water industry commission FOR SCOTLAND

ACHIEVING BEST VALUE FOR WATER AND SEWERAGE CUSTOMERS

ANNUAL REPORT AND FINANCIAL STATEMENTS

2013-2014

SCOTLAND ALREADY HAS RESPONSIBILITY FOR ECONOMIC REGULATION IN THE WATER AND SEWERAGE SECTOR, AND WE HAVE AN EXTREMELY GOOD TRACK RECORD.

'Scotland's Future', November 2013.

As economic regulator of the Scottish water and sewerage industry our statutory role is to promote the interests of households and businesses. We do this by incentivising Scottish Water to maintain stable prices, by insisting on better service and by facilitating greater value and choice through the competitive retail framework for non-household customers.

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SG/2014/234

For the period 1 April 2013 to 31 March 2014.
Laid before the Scottish Parliament by the Scottish Ministers under Part 1, section 5(4) of the Water Industry (Scotland) Act 2002 (as amended).

November 2014

CHAIRMAN'S FOREWORD

The Commission has been particularly busy over the last year.

The six months up to the end of March 2014 was focused on work leading up to the publication of our draft determination for the Strategic Review of Charges covering the period from April 2015 to March 2021. The Scottish Government published its Directions and Principles of Charging for Scottish Water for the period 2015-21 in October. In addition, it has completed its review of the exemption scheme for properties occupied by charitable organisations. Now that these elements are finalised, the Commission will produce its final determination in November 2014.

The Strategic Review of Charges has involved a high degree of cooperation between Scottish Water, the Customer Forum, the Scottish Environment Protection Agency (SEPA), the Drinking Water Quality Regulator (DWQR), Citizens Advice Scotland and other parties. All parties have worked with a common goal of achieving the best outcome for Scottish Water's customers as well as for those affected by the company's performance and infrastructure. We would like to thank everyone who has been involved in the process for their contribution to a set of draft proposals that have been widely recognised as being good for both residential and business customers at the same time as offering drinking water quality and environmental improvements over the period covered by the review.

As work on the Strategic Review of Charges tailed off, the Commission has become more heavily involved in the work required to establish the Anglo-Scottish retail markets for non-household customers. The Water Act 2014 became law in the spring and the goal is to open the market south of the border in April 2017. Drawing on its experience of retail competition in Scotland since 2008, the Commission has been working closely with Ofwat and Defra to develop a common set of rules and operating procedures that will, it is hoped, benefit business customers in Scotland as well as those in England. The prospect of market opening in England has already stimulated a significant level of new entry into the Scottish market and indicators of competition suggest that an increasing number of Scottish businesses are receiving either lower prices and/or a wider range of services. We expect that such competition will continue to grow over the period to 2017.

I would like to thank John Reynolds who resigned from the Commission in May 2014 for his substantial contribution to the work of the Commission, including as Chairman of our Audit Committee. I should also note the departure of Richard Khaldi, who was formerly Head of our Competition team. While his decision to leave is a sore loss to the Commission, we expect to maintain our contact with him in his new job as a senior director at Ofwat. We offer our best wishes for the future to both of them and to other members of staff who have retired or moved on over the last year.

The Chief Executive and the staff of the Commission have borne the heavy burden of work undertaken by the Commission with enthusiasm and good humour. The Commission operates with a very lean complement of staff; we are extremely grateful to all of them for their good will, competence and overall contribution to the effective discharge of our responsibilities.

G A Hughes

Professor Gordon Hughes
Chairman
November 2014

CHAPTER ONE

ENSURING VALUE FOR MONEY FOR CUSTOMERS

One of the main ways in which we promote the interests of customers is by setting limits on charges for water and sewerage services. This process is called the Strategic Review of Charges (sometimes referred to as the price review). At each review, we set price limits that deliver Scottish Ministers' objectives for the water industry at the lowest reasonable overall cost.

Strategic Review: 2010-15

We are now in the final year of the five-year regulatory control period covered by our 2010-15 Strategic Review of Charges[1].

During the period Scottish Water has been able to outperform our determination, by being more efficient and by controlling costs. As a result customers have enjoyed three years of price freezes (2010-11, 2011-12 and 2012-13), and two years of below inflation increases (2013-14 and 2014-15)[2].

1. Water Industry Commission for Scotland, *'The Strategic Review of Charges 2010-15: The final determination'*, November 2009.

2. The inflation measure used in the current 2010-15 regulatory period is RPI. For the 2015-21 regulatory period it has been agreed that prices will be measured against CPI.

Typical household bills will increase by £5 or less each year.

Strategic Review: 2015-21

We set out our approach to the 2015-21 Strategic Review in our methodology document, *'Innovation and Choice'* in May 2013. This explained the changes we were making to the regulatory framework in order to ensure that Scottish Water would be equipped for future challenges and continues to provide best value for money from the resources available to it. In particular we made a number of changes to the incentives that are in place so that Scottish Water continues to be challenged – and to challenge itself – to operate its business and deliver improvements in the most cost-effective way.

In March 2014 we published our draft determination of water and sewerage charges for 2015-21. The determination set out the price limits that will apply from April 2015.

Under the proposals, all household customers' bills will increase below the rate of inflation across the six-year regulatory control period. There would also be no increase in the maximum charges payable by a non-household customer, unless there is a substantial increase in inflation.

