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# *Children's Hearings Scotland*

Annual Report to Those Charged  
with Governance and the Auditor  
General for Scotland

Year ended 31 March 2015

30 June 2015



Audit and Risk Management Committee Members  
Children's Hearings Scotland  
Ladywell House  
Ladywell Road  
Edinburgh  
EH12 7TB

30 June 2015

Dear Sirs

We are pleased to enclose our report to the Audit and Risk Management Committee in respect of our audit for the year ended 31 March 2015. The primary purpose of this report is to communicate the significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit and Risk Management Committee in February 2015. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are detailed in Section 2.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the financial statements. At the time of writing, the key outstanding matters, where our work has commenced but is not yet finalised, are:

- Final review and completion procedures by Engagement Manager and Engagement Leader;
- Subsequent events review; and
- Approval of financial statements and receipt of Management Representation Letter.

We will provide an oral update on these matters at the meeting on 30 June 2015 and we look forward to discussing our report with you on this date. Attending the meeting from PwC will be James Gray.

Yours faithfully

PricewaterhouseCoopers LLP

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# ***Section 1. Executive summary***

## **Introduction**

We set out in this report our significant findings from our audit of Children's Hearings Scotland ("the Body") for 2014/15, together with those matters which auditing standards require us to report to you as "those charged with governance" of the Body.

We carried out our audit work in line with our 2014/15 audit plan that we presented to you in February 2015. Our audit is not designed to identify all matters that may be relevant to you. Accordingly, the audit does not identify all such matters. 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.

## **Framework for Our Audit**

Our audit is conducted in accordance with Auditing Standards (International Standards on Auditing ("ISAs") (UK and Ireland)) and the Code of Audit Practice ("the Code").

The Code explains how external auditors should carry out their functions under the Public Finance and Accountability (Scotland) Act 2000. The audit of financial statements is covered by engagement and ethical standards issued by the UK Auditing Practices Board (APB), so the Code focuses more on the wider functions of public sector auditors. We have conducted our audit in accordance with the relevant requirements of the Code.

## **Respective Responsibilities of Management and Auditors**

### ***Management***

It is the responsibility of the Body's management to prepare the financial statements in accordance with statutory and other relevant requirements. This means:

- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements timeously which give a true and fair view of the financial position of the Body and its expenditure and income for the year ended 31 March 2015; and
- preparing a Directors' Report, a Strategic Report, a Governance Statement and a Remuneration Report.

### ***Auditors' responsibilities***

Our responsibilities are to provide you with an audit report stating whether, in our opinion the financial statements and the part of the Remuneration Report to be audited and give an opinion on:

- whether they give a true and fair view of the financial position of the Body and its expenditure and income for the year;
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
- whether the information which comprises the annual report included with the financial statements is consistent with the financial statements; and
- whether expenditure and receipts have been incurred and applied in accordance with guidance from Scottish Ministers (the regularity opinion).

We are also required to review and report as necessary on other information published with the financial statements, including the directors' report, governance statement and the remuneration report.

## Financial Statements

As a result of our work, we proposed a number of disclosure audit adjustments to the draft financial statements. All identified misstatements were corrected by management therefore no uncorrected misstatements remain in the final financial statements.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the annual accounts.

## Financial performance

The Body's key financial performance for the period is as follows:

- Net expenditure before Scottish Government funding of £3.76 million as at 31 March 2015, compared with net expenditure before Scottish Government funding of £3.30 million as at 31 March 2014, with the increase of £0.46 million in the year being largely attributed to:
  - an increase in "Training of Panel and AST Members" of £0.41 million through the national training contract operating for a full year (2013/14 – 6 months);
  - an increase in "Panel and AST Member Expenses" of £0.15; and
  - a decrease of £0.18 million in "Running Costs".
- Net liabilities of £0.03 million as at 31 March 2015, compared with net assets of £0.28 million as at 31 March 2014, with the decrease of £0.31 million in the year being largely attributed to:
  - a decrease during the year of cash and cash equivalents of £0.14 million; and
  - an increase during the year in the net pension liability of £0.19 million.

