially misstated

Change vs prior year



### Other audit risk

- Interest income earned through debt investments could be recorded in the incorrect period, at the incorrect amount (accuracy), or not recorded at all (completeness).



### Planned response

- We will recalculate the investment income earned on debt investments in line with the terms and conditions stipulated in the investment agreements. We will investigate any differences above our misstatement reporting threshold.
- We will agree investment income receipts for a selection of debt investments to bank statements.



### Other audit risk

- Cash balances, as reported by management, may not be complete or accurate, or the company may not have the rights to ownership of the bank accounts



### Planned response

- All year end cash balances recorded in the financial statements will be agreed to third party confirmations received independently. We will investigate any reconciling items above our misstatement reporting threshold.
- We will substantively test the period-end bank reconciliation.


# Group audit – Revised requirements



ISA (UK) 600 (Revised): Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) is effective for periods commencing on or after 15 December 2023. Given the relatively non-complex Group structure, this is not expected to significantly impact our approach year-on-year but we include the below for completeness.

## Key Changes

## Impact on our audit

<p><b>Risk-based approach</b></p>	<ul style="list-style-type: none"> <li>• More granular risk assessment, and greater emphasis on the group auditor’s overall responsibility for identifying and assessing the risks to the group financial statements (group FS).</li> </ul>	<ul style="list-style-type: none"> <li>• We lead the identification and assessment of risks to the group FS with involvement from component auditors as appropriate. <b>Consequently, the nature of risk assessment procedures we perform has changed and their extent has increased.</b></li> <li>• The approach to identifying and assessing risks to the group FS is more consistent, and risks are more clearly linked to the components in which they arise (see page 13).</li> </ul>
<p><b>Approach that is more responsive to risks to the group FS</b></p>	<ul style="list-style-type: none"> <li>• New requirement for the group auditor to take overall responsibility for determining the nature, timing and extent of audit procedures to be performed to respond to risks to the group FS.</li> </ul>	<ul style="list-style-type: none"> <li>• We lead the design of the response to risks to the group FS with involvement from component auditors as appropriate, which means a more targeted, consistent response to identified risks to the group FS. (see pages 12-13, 21).</li> <li>• We exercise more judgment in determining the components at which audit work will be performed and the type of work performed. Compared to the prior year, there is no change to the number of components at which audit work will be performed, and we have changed the type of work performed on the financial information of some components in scope.</li> <li>• As we are prescribing required work at a more granular level, there may be increased work for component auditors, particularly in year one, to align the requirements of the group audit and local statutory audits.</li> </ul>
<p><b>Enhanced quality management</b></p>	<ul style="list-style-type: none"> <li>• Enhanced leadership, direction, supervision and review responsibilities of the group engagement partner to proactively manage and achieve audit quality in a group audit.</li> </ul>	<ul style="list-style-type: none"> <li>• We determine the resources needed to perform the group audit, including the nature, timing and extent to which component auditors, as appropriate are to be involved in audit work at components. When making this judgement, we evaluate whether we can be sufficiently and appropriately involved in the work of component auditors.</li> </ul>
<p><b>Strengthened communication</b></p> 	<ul style="list-style-type: none"> <li>• Reinforcing/strengthening requirements for more robust and frequent communications and interactions between the group auditor and component auditors during the audit.</li> </ul>	<ul style="list-style-type: none"> <li>• Interactions and two-way communications between the group and component auditor, as appropriate are strengthened, including in relation to our respective responsibilities and how these will be met; relevant ethical requirements, including independence standards; determining the competence and capabilities of the component auditor as appropriate; and determining the nature and extent of our involvement in their work.</li> </ul>

# Group audit

● KPMG group auditor  
 ● KPMG component auditor  
 ● Other component auditor



## Overview of the work to be performed at components

Significant risks	1	2	3	
Management override of controls	●	●	●	See page 8
Valuation of certain unlisted investments	●			See page 9
<b>Other areas of audit risks</b>				
Going concern	●			See page 10
Interest income	●	●		See page 11
Cash	●	●	●	See page 11

