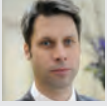


# Completing the puzzle: integrating tax into operational change



## Our roundtable guests:



**Ulrich Borgne**  
CFO, GE Healthcare UK & Ireland



**Stuart McDougall**  
Head of UK TESC, KPMG



**Philip de Klerk**  
CFO, INEOS Olefins & Polymers



**Chris O'Shea**  
Finance director, Europe & Central Asia,  
BG Group



**Steve Dunkerley**  
Project director and associate editor,  
*FDE*



**Erik ter Horst**  
CFO, EMEA and Latin America, BT  
Global Services



**Michael Jones**  
Editor, *FDE*



**Andrew Underwood**  
Partner, KPMG



**Terry McConnell**  
Group head of finance operations,  
British American Tobacco



**Robert van der Zalm**  
CFO aluminium, BHP Billiton



# Completing the puzzle

At a recent roundtable, hosted by KPMG in partnership with *FDE*, eight leading CFOs gathered to discuss their views on how organisations can take a renewed approach to driving business transformation programmes through the integration of commercial and tax considerations.

Co-hosted by KPMG's Andrew Underwood and Stuart McDougall, who are experienced in tax efficient supply chain management (TESCM), and led by *FDE*'s Michael Jones and Steve Dunkerley, the aim of the meeting was for representatives to be able to share their insights and learn from the experiences of others.

In the slow-growth economy, multinational companies are looking to embed sustainable, cost-efficient operating models to stay ahead of the competition and release funds for future growth. And the integration of TESCM into these corporations' business transformation programmes means they are able to implement operational and tax improvements, leading to increased efficiency and reduced risk.

CFOs from companies including BHP Billiton, GE Healthcare, BT and Ineos were keen to discuss the business drivers underpinning successful TESCM programmes as well as the challenges that have been faced as businesses attempt to change their models, touching on subjects such as procurement, operational simplification and the impact of the downturn.

For Underwood and McDougall, the key message to get across was that business transformation on both a global and regional scale must be as much an operations-driven change as a tax optimisation exercise.

As multinational corporations expand their global footprints and business models are restructured, decisions have to be made about the degree to which operations should be centralised. At an *FDE* roundtable hosted by KPMG, and attended by finance leaders from BAT, Ineos, GE Healthcare, BG Group, BT and BHP Billiton, it became clear that, in order to achieve successful business transformation, commercial and operational considerations must join together with the tax piece to complete the puzzle.



**Michael Jones, *FDE*:**

How important is it to achieve a balance between operational and tax decisions?

why there's so much interest; business models are evolving and operations are developing.

**Stuart McDougall, *KPMG*:**

We see it very much as an operations-driven change with tax optimisation. And I think that's very different from if you go back 15-20 years when it was tax-driven and, if you were lucky, you might implement some operational change to make it all stack up. I think there's been a big step change and that's

**Erik ter Horst, *BT*:**

Within BT Global Services there is reorganisation ongoing, but not a lot of that is tax driven. So there's a difference between operational changes – how we change the business – and what the implication is on the tax side.

**Michael Jones:**

But for many of your businesses, the country in which you operate

can be advantageous in terms of tax. Can you discuss this further?

### **Chris O'Shea, BG Group:**

The reality is that most of our production and manufacturing business is site specific; our plant and equipment is not mobile. It's got to be where the oil and gas is. And often because of that, we, as an industry, possibly don't think as broadly about how we can optimise our tax position with regards to the supply chain as other industries.

Often there is a separate tax code for natural resources businesses in a country. We have a large tax bill and we try to ensure that tax is involved in a lot of business decisions to make sure we structure our business optimally. I'd like to hear how that works in other businesses.

### **Terry McConnell, British American Tobacco:**

From the beginning of this year we decided to centralise our management of capital expenditure across the operations function. We did this because innovation is a key pillar of our marketing strategy and our investment in innovative technologies is an increasing amount of our overall spend, so we wanted to have more visibility and control over this.

To facilitate this we tiered our factories in terms of performance, forecast future market dynamics and trade blocs,

and used this analysis to determine where we were likely to invest in the future. That way we have been able to focus our spend and also aim for it to be as tax efficient as possible.