## Audit overview and conclusions

We expect to issue an unqualified audit opinion on the financial statements.

## Findings arising from the audit

Section 2 of this report summarises the findings arising from our audit.

## Misstatements and significant audit adjustments

All misstatements identified during the audit have been adjusted within the accounts; therefore, we have no summary of uncorrected misstatements to present in this report.

## Action Plan

We have detailed 3 recommendations for CHS within our Action Plan which can be seen in Appendix 1 of this report and which were identified by the audit team as part of the audit process.

## Additional insight – journals

A key focus in our audit is sharing insight. During our audit procedures for testing manual journals, we have interrogated the data from which we performed our manual journals testing to identify observations for your consideration. These are included within Appendix 2.

We look forward to the opportunity to discuss the report with you at the Audit and Risk Management Committee meeting on 30 June 2015.

We would also like to take this opportunity to express our thanks for the co-operation and assistance we have received from the management and staff of Children's Hearings Scotland throughout our work.

## Section 2: Significant audit and accounting matters

We have set out in this section the significant matters arising from our audit.

### Matters identified in our audit plan

Set out below is a summary of our response to matters identified in our audit plan:

Matter arising	Audit response
<p><b><i>Fraud and management override of controls</i></b> ISA (UK&amp;I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit.</p> <p>This includes consideration of the risk that management may override controls in order to manipulate the financial statements.</p>	<ul style="list-style-type: none"> <li>• We tested high risk manual journals and identified the business rationale for these transactions;</li> <li>• We examined management's accounting estimates for bias and performed detailed testing over accruals and pension assumptions; and</li> <li>• We performed unpredictability testing over the arrangements in place with Local Authorities for the payment of Panel and AST member's expenses.</li> </ul> <p>Our work did not identify any material errors that required adjustment to the financial statements.</p>
<p><b><i>Recognition of expenditure</i></b> Under ISA (UK&amp;I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. (As CHS is wholly funded through Scottish Government Grant in Aid income, the risk of fraud in revenue recognition has been rebutted for CHS.)</p> <p>However for public sector bodies we extend this risk to the risk of fraud in expenditure recognition. There is a risk that CHS could adopt accounting policies or treat expenditure transactions in such a way as to lead to material misstatement in the reported expenditure position.</p>	<ul style="list-style-type: none"> <li>• We evaluated and tested the accounting policy for expenditure recognition to ensure that it is consistent with the requirements of the International Financial Reporting Standards (IFRSs), as adopted by the European Union, and as interpreted and adapted by the 2014/15 Government Financial Reporting Manual (FReM);</li> <li>• We performed substantive testing on a sample of expenditure transactions and confirmed with reference to supporting documentation that each was recorded at the correct value, in the correct accounting period and was posted correctly within the accounts;</li> <li>• We performed substantive cut-off testing on a sample of expenditure transactions posted in the month pre year end and the month post year end and confirmed with reference to supporting documentation that each was recorded at the correct value, in the correct accounting period and was posted correctly within the accounts;</li> <li>• We identified high risk manual journals posted to expenditure accounts and identified the rationale for these transactions; and</li> <li>• We reviewed estimates for expenditure such as accruals for example, to ensure that it was accounted for on an accurate basis and in the proper period.</li> </ul> <p>We did not identify any issues to report to you as a result of our work.</p>

## Materiality

We have conducted our work in accordance with the materiality levels detailed below. We have applied a de minimis level of £3,760. This is the level above which all uncorrected misstatements are reported to the Audit and Risk Management Committee.

We note that our final overall materiality calculated below at £75,200 has increased from the amount of £65,000 communicated in our Audit Plan presented to the Audit and Risk Management Committee in February 2015. The increase in the overall materiality of £10,200 is due to our final calculation being based on the year end financial statements as opposed to our earlier calculation in February 2015 which was based on budgeted expenditure for the year. The change is deemed minimal and has not impacted our planned audit approach in any way.