S.No	Entity
1	Scottish National Investment Bank plc (Parent)
2	Scottish Investments Limited (SIL) (Component)
2	Scottish Investments Services Limited (SISL) (Component)

# Mandatory communications



Type	Statements
<b>Management’s responsibilities (and, where appropriate, those charged with governance)</b>	<p>Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error.</p> <p>Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.</p>
<b>Auditor’s responsibilities</b>	<p>The Audit Scotland letter of appointment and Code of Practice and our subsidiary engagement letters communicate our responsibilities to form and express 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.</p>
<b>Auditor’s responsibilities – Fraud</b>	<p>This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.</p>
<b>Auditor’s responsibilities – Other information</b>	<p>The Audit Scotland letter of appointment and Code of Practice and our subsidiary engagement letters communicate our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.</p>
<b>Independence</b>	<p>Our independence confirmation letter on page 17 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm’s independence and the integrity and objectivity of the audit engagement partner and audit staff.</p>

# Audit timeline



We have developed our audit timeline based on management’s financial reporting timetable. If we need to make significant changes to the audit timeline below, then we will communicate the reasons to you on a timely basis.

Activity	2024		2025						
	Nov	Dec	Jan	Feb	March	April	May	June	July
Risk assessment and planning	■								
Interim testing (income and journal entries)		■							
Detailed risk assessment of accounting estimates		■							
Year-end audit fieldwork						■			
Procedures on financial statements/annual report								■	

# Appendix

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# Confirmation of independence



**We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.**

To the Audit Committee members

## **Assessment of our objectivity and independence as auditor of Scottish National Investment Bank Plc and its subsidiaries (“the Group”)**

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP’s objectivity and independence, the threats to KPMG LLP’s independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP’s objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

### **General procedures to safeguard independence and objectivity**

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values;
- Communications;
- Internal accountability;
- Risk management; and
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

### **Independence and objectivity considerations relating to the provision of non-audit services**

We have not provided any non-audit services to the Group.

### **Application of the FRC Ethical Standard 2019**

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

We confirm that as at the date of this document we are not providing any non-audit or additional services that required to be grandfathered.

### **Confirmation of audit independence**

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the Group and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP



# KPMG's Audit quality framework



**Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.**

To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.

## ■ Commitment to continuous improvement

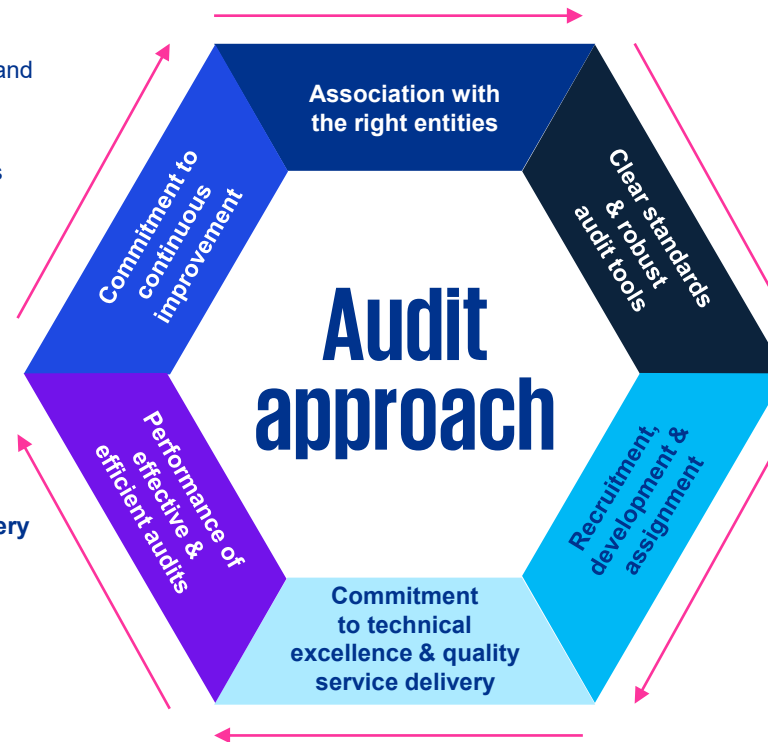
- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