### **Erik ter Horst:**

There is a difference between the investment decision you as BAT are taking and the way investments decisions are taken within BT. A large part of our investment decisions are



Erik ter Horst.

customer-driven; if BAT wants a connection somewhere we need to have that connection available.

That's a struggle for a company like BT in terms of the balance between centralisation and speed of customer installations. My personal opinion

is that control is good but it shouldn't limit your operational ability and be balanced between these views.

### **Steve Dunkerley, FDE:**

So how is it possible to get a balance between what you're trying to do organisationally and what you want to do fiscally?

### **Terry McConnell:**

We've probably all experienced a situation where we've done things fiscally but it's got ahead of what we're trying to do operationally. This doesn't usually work as the two have to go hand in hand.

In our industry, given that the indirect taxes we pay make up

60-80% of the cost of our product, we've always tried to ensure that if we're doing any type of reorganisation that impacts our tax payments, that we prepare a business case with which we can go to the relevant tax authorities and explain to them what benefit they will be getting from the change.

In my experience, the doors are usually open. And that's always been the BAT way; we've never wanted to do anything that would surprise our stakeholders, including the tax authorities. In some parts of the world, say, within Western Europe, transfer pricing concepts have been around for about 20 years so when you're dealing with the tax authorities there, you tend to find that they've already had experience with what you're trying to implement.

In emerging markets where these concepts are relatively new, you have to invest the time to help the authorities understand what's being proposed. This may take more time but we find this approach is ultimately worthwhile.

### **Erik ter Horst:**

Did you make an internal evaluation after say ten years about whether it really brought the benefits? My feeling is that if you look at the longer run, the benefits are limited and the advice you pay to these kinds of guys offsets the benefit you will see.

### **Terry McConnell:**

There are a lot of people who are sceptical of the sustainability. The key is that you can't just reorganise for tax reasons alone – there has to be a real organisational change behind it

with clear financial benefits. As long as you do that, the benefits are sustainable. Where we've reduced the number of factories or made improvements to our supply chain, those benefits are usually clear to all involved. And then you look at the fiscal optimisation of those benefits. That approach has ensured that the benefits have been sustainable in our case. If you can't sustain the underlying levers of the change and maintain the financial benefits of such, however, you will usually lose the fiscal benefit over time.

### **Stuart McDougall:**

And I think that's where we see the difference. If you look back ten years, people concentrate on transfer pricing changes and doing something that doesn't really impact anything other than profits. But the ones that are making a difference now, the bigger programmes that are really developing value, include a programme for operational transformation. Tax should never be driving the project because the minute that happens, there's something fundamentally wrong with it.

If that's the biggest benefit you're getting, there's something wrong. We're seeing many more programmes – whether it's driving cost savings or revenue growth – where there's a tax strategy on top giving additional value that pays for other elements of the programme.



Chris O'Shea.

### **Terry McConnell:**

In BAT we have been engaging with tax authorities in the countries in which we operate in regards to longer-term tax excise strategies for some time.

And we've also been open to engagement with other stakeholders due to the health consequences of our product. That's why we always try to do

things that we believe will be sustainable. Doing things for the short term isn't really an option for our industry. External stakeholders opinions are important to our industry and we need to make sure we engage with them.



Steve Dunkerley and Michael Jones.

### **Ulrich Borgne, GE Healthcare:**

But who makes the decision? You've got operational people coming to you, you've got tax people coming to you and someone has to take a decision. Is it the finance function, tax or operations?

### **Terry McConnell:**

The finance function within BAT has always been quite an influential function, working closely with marketing and operations. Finance tends to be the bridge, collaborating across the company, taking advice from external or internal experts like tax and treasury, and determining the optimal financial decision.

### **Ulrich Borgne:**

I agree, and that's the way we organise the function here too. I see finance as the best internal advisor function for a CEO.

### **Philip de Klerk, Ineos:**

All our critical decisions have historically been taken by a group of people based in the New Forest in the UK. We have recently relocated our head office to Switzerland and, in order to achieve cohesion and efficiency around management and control of our businesses, we also intend to move key entrepreneurial functions to Switzerland. Accordingly, all management and control will take place in Switzerland and those entrepreneurial functions are therefore taxable in the country. This gives us the chance to review our tax optimisation strategy in light of a change in location.

### **Stuart McDougall:**

In fact, you have a business model there that fits the tax model; it's just a change in the location.