	£
<b>Overall materiality</b> – This is the amount we have applied in assessing the overall impact on the group financial statements of potential adjustments	75,200
<b>Performance materiality</b> - We have applied this to direct the amount of work performed over each financial statement line item – for example in calculating sample sizes	56,400
<b>De minimis posting level</b> - Under ISA (UK & I) 450, we are required to report to the Audit and Risk Management Committee on all unadjusted misstatements in excess of a 'de-minimis' or 'clearly trifling' amount	3,760

## Misstatements and significant audit adjustments

There are no uncorrected misstatements arising from our audit to report to you.

## Qualitative aspects of accounting practices

### Financial statement disclosures

We have also reviewed, and tested, the material disclosures in the financial statements. We identified no significant issues as part of this work.

### Governance Statement

The Financial Reporting Manual requires Chief Executives to sign a Governance Statement which covers all controls including financial, operational, compliance and the management of risk.

We reviewed the governance statement and based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

## Accounting and audit matters

### Related parties

In forming an opinion on the financial statements, we are required to evaluate:

- whether identified related party relationships and transactions have been appropriately accounted for and disclosed; and
- whether the effects of the related party relationships and transactions cause the financial statements to be misleading.



It is a requirement of International Accounting Standard 24 that transactions with related parties are identified and disclosed in the financial statements. In the context of the Body, related parties would include Directors and Senior Management and their close family members. Related party transactions are identified and declared by Directors and Senior Management and will either relate directly to that individual or will be an interest of that individual's close family member. Failure to capture this information may result in an incomplete listing of related parties being disclosed to the audit team and an incomplete listing of related party transactions being disclosed in the financial statements.

The audit team were able to review responses from all Directors and Senior Management from whom we had requested details of their related parties as part of our audit procedures. We noted that 2 individuals who had left the Body during 2014/15 had not completed a return/declaration however the audit team performed additional audit procedures to determine whether any related parties required disclosure in relation to these 2 individuals and no matters were noted.

In addition, we performed audit procedures to confirm that all other related party declarations were complete and that the related party disclosure within the accounts was complete. During this testing we identified that the Scottish Government, Scottish Children's Reporter Administration (SCRA) and the Lothian Pension Fund which is administered by Edinburgh City Council are considered to be related parties of CHS and as a result Grant in Aid of £3.60 million, expenditure of £0.11 million and contributions paid of £0.12 million relating to these related parties respectively should be disclosed within the Related Party Transactions note in the annual accounts. Management agreed with PwC's findings and have updated the disclosures within the annual accounts accordingly.

We are satisfied that the related party listing provided by the Body to the audit team is complete and that the related party transaction disclosure within the financial statements is now complete.

### ***Pension liability***

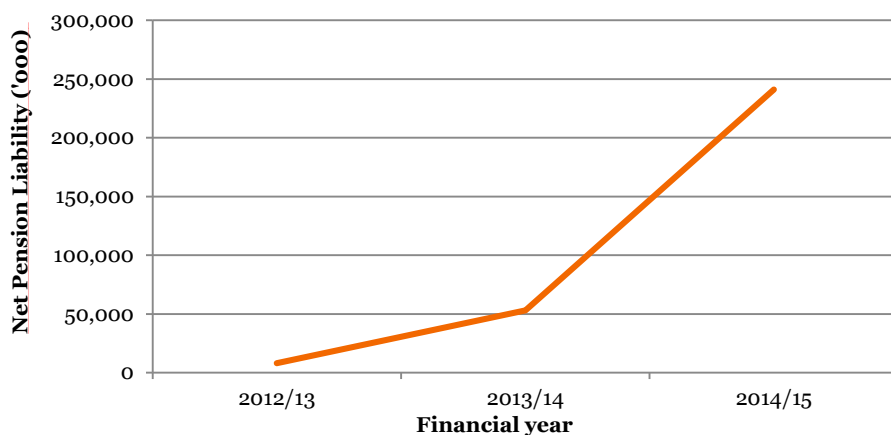
CHS has an agreement with Edinburgh City Council under which all staff are eligible to enter the Local Government Pension Scheme managed by the Council in accordance with scheme rules. It is a defined benefit scheme providing pension benefits and life assurance for all staff members called the Lothian Pension Fund.