## ■ Performance of effective & efficient audits

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

## ■ Commitment to technical excellence & quality service delivery

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights



## ■ Association with the right entities

- Select entities within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

## ■ Clear standards & robust audit tools

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

## ■ Recruitment, development & assignment of appropriately qualified personnel

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

# Newly effective accounting standards



Standards	Expected impact				Effective for years beginning on or after		Early adoption permitted
	High	Moderate	Low	None	01 Jan 2024	1 Jan 2025	
Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)				○	✓		✓
Classification of liabilities as Current or Non-Current and Non-current Liabilities with Covenants (Amendments to IAS 1 Presentation of Financial Statements)			●		✓		✓
Supplier Finance Arrangements (Amendments to IAS 7 and IFRS 7)				○	✓		✓
Lack of exchangeability (Amendments to IAS 21)				○		✓	✓
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures) *				○			✓
UK legislation on international tax system reform (BEPS)				○	✓		✓
IFRS S1** General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2** Climate-related Disclosures			●		✓		✓

\* The effective date for these amendments was deferred indefinitely. Early adoption continues to be permitted.

\*\* The implementation and the effective dates of IFRS® Sustainability Disclosure Standards are subject to local regulation

# IFRS 17 for corporates: Summary of key changes



## Summary and background

**Many corporates have, knowingly or unknowingly, applied IAS 37 provision accounting to their insurance arrangements. This often resulted in zero accounting. Whilst this was acceptable last year, it is no longer acceptable under IFRS 17.**

**It is not always obvious which contracts may meet the definition of insurance contracts and the effect of IFRS 17 may be extensive.**

**The accounting for contracts in scope of IFRS 17 will be much more challenging compared to IFRS 4.**

**Transition to IFRS 17 will impact our audit approach. We have summarised the main changes, where we see insurance contracts issued by corporates and suggested next steps.**

## What impact will the transition to IFRS 17 have on corporates?

IFRS 17 applies to insurance contracts regardless of whether they are issued by insurers or corporates.

IFRS 17 contains more detailed and complex prescriptive guidance for identification, recognition, measurement and disclosure of insurance contracts.

Identification of insurance contracts that are in scope of IFRS 17 is becoming more complicated.

Previously corporates were allowed to measure insurance contracts at management's best estimate of the costs required to settle the obligation, which often was zero. IFRS 17 will require the application of more complex models to measure liabilities. Whilst this will no longer be zero it may be relatively low.

IFRS 15 scopes out contracts within the scope of IFRS 17. It is possible that certain contracts considered to be IFRS 15 service contracts meet the definition of insurance contracts and therefore IFRS 17 applies. Entities should be aware of the indications that an insurance contract exists. Whilst this is not expected to be common we have identified a number of examples in corporates.

## Where could corporates encounter insurance contracts or insurance components?

Here are a few examples where corporates may find insurance contracts:

- Financial guarantees provided by parent to subsidiary lenders (although IFRS 9 can be applied to these arrangements)
- Extended warranties issued by entities who were not the manufacturer, dealer or retailer in connection with sale of goods and services
- Performance guarantees, retention bonds, performance maintenance guarantee
- Self-insurance through captive insurance entities
- Certain service contracts where (i) there is a variable element of the fee arrangement, (ii) which is based on performance measures that could be affected by adverse event, that (iii) could lead to a loss. This may occur in thin margin contracts with significant variable fees.

## Where could corporates encounter insurance contracts or insurance components?

If corporates are issuing insurance contracts, these still might not be accounted for under IFRS 17 if they meet a scope exclusion granted by IFRS 17. Some scope exclusions are mandatory and other scope exclusions are optional, or applied only when certain criteria are met.

IFRS 17 also provides guidance on whether a non insurance component can be separated from an insurance contract, for example, separating an IFRS 15 service contract component from an insurance contract.

Some insurance contracts may be eliminated or excluded at the consolidation level.

## Approaching the implementation of IFRS 17

Corporates need to assess whether they have issued any insurance contracts as defined in IFRS 17.