### **Steve Dunkerley:**

How much will fiscal authorities accept if you sit down with them and discuss your proposal?

### **Chris O'Shea:**

I think you'll be surprised at what

fiscal authorities will accept when you take the time to engage properly with them. If you look at developing countries, for example, we used to find that at Shell we would sometimes arrange meetings with other fiscal authorities so they could think about how to set up their framework because usually it was underdeveloped.

Transparency helps; you often get a better decision where you engage properly. Sometimes you may think you're being aggressive but actually the fiscal authorities are happy with what you've put forward.

I think what we've found in our industry is that by having that discussion, you're saying to the government, 'If you want to attract investment you need to think about your fiscal framework to ensure it does just that.' We've also been open with the British Government on how we evaluate decisions. We are a global company and evaluate investment decisions on that basis. We had a very open discussion with the UK's fiscal authorities about our evaluation criteria, and this



Philip de Klerk.

showed them that the UK did not necessarily compete well for investment funds due to the fact it is a mature oil and gas province with smaller and more technologically challenging developments. The response was the introduction of allowances to stimulate the development of marginal fields.

A similar story exists in Norway. A few years ago the government noticed a drop in oil and gas exploration activity relative to other countries. The tax rate in Norway is 78%, and normally tax relief comes only when you have taxable income. The Norwegian Government decided to offer a tax

refund for all exploration expenditure – namely, you have to fund 100% of the exploration cost for year one, but you get 78% back in year two irrespective of whether your exploration successfully finds anything. Now we're seeing that Norway is one of the busier exploration provinces.

### **Ulrich Borgne:**

In my opinion, transfer pricing rules are too vague: we have got transfer pricing transactions from everywhere in our group and I'm never sure whether I am on the safe side or if I am being too aggressive. What do you think?

### **Terry McConnell:**

At BAT we try and ensure that our transfer pricing is supported by real commercial substance. There was a time when some companies believed just getting the legal documentation was sufficient, but these days you need to do more than just get the paper trail right. Real commercial substance is required.

### **Stuart McDougall:**

At the end of the day, it's how much profit you make in any location, but I think you're right. I think once you have a certain level of substance, you've got enough influence that you trap enough of the benefit. It's a given that tax authorities will challenge. And they will win on instances because transfer pricing, by its nature, means there is no exact answer.

There are also many other reasons why tax authorities might win, so there must be an acceptance that you will get 80% of the benefit. The tax function has to be able to explain internally



Andrew Underwood.

what it can deliver and what it can't so it's not over-promising and not over-delivering – that's how tax can become a business partner. It's one of the tensions I continue to see.

How do the operations guys think about tax? And how can they integrate themselves and not be geeks that come up with ideas that are implemented by people who don't understand or believe in them.

### **Robert van der Zalm, BHP Billiton:**

They've got to want to be part of the business and not be functional silos. Often they are brought in as functional experts who pronounce what you can and can't do from a tax perspective. You've got to integrate tax and it's not a matter of tax putting up their issues and saying, 'Our tax risks are different to your other business risks.'

A tax risk is only another risk. Like other risks, they should all be put on the table, and then optimised. In other words, tax needs to be part of the team, and the mindset needs to reflect 'we're all trying to achieve that optimised outcome and it's a matter of how to manage all these risks.'

### **Andrew Underwood, KPMG:**

It's not just tax. The point is that tax is one of the many functional parts of your business. Successful programmes integrate, from the very outset, all considerations – from finance to operations, IT to tax, legal to HR. You've got a number of different elements, work streams, if you like, that you need to bring to the table from day one so you can consider all the opportunities, challenges and

risks in order to develop a robust and fully thought through business case.

Effective implementation is clearly crucial; all of those work streams must flow together in an integrated fashion. I think where it fails is when you get gaps in integration – you haven't got tax, you haven't got IT, or it's lip service rather than really dedicating time or resources to



Robert van der Zalm.

the programme. But in terms of the programmes we've been working on, an integrated approach has

“ Successful programmes integrate, from the very outset, all considerations – from finance to operations, IT to tax, legal to HR. ”

been key to success from start to finish. And when I say integrated, I mean integrated thinking.