The Body's share of the Lothian Pension Fund is a net pension liability of £0.24 million (2014: £0.05 million).

Although assets increased in value in this period to £0.57 million from £0.27 million in 2014/15, an increase of £0.30m (111%), the value of the liabilities has increased to £0.81 million from £0.32 million in 2014/15, an increase of £0.49 million (153%).

The chart below shows the movement in your net pension liability over the last few years.

### ***Pension Liability between 2012/13 and 2014/15***



As part of our audit work, we independently confirmed the pension assets and accuracy of the census data held by the pension fund as part of our audit procedures. We have also reviewed the key assumptions applied to the pension scheme's valuation of its liabilities and compared these with our own actuarial specialists' expectations. This included benchmarking the assumptions against a range of other schemes with March 2015 year ends.

We note that all assumptions used fell within the expected range of the PwC actuary specialists however we noted that the salary increase assumptions of 4.4% made by Hymans Robertson in relation to the scheme is a higher increase than what we would expect to see for a Public Sector body in future years. As such we recommend that going forward management challenge the assumptions of the experts in relation to the scheme, particularly those over which management have greater insight, such as anticipated salary increases and have documented this within our Action Plan in Appendix 1 of this report.

No further issues were identified as a result of our testing of the net pension liability.

### ***Reduction in reserves***

Management confirmed that at the start of 2014/15 the Scottish Government requested that CHS reduce the general fund balance from £0.32 million as at 31 March 2014 to £0.07 million by 31 March 2016. CHS has agreed to this reduction and in 2014/15 has primarily addressed this through reduced drawdowns from Grant in Aid in the current year (£3.6 million of an allocated £3.7 million).

We have confirmed the original allocated amount of £3.7 million to the Grant in Aid letter for 2014/15. In addition we have agreed the £3.6 million draw down to receipts at bank as well as confirmation of amounts paid to SCRA in respect of the Shared Service Level agreement existing between the bodies. CHS has also disclosed this matter within the Directors Report.

We note that the general fund balance as at 31 March 2015 is £0.16 million. Management has confirmed that they anticipate that CHS will have a closing General Fund reserve of £0.07 million as at 31 March 2016. We have reviewed management's budgets for 2015/16 and we have not identified any key indicators or been made aware of any factors that would suggest that CHS will struggle to meet this target.

### ***Compensation costs***

Two payments were made during 2014/15 in relation to voluntary exits. Agreements are in place in relation to both exits and management confirmed that both compensation payments were approved by the Scottish Government in accordance with CHS's delegated authority.

We have confirmed the amounts of compensation payments made to the individuals and have reviewed correspondence with CHS's solicitors in relation to the agreements in place. We have obtained and reviewed correspondence between Scottish Government and CHS in relation to the approval of the compensation payments

to be made. We have also reviewed the disclosures within the annual report and accounts in relation to this matter to ensure it is compliant with the requirements of the FReM.

We are satisfied that the payments made by CHS were appropriate, approved by the Scottish Government and have been disclosed within CHS's annual report and accounts for 2014/15 in accordance with the requirements of the FReM.

## ***Going Forward***

### ***Senior Finance position***

The Interim Director of Finance and Corporate Services will exit the organisation on 30 June 2015 without a direct like for like replacement having been recruited. Instead, CHS is changing its organisational structure, by deleting the Director of Finance and Corporate Services post and replacing it with a Deputy Chief Executive position. This new role will have responsibility for a large element of budget delivery, however, it will not be a dedicated finance position. Therefore, CHS has made arrangements to obtain strategic financial advice and support from the Director of Finance and Head of Finance at the Scottish Children's Reporter Administration (SCRA), which will be delivered through the existing finance service level agreement between the two bodies.