To determine this, the key questions are:

- Is there a contract between the issuer and the policyholder?
- Is there a significant pre-existing insurance risk, which may be a non-financial risk specific to a party?
- Is there an uncertain future event that would adversely affect the holder?
- Does the contract compensate the policyholder if the event occurs?
- Do any of the scope exclusion apply?

Entities risk underestimating the complexity of IFRS 17, both technical and operational, and the effort that will be required in identification of insurance contracts, further assessment of mandatory and optional exclusions, separation of non-insurance components.

As your auditors, it is critical that we are involved throughout your transition to IFRS 17 journey. Engaging with you at an early stage on the key accounting decisions and judgements will avoid late surprises.

# Group audit

## Overview of the work to be performed at components

### Projected FY25 results

**£30.6m** 

Extrapolated P1-6 consolidated revenue

 59% vs 2024

**£595.5m** 

Consolidated assets

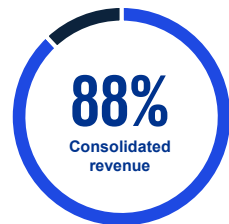
 15% vs 2024


**£14.2m** 

Extrapolated P1-6 consolidated profit before tax

 203% vs 2024

### Audit procedures performed to respond to risks to Group FS



-  Audit
-  Specified audit procedures
-  No risks to group FS identified

### Auditor performing work to respond to risks to Group FS



-  KPMG group auditor
-  Other component auditor

# Controls reporting by companies: this year and into the future



On 22 January 2024, the FRC published their [2024 UK Corporate Governance Code](#) which incorporated the change to the future of internal controls reporting.

The board already has responsibilities to monitor the effectiveness of internal controls and report in relation to these in the annual report however as the demand for high quality, transparent and reliable reporting increases, so does the demand for efficient and reliable internal controls, this message is strengthened in the proposed amendments to the Corporate Governance Code.

## ***What are the current requirements in respect of an entity's internal controls?***

The current **UK Corporate Governance Code 2018** ("the Code") already requires the board to:

- establish an effective risk management and internal control system;
- monitor and review the effectiveness of the risk management and internal controls system and;
- report on this process and assessment within the annual report including any incremental improvements that a Company is making;

The risk management and internal control system considered by the Board is broader than those risks and controls relating to financial reporting. It should cover operational, financial and compliance controls as well as the board response to its principal risks and mitigations, such as cyber, bribery and corruption compliance.

## ***Why is it important?***

Over half of FTSE 350 and Small Cap companies provide a statement of effective internal controls or that no weaknesses or inefficiencies identified\* that does not mean that there are no non-performing controls. There is increasing focus on the articulation in the Annual Report as to how the Board has arrived at such an assessment.

Reporting on the steps taken by the board to review its risk management and internal control systems provides shareholders and other stakeholders with assurance that the company has taken active steps to assure the efficiency and resilience of these systems. By doing this, it also increases confidence in the company's capability to identify and manage risks effectively and allows investors to make informed decisions.

## ***What is the future of internal controls reporting?***

On 22 January 2024, the FRC published their [2024 UK Corporate Governance Code](#) which incorporated the change to the future of internal controls reporting. Whilst the 2024 code will apply to accounting periods beginning on or after 1 January 2025, this 'new' internal controls element will not be applicable until periods beginning on or after 1 January 2026.

Principle O has been amended to make the board responsible for both establishing and maintaining the effectiveness of the risk management and

internal control framework.

Regarding monitoring and reviewing internal controls (Provision 29), the Code's existing expectations remain - namely that the Board should monitor the company's risk management and internal control framework and, conducting an annual review of its effectiveness. However, the FRC now requires Boards to explain through a declaration in their Annual Reports how they have done this and their conclusions.

The declaration and description of ineffective material controls relate to the balance sheet date, deviating from the proposed "throughout the reporting period and up to the date of the annual report". It is also worth noting that "material controls" include financial, operating, reporting, and compliance controls, including both financial and non-financial reporting.

The FRC emphasises the board's role in determining what constitutes "material internal controls," recognising variations in business needs and the differing maturity levels of non-financial controls across businesses. The Board is tasked with deciding the appropriate maturity level for its business and the required assurance for control effectiveness.