### **Ulrich Borgne:**

When we transformed the business at GE Healthcare two years ago

and created the regional view of the business, I made a point that tax should remain close to the finance function. Now I have the tax function sitting with finance. This kind of informal discussion, between tax and finance people on a daily basis, is probably a good recipe.

### **Robert van der Zalm:**

They've got to be close to the business, whether it's in the finance function or not. But with any sort of restructuring, you need to see it as a project and manage it as such. But project management skills are not always well developed and part of the standard finance skill set, despite the fact that we end up doing a lot of projects.

### **Andrew Underwood:**

Indeed. I was with a client we've been working with for the last three years, a US CEO who was talking about lessons he had learnt from the company's European restructuring programme and he said to me: "The biggest lesson for us was not the changes required from an operational, technical or tax perspective, it's been the requirement of a new skill set around the managing of big programmes." The biggest challenge for them was to realise how poor they were at it.

Getting a programme of this scale set up, managed and running with the integration of all the different streams is a significant early milestone in these business transformations.

## Integrating tax into transformation

### Steve Dunkerley:

Is IT an enabler of this process?

### Philip de Klerk:

Definitely. IT is an enabler to help integrate the organisation. We upgraded our ERP system and that has driven and will drive a lot of the change needed in the business.

### Michael Jones:

What are the tax considerations involved in updating your ERP system or integrating a new one?

### Philip de Klerk:

None, because that was all optimised in the organisational structure and the ERP system will not necessarily facilitate our tax bill in the end. What you can do, however, is ask different people



Terry McConnell.

to perform centrally activities for certain taxes, such as VAT. I've centralised half of that in Belgium and it's more efficient.

### Chris O'Shea:

With your ERP system, you've got to understand what you want before you do anything and you need to be willing to change your business processes. Otherwise you buy a system that you think

sounds really good, and you try to bolt it on to your existing business processes, but you find you're spending more money because your processes and ERP are out of sync.

One of the things you can do is use an ERP system implementation to straitjacket the things you do in order to make sure the business runs the way you want it to run. This helps your controls and efficiency. Discipline is important in ensuring a tax-optimised supply chain is not jeopardised by a lack of diligence in following stringent rules; otherwise, people can forget what they're supposed to do, and where they're supposed to do it.

### Terry McConnell:

And that's the critical thing when you make an ERP change.

## Optimising tax and cost in the post-crisis world

The economic downturn has caused many companies to restructure, or at least rethink, their organisation. Among the prime objectives of these efforts, controlling cost and optimising tax positions feature high on the list.

This is true even for companies that have weathered the last two years, such as Henkel, the multinational product company well-known in the laundry and home care, cosmetics/toiletries and adhesive technologies markets through brands such as Persil, Schwarzkopf, Loctite, Purex and Dial.

While the downturn has not directly caused new restructuring, it has focused the company's efforts on existing programmes.

"Volatility and uncertainty in the market are still at unprecedented levels, so we have developed tools to look at scenario planning. That was an immediate reaction to the crisis. You can't have a firm set of parameters in place," says Lothar Steinebach, Henkel's CFO (pictured).

The €3.7 billion acquisition of National Starch in early 2008 required Henkel to optimise its manufacturing footprint, and plans for integrating the businesses were accelerated by the financial crisis. More broadly, however, tax is a key issue.



"Tax efficiency in a globalised world is one of the biggest challenges," says Steinebach. "The way we manage our business is totally different to ten years ago. It has affected the organisation and how our reporting lines are organised. We organise the tax function on a world-wide scale to have a system to combine compliance and tax management.

"Tax affects our operations people and how they do business. For instance, some tax issues may only come up six years later when the audit is done. We therefore have two approaches: we abbreviate the delay between the tax year and the tax audit, and we have established a global tax group that has dialogue with the tax authorities and structures our affairs to be efficient and compliant. It is proactive, which gives us a new dimension."

Tax remains a local issue, but is overlaid with a global awareness that helps optimise Henkel's overall position.

"The company used to be reactive to tax issues, but it is now much more proactive," says Steinebach. "We have a better grip on where we are heading, and our effective tax rate has come down significantly because of it."

We had loads of IT systems five to six years ago and we've consolidated on SAP. We evaluated whether we could move immediately just to one system and concluded that the risk was just too high given our business model at that time. We ended up with a significantly lower number of IT systems than the 60 odd that we'd had before.