The Director of Finance at SCRA will provide approximately 1 day of support to CHS each week on average, whilst the Head of Finance will provide 2 days support on average per week. CHS is content that the arrangement will provide sufficient professional finance support to the organisation, and recognise that it will benefit from a level of financial expertise that it may find difficult to recruit to locally.

Whilst the arrangement has the potential to provide benefits to CHS, it is important that appropriate governance arrangements are in place to ensure that strong financial management and control continue within the organization. As such we have made a recommendation in relation to this matter – See **Appendix 2**.

### ***Financial outlook 2016/17 and beyond***

Financial sustainability has become a key matter for consideration by all public sector entities and it is vital that consideration of longer term financial plans has taken place.

CHS has a 3-year financial plan covering the period 2015-2018 which sets out forecast budgets for those financial years. It assumes a 1% pay award each year (plus incremental movements), no inflation on non-pay budgets and a flat cash GiA financial settlement. These assumptions lead to a forecast budget break-even in 2017/18.

However, the table below shows the impact by 2017/18 of the pay award over the next 3 years averaging 2% instead of 1%, and of non-pay expenditure increasing by 1% per year which PwC believe is a more realistic scenario:

	<b>2017/18</b>
Staff costs	993,900
Non-pay expenditure	2,706,100
GiA	(3,700,000)
<b>Surplus</b>	<b>0</b>
Additional 1% pay per annum	30,000
1% inflation non-pay	82,000
<b>Adjusted deficit</b>	<b>112,000</b>
As a % of GiA	3.00%

Under this scenario, the table shows that without corresponding reductions in non-pay expenditure CHS would operate a deficit of £112,000 in 2017/18 assuming GiA remains constant over the next 3 years.

In addition to this, given that CHS is a new body, uncertainties remain over the level of activity that it will be required to undertake, as a result of a lack of historic data. If activity levels were to be higher than currently forecast, the organisation has no headroom to absorb this within its current forecast budget. As such we have proposed a recommendation in relation to this matter - see **Appendix 2**.

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# ***Section 3. Governance and internal control***

## **Governance structure**

We have assessed the Body's overall governance arrangements including a review of Board and key Committee structures and minutes, and financial reporting to the Board. Appropriate evidence of activity has been provided by the Body.

The Code of Audit Practice requires us to review and report on the Body's Annual Governance Statement. The Body has used the appropriate format for its Statement and has outlined the processes it had employed to identify and evaluate risks. In addition, key elements of the Body's control framework have been highlighted.

We consider that the governance arrangements in place are appropriate.

## **System of internal control**

The Chief Executive Officer in conjunction with management and the Audit and Risk Management Committee are responsible for developing and implementing systems of internal financial control and having in place proper arrangements to monitor their adequacy and effectiveness in practice.

We review these arrangements for the purposes of our audit of the financial statements and for our review of the annual governance statement and report to you any significant deficiencies in internal control that we find during our audit.

We have no significant matters to bring to your attention in relation to the system of internal control.

## **Risk management**

Responsibilities for the risk management process lies with the Board, which is provided with information and guidance by the Audit and Risk Management Committee and the management team.

Reports on the management of risk are standing agenda items at meetings of the Board, and the Audit and Risk Management Committee. The risk register is reviewed regularly by the Audit and Risk Management Committee at their meetings.

## **Internal Audit**

The role of internal audit is determined by management and therefore its objectives differ from ours. Part of our overall audit approach involves gaining an understanding of the internal audit function to determine if it would be effective and efficient to use their work.

Internal audit have performed four reviews within 2014/15:

- Partnership Working – Local Authority Expenses Management;
- Internal and External Communications;
- Expenditure and Creditor Payments; and
- AST / Panel Management

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Due to the areas of internal audit focus completed in the year, we did not place specific reliance on the reports issued, but they did assist us in updating our risk assessment.

Scott Moncrieff in their role as Internal Auditors have included their opinion within the Internal Audit annual report stated “Children’s Hearings Scotland has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the CHS’s objectives and the management of key risks. Proper arrangements are in place, in the areas we have reviewed, to promote and secure value for money”.