## ***What is the auditor's responsibility in respect of the Board's assessment of internal controls?***

The board's assessment of controls is much wider than internal controls relevant to the audit, therefore the auditor's consideration under ISA (UK) 315 (Revised July 2020) will be narrower in scope. The auditor is therefore not expected to assess whether all risks and controls have been addressed by the directors or that risks are satisfactorily addressed by internal controls.

However, given these disclosures are included within the narrative reporting, auditors are required by ISA (UK) 720 to perform such procedures as are necessary in the auditor's professional judgment to identify material inconsistencies or material misstatements within these disclosures and our knowledge obtained during the audit or the disclosures in the financial statements.

# Establishing best practice for risk management and internal controls: Principle 0 of the UK Code requires the board to establish the company's risk management procedures



## Board's responsibilities for risk management and internal control

The board has responsibility for an organisation's overall approach to risk management and internal control by

- ensuring the design and implementation of appropriate risk management and internal control systems that identify the risks facing the company and enable the board to make a robust assessment of the principal risks;
- determining the nature and extent of the principal risks faced and those risks which the organisation is willing to take in achieving its strategic objectives (determining its "risk appetite");
- ensuring that appropriate culture and reward systems have been embedded throughout the organisation;
- agreeing how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or their impact;
- monitoring and reviewing the risk management and internal control systems, and management's process of monitoring and reviewing, and satisfying itself that they are functioning effectively and that corrective action is being taken where necessary; and
- ensuring sound internal and external information and communication processes and taking responsibility for external communication on risk management and internal control.

## Establishment of the risk management and internal control systems

The risk management and internal control systems encompass the policies, culture, organisation, behaviours, processes, systems and other aspects of a company that, taken together:

- facilitate its effective and efficient operation by enabling it to assess current and emerging risks, respond appropriately to risks and significant control failures and to safeguard its assets;
- help to reduce the likelihood and impact of poor judgement in decision-making; risk-taking that exceeds the levels agreed by the board; human error; or control processes being deliberately circumvented;
- help ensure the quality of internal and external reporting; and
- help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.

A company's systems of risk management and internal control will include: risk assessment; management or mitigation of risks, including the use of control processes; information and communication systems; and processes for monitoring and reviewing their continuing effectiveness.

## Monitoring and review of those systems

The board should define the processes to be adopted for its on-going monitoring and review, including specifying the requirements, scope and frequency for reporting and assurance.

Regular reports to the board should provide a balanced assessment of the risks and the effectiveness of the systems of risk management and internal control in managing those risks.

The board should form its own view on effectiveness, based on the evidence it obtains, exercising the standard of care generally applicable to directors in the exercise of their duties.

Annual review should consider:

- the company's willingness to take on risk (its "**risk appetite**"), the desired culture within the company and whether this culture has been embedded;
- the **operation of the risk management and internal control systems**, covering the design, implementation, monitoring and review and identification of risks and determination of those which are principal to the company;
- the integration of risk management and internal controls with considerations of strategy and business model, and with business planning processes;
- the changes in the nature, likelihood and impact of principal risks, and the company's ability to respond to changes in its business and the external environment;
- the extent, frequency and quality of the communication of the results of management's monitoring to the board with an assessment of the effectiveness of controls.

## Board's related financial and business reporting responsibilities

The process of monitoring and review is intended to allow the board to conclude whether the systems are properly aligned with strategic objectives; and satisfy itself that the systems address the company's risks and are being developed, applied and maintained appropriately.

Effective monitoring and reviewing the risk management and internal control systems by the board should be articulated within the annual report. The required disclosures are:

- reporting on the principal risks facing the company and how they are managed or mitigated (as required by the Companies Act 2006 (the "Companies Act") and the UK Corporate Governance Code 2018 ("UK Code"): Provision 28);
- reporting on whether the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due (as required by the UK Code: Provision 31);
- reporting on the going concern basis of accounting (as required by accounting standards and the UK Code: Provision 30); and
- reporting on the review of the risk management and internal control system (as required by the UK Code: Provision 29), and the main features of the company's risk management and internal control system in relation to the financial reporting process (as required under the UK Listing Authority's Disclosure and Transparency Rules: 7.2.5).