But what is important when you're making an ERP change is that it gives you the opportunity to make business process change – even if that just means applying more discipline to the way you work, or supporting changes you're making on the tax front through providing greater visibility.

**Andrew Underwood:**

There's also a requirement to change performance metrics and the way people are managed and rewarded. I think that's the bit that's also very emotive, but it's part and parcel of these sorts of programmes.

You can't just expect people to do what's right for the group without changing the way they're evaluated and measured within the centre and out in the operating businesses. It's a crucial enabler to the change.

**Erik ter Horst:**

I think it's critical indeed. We believe we can work with one system worldwide and we're in the middle of that process, implementing Oracle everywhere in the world. I agree that a common system within your organisation creates a kind of rigour and discipline that helps you with the tax activities so this can be seen as an enabler.

**Michael Jones:**

How much change have you seen in procurement models?

**Andrew Underwood:**

One of the areas we've had a lot of interest in during the last couple of years is in the area of procurement because organisations are looking to leverage global scale and scope and really drive benefit and synergies.

We're seeing a huge amount of interest from companies prepared to look at alternative operating models; they are less focused on



Stuart McDougall.

changing core supply chain structures across the globe and more focused on how to manage the procurement function to drive additional value from an operational perspective. Can we do this and also make it more tax efficient? I'd be interested to understand if anyone's looked at that or considered procurement in isolation from other processes.

**Erik ter Horst:**

I think that's quite a struggle and I do recognise development on this within BT is at the moment. Globalised procurement works best

for big supplier contracts, However, I do see at the local level that, in some cases, you are better placed with local contacts and as a result can obtain a better local deal. Sometimes, there is friction between globalised and local, you need to find a balance between global and local involvement.

**Andrew Underwood:**

I think there's a myth that companies are moving to a fully centralised or global model. We're not saying all procurement goes through this central procurement structure; what we're saying is that part of the feasibility assessment is how much could, and how much still needs to remain local. Local market conditions mean you can never get 100% of global spend going through the global procurement function.

**Erik ter Horst:**

Indeed, and that's the balance you need to find. There is also a need to create transparency around it. If you get a global contract where there are agreed volume discounts it is important to share this with all parties involved. Otherwise you never get the trust around this model.

**Chris O'Shea:**

We're lucky at BG because we have one system across the globe and we took that decision a number of years ago. One of the things that you often assume is that you have information on what you're buying from each supplier, but this isn't always the case. However, you can be sure that the supplier knows exactly what they're selling you, and where they are selling it.

Understanding who your key

suppliers are, and your level of business with them, is critical; it will help you to determine which contract you want to have globally and which you want to have locally or regionally. And that's one of the benefits of the ERP system: having the information to make a decision, irrespective of what decision you then make.



Ulrich Borgne.

### **Stuart McDougall:**

It's about identifying which parts of procurement you want to centralise. Clearly the category strategy is always going to get benefits. You then implement that through one tier negotiations and tiered local negotiations.

But even from a tax perspective,

tax optimisation is still a benefit within that strategy piece along with negotiating the absolute value, optimising and then capturing as well. You have the ability to drive benefit through adapting the idea of global procurement, particularly related to indirect spend.

### **Chris O'Shea:**

Although this does depend where you work. I think when you work in developing

countries, it can be more difficult to undertake global procurement because host governments can be inherently nervous of that for a number of reasons, including transfer pricing.

Governments naturally want to help build their economy, and this

can lead to a desire to have local supply contracts with local suppliers; they may not always want a global supplier coming in. Moreover, I don't know if it's the same for other industries, but we mostly operate through joint ventures, which can require partner approval on procurement – again, that can be a barrier to global procurement.

### **Terry McConnell:**

Indirect procurement is an area where we've been involved in closely over the last few years with the move towards greater collaboration across industries to get scale benefits, and using experts in category management and global sourcing.

In BAT we analysed our indirect spend and believe that about 50% could be negotiated globally. As we bring in experts to manage a global category we can support this through understanding where the critical business decisions will be made, organising ourselves in an

## Vodafone: procurement and sourcing

It is no small undertaking for a company as large as Vodafone to shift its buying strategy. But, after rigorously reviewing its spend, the London-based telecommunications giant made the switch from decentralised buying to a centre-led, commodity-based structure.