Based on audit work performed we consider the Internal Audit function within CHS to be appropriate for the need of the Body.

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## ***Section 4. Fraud***

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors and management are summarised below:

### **Auditors' responsibility**

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

### **Management's responsibility**

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Management have confirmed that they are not aware of any actual or suspected significant frauds having occurred during 2014/15. We confirm that we have not identified any actual or suspected significant frauds as part of our audit procedures.

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## ***Section 5. Independence***

### **Independence and objectivity**

We have made enquiries of all PricewaterhouseCoopers' teams providing services to you and of those responsible in the UK Firm for compliance matters.

There are no matters which we perceive may impact our independence and objectivity of the audit team.

### **Independence conclusion**

At the date of this report we confirm that in our professional judgement, we are independent accountants with respect to the Body, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.



# Appendix 1: Action Plan

<i>Finding</i>	<i>Management response</i>
<p><b>Pension assumptions – salary increases</b> We noted that the salary increase assumptions of 4.4% made by Hymans Robertson in relation to the Lothian Pension Fund is a higher increase than what we would expect to see for a Public Sector body in future years.</p> <p>We recommend that going forward management challenge the assumptions of the experts in relation to the scheme, particularly those over which management have greater insight, such as anticipated salary increases.</p>	<p>CHS accept this recommendation.</p>
<p><b>Senior Finance Role</b> – CHS has decided to obtain its senior finance support and advice through its service level agreement with SCRA on a trial basis, rather than recruit directly to a CHS post. There are a number of benefits and opportunities that this will provide, but it is important that the roles and responsibilities of the staff at SCRA and senior management at CHS are clear, and well understood, to ensure effective governance remains in place around financial management and financial control.</p>	<p>The IDoFCS is putting in place effective governance arrangements around the new arrangements for financial management and financial control as part of the financial handover before his departure. The CHS Board has also agreed to carry out a formal review of the new arrangements after 6 months.</p>
<p><b>Financial Outlook</b> – whilst the current 3 year draft financial strategy reflects a break-even position in 2017/18, there are a number of cost pressures which are not yet quantifiable.</p> <p>Once the financial settlement for 2016/17 is known, finance should undertake an exercise to update the financial strategy, and to perform some sensitivity analysis within it to determine how susceptible the organisation is to changes in income and expenditure levels. This should be used as the basis for then developing budget contingency plans to manage any adverse movements in forecast budgets.</p>	<p>The CHS Board is currently considering the draft financial strategy and have been advised of cost pressures particularly around Panel and AST Member expenses which is demand led and staff pay increases.</p> <p>The CHS financial position is also a standing item on the agenda for SG Accountability meetings and Sponsor Branch would always advise around mid-year of the likely GIA allocation for the following financial year. This would give sufficient time for CHS to develop budget contingency plans if required.</p>

## Appendix 2: Journals Insight

### Testing of Journals

During journals testing, we utilised PwC's auditing tool 'Halo', which analyses journals posted during the year and allows target testing over 'risk' areas. Examples of the analysis produced by Halo over the journals posted by CHS throughout the year are shown below. We ask management to consider whether the analysis below is in line with their expectations.

<b>Analysis</b>	<b>Results</b>	<b>PwC Commentary</b>
Total number of journals	1,687	Total number of distinct journals posted during the year.
Journals < £10	98	We noted 98 journals with a value lower than £10.
Number of users	7	Investigation of access found all users to be appropriate given their role.
Number of users posting <10 journals	1	14% of users posted less than ten journals during the year.
Number of duplicate journals	382	22.6% of journals posted during the year were found to be duplicates. Investigation of these found the majority of journals in relation to monthly costs
Number of reversing journals	37	A reversing journal is one having exactly the opposite net reporting amounts posted to exactly the same accounts.

*In the event that, pursuant to a request which Children's Hearings Scotland has received under the Freedom of Information Scotland Act 2002, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. Children's Hearings Scotland agrees to pay due regard to any representations which PwC may make in connection with such disclosure and Children's Hearings Scotland shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Children's Hearings Scotland discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.*

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