# Audit Scotland Code of Audit Practice



The Code of Audit Practice sets the framework for public audit in Scotland. It outlines the responsibilities of external auditors appointed by the Auditor General for Scotland and the Accounts Commission and describes the scope of public audit in Scotland. This is set out on the following pages.

The 2021 Code of Audit Practice has four areas used to define the wider audit scope. These are financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes. Any updates to the Code will be reflected and communicated at the completion of our audit.

Our audit will take the above areas into account in its execution.

## Responsibilities of management

### Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

# Audit Scotland Code of Audit Practice (cont.)



## Responsibilities of management

### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

### Corporate governance arrangements

Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.

### Financial position

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and their future use;
- how they plan to deal with uncertainty in the medium and longer term; and
- the impact of planned future policies and foreseeable developments on their financial position.

### Best Value, use of resources and performance

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

# Audit Scotland Code of Audit Practice (cont.)



## Responsibilities of auditors

### Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  - suitability and effectiveness of corporate governance arrangements; and
  - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

# Audit Scotland Code of Audit Practice (cont.)



## Responsibilities of auditors

### General principles

This Code is designed such that adherence to it will result in an audit that exhibits these principles.

### Independent

When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.

Our independence confirmation letter (page 16) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

### Proportionate and risk based

Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self-evaluation evidence when assessing and identifying audit risk.

### Quality focused

Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

# Audit Scotland Code of Audit Practice (cont.)



## Responsibilities of auditors

### Coordinated and integrated

It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.

### Public focussed

The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm's-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.

### Transparent

Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.

### Adds value

It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement where significant risks are identified.

# 2024 AQR results

The FRC published reports on the findings of AQR and QAD 2023/24 inspection of KPMG and the other large firms (which largely covered years ending between June 2022 and May 2023) on 30 July 2024



Percentage of our audits rated 'good' or 'limited improvements required' by AQR



KPMG audits rated 'good' or 'limited improvements required' by QAD

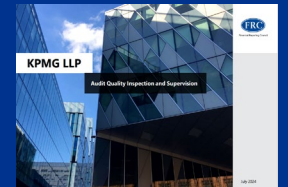


Proportion of AQR scope audit engagements reviewed

Key findings	Our response	Good practice identified
<p><b>Estimates</b></p> <p>"Improve the quality and consistency of the audit of estimates, particularly for impairment assessments and expected credit loss provisions."</p>	<p>Increased specialist support and a dedicated impairment triage process, together with additional training and guidance and improvements to our work papers are reducing the findings we have in this complex topic and leading to areas of good practice.</p>	<p>At an engagement level areas of good practices were identified including:</p> <ul style="list-style-type: none"> <li>• Risk assessment and planning including lease accounting and inventory;</li> <li>• Challenge of management;</li> <li>• Use of specialists;</li> <li>• Group audit oversight;</li> <li>• Testing of controls; and</li> <li>• Challenge by the Engagement Quality Control Reviewer.</li> </ul>
<p><b>Risk Assessment</b></p> <p>"Improve the quality and consistency of risk assessment and response to internal control deficiencies."</p>	<p>We've enhanced our risk assessment procedure library and issued a standard work paper for teams to use when they identify findings related to GITCs and take a substantive approach to the audit as a result to make sure the impact on of these findings on the audit approach is well documents. Risk assessment has been a core part of our audit university for 2024 to respond to these findings.</p>	<p>Good practices were identified in various areas at the firm level including independence monitoring, training and methodology and the single quality plan and quality initiatives.</p>

The Audit Quality Review (AQR) team of the Financial Reporting Council (FRC) undertakes independent inspections of the overall quality of the audit work of those UK audit firms that audit listed and other major public interest entities. The AQR inspections involve a number of file reviews at each firm visited. The result of these file reviews are summarised into three main categories as follows:

- Good or limited improvements required;
- Improvements required;
- Significant improvements required





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