Previously, each of Vodafone's companies had their own supply chain management department, which acted independently. But when Detlef Schultz was hired as global supply chain management director things began to change as he set about making the most of Vodafone's huge global presence and scale in purchasing.

He decided to retool the organisation's strategy according to what made sense to buy globally, and what made sense to buy locally. There were still many commodities that could be bought more efficiently by one purchasing representative for the whole company, but

some items and services made a lot more sense when bought and managed locally. Vodafone, therefore, established centres of competence globally, with people who really knew their stuff in each category.

As soon as the company defined its procurement categories, it set up four procurement models for specific tasks within company-wide purchasing:

- **Global catalogue team.** Works globally to set up a catalogue for all operations centres to use.
- **Best practice sharing team.** Shares approaches for buying local commodities or services from an operating company that has established the best practice.
- **Purchasing council.** A category manager-led buying group that oversees supplier selection as well as overall category strategy.

efficient manner, and then reviewing the optimal fiscal locations for those teams.

### **Ulrich Borgne:**

One way to optimise purchasing is through having one system and a preferred suppliers master list. If the supplier you would like to use is not on the list then it probably means the group doesn't want you to use it, so that's where there's a good control.

### **Robert van der Zalm:**

I think it's more about doing whatever is consistent with your business model and I think a lot of people think about efficiency over effectiveness.

But if you turn it around and think about it from the effectiveness perspective first, does that fit with the business model? Once you've made your business model, you can think about efficiency.

### **Michael Jones:**

Perhaps we could wrap up the

discussion by talking about the impact the downturn has had on driving cost optimisation and the tax implications of that. How has this affected your businesses?

### **Ulrich Borgne:**

Before the recession our business was not too much focused on cash; the metrics were more orders, sales, standard margin and operating margin. Now we're looking at how to squeeze the balance sheet in terms of inventory, receivables, payables and so on.

We never did that before, so that is a big change. Also, we now place costs in smaller buckets to analyse what we spend, target one bucket and implement actions to reduce the cost in this particular bucket. We call this technique 'bullet train' as the aim is to take some costs out very quickly.

### **Michael Jones:**

Is that intense focus on particular

areas something that is familiar to others around the table?

### **Terry McConnell:**

It's a natural thing to focus in on particular cost lines in more cost-conscious times because it's what everybody else is doing.

But you do need to be careful about which items you are focusing on. Some of these things will make you more efficient, but you'll lose effectiveness as a consequence.

### **Chris O'Shea:**

Identifying which costs you can and should go after is very important. And you can create a virtuous circle by encouraging competition on cost cutting within your organisation, empowering people to take control.

However, you also need to make sure your areas of focus are appropriate. The last thing you want to do is introduce cynicism into the organisation by targeting the wrong things.

- **Project task force.** For projects that span local and global procurement needs, manages cooperation between the two levels for a specific project.

In essence, Vodafone established one procurement organisation to work for all its companies, instead of having smaller satellite operations working independently.

Having evaluated several locations for the establishment of the Vodafone Procurement Company, Vodafone decided to move to Luxembourg because of its geographical advantages, supportive business environment and neutrality. E-sourcing has also been adopted globally, allowing procurement efficiencies.

Rather than use e-auctions to source commodities, Vodafone uses them in complex areas.

The business transformation undergone by the UK-based telecommunications company has allowed Vodafone to deepen its relationships and capability when it comes to working with suppliers in global partnership.

Schultz lists a number of challenges he faced in establishing the Vodafone Procurement Company. One was trying to understand which part of the supply chain must be treated as a local responsibility and which globally. "I think we have come together as one SCM community and I'm happy that we are now – after 18 months – one team across 18 geographies."

But what of tax? Any sensible business decision has to take into account the tax implications, and, for Vodafone, this one was certainly no different (Ireland also made the shortlist of possible locations).

### **Sources:**

SupplyChainStandard.com  
www.purchasing.com  
IDC, Procurement Leaders



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# Are you reaping all the benefits from transformation?

In the rapidly changing global economy, multinational companies are continually evolving to stay ahead of their competition. Integrating KPMG's Tax Efficient Supply Chain Management (TESCM) into these programmes can help businesses achieve greater shareholder and bottom-line value than traditional efficiency, risk or restructuring programmes can alone.

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