The draft determination funds an investment programme of more than £3.5 billion[3] over six years. It is important that customers receive value for money for this investment. Encouraged by the Commission, Scottish Water is adopting innovative approaches in a number of areas, including novel solutions at water and wastewater treatment works, and improved approaches to sustainable land management. Delivery of the benefits of the investment programme will be monitored by the Commission and by the quality regulators and Citizens Advice Scotland within the Government-chaired Outputs Monitoring Group.

We consulted on the draft determination and have published the responses on our website. We are taking the responses into account and will publish our final decisions in November.

"Our draft determination represented good news for customers and the environment. It ensured that prospects for future prices are not compromised and that all of the Scottish Government's environmental and drinking water quality objectives for the industry can be delivered."

Alan Sutherland, Chief Executive

3. £3.5 billion is the total investment in out-turn prices.

The average household bill for water services in Scotland for 2013-14 is £54 cheaper than in England or Wales and standards of service are among the highest in the UK.

> "I believe that the approach adopted by the regulator in Scotland has been inspired and is clearly breaking new ground in empowering customers."

Peter Peacock, Chair of the Customer Forum, quoted in 'Utility Week', 4 April 2014.

The role of the Customer Forum

We put in place a number of regulatory innovations for the 2014 review, including the establishment of the Customer Forum. Its role was to identify customer priorities and to secure the best outcome for customers within the ranges for the key inputs to the price review that the Commission had determined (these included operational expenditure, capital expenditure and financeability).

Over a period of several months, the Forum was involved in direct discussions with Scottish Water, culminating in an agreement on changes to Scottish Water's draft Business Plan. The Commission's draft determination reflected that agreement.

Professor Stephen Littlechild recently completed a review of the Customer Forum and its effectiveness. His assessment was that the process, with the active cooperation of Scottish Water, had "led to a more thorough investigation and understanding of customer preferences, certainly more than would otherwise have taken place as part of a conventional price control review"[4].

It is our intention to work closely with Citizens Advice Scotland, Scottish Water and the Scottish Government to decide whether and how the Customer Forum's role should develop.

4. 'RPI-X, competition as a rivalrous discovery process, and customer engagement', Paper presented at the Conference, *The British Utility Regulation Model: Beyond Competition and Incentive Regulation?* LSE 31 March 2014. Revised version 11 July 2014.

Developing our approach: the 2021 Strategic Review

As we are nearing the end of the Strategic Review of Charges for the period 2015-21 we are now beginning to review the approach that we took and the ways in which the regulatory framework may continue to evolve. We believe that the following principles will continue to apply.

- **Customer legitimacy, which derives in large part from the central involvement of customers in the process, is of paramount importance.**
- **Customers in Scotland should consider their water and sewerage bills to be reasonable.**
- **The Commission will work with Scottish Water, and others, to ensure that the best value for money solution is chosen.**

A key element of our developing approach is our early work on 'innovation, risk and reward'. The objective of this work is to encourage more cost-effective, innovative solutions while protecting customers from risk. An example of this approach is the work we have been doing with the Centre of Expertise for Water and others on catchment management.

Remaining steps of the 2015-21 Review

November 2014

The Commission publishes its final determination

January 2015

Scottish Water decides whether or not to accept the final determination

March 2015

Scottish Water publishes its delivery plan

April 2015

New charges apply

CHAPTER TWO

MONITORING SCOTTISH WATER'S PERFORMANCE

Customers are entitled to expect a water and sewerage service that is delivered in an efficient way. We monitor Scottish Water's progress in reducing both its operating costs and its capital investment costs, and assess carefully what the company should be capable of achieving. This allows us to adopt our 'trust but verify' approach.

How we monitor performance

We are a member of the Outputs Monitoring Group, which is chaired by the Scottish Government and includes representatives from Scottish Water, SEPA, the DWQR and Citizens Advice Scotland.

The group meets every three months to review progress against ministerial objectives (which are set out in an agreed programme of works) and against interim milestones for output delivery (set out in Scottish Water's agreed delivery plan). The group publishes quarterly reports on the Scottish Government's website.

Monitoring customer service

We are committed to ensuring that customers see improvements in the level of service they receive. After consultation with the Customer Forum and Scottish Water, we are moving towards a 'three pillar' approach to assessing Scottish Water's service performance:

- **The overall performance assessment (OPA) will be retained in its entirety. This will ensure that essential components of service performance will continue to be monitored and that recent improvements in performance will not be lost in the pursuit of new measures of performance. It would also allow accurate year-on-year comparisons to be made.**

- **Customer satisfaction will be measured and performance will be benchmarked against Scottish Water's peers and comparator sectors. Work on this has already begun with the establishment of the High Esteem Test and the Customer Experience Measure (CEM), which will be developed by March 2015 for both household and non-household customers.**

- **Progress in areas that the Customer Forum had identified as being customer priorities will be monitored through new enhanced service activity measures in a number of areas (including external flooding, visible leakage, and carbon footprint reductions).**

Arrangements are in place to ensure that Scottish Water delivers the commitments it signed up to under the regulatory contract.

Overview of performance 2013-14

We assess performance by comparing what was delivered in 2013-14 with Scottish Water's delivery plan projections for that year. The plan sets out the output delivery profiles for delivering the Scottish Government's objectives for 2010-15, within the financial limits that we set at our final determination.

The figures on pages 12-13 provide an overall rating, alongside a summary comment on performance, for each of the eight main areas that affect outcomes for customers and the environment.

We are pleased to report that, overall, Scottish Water continued to perform well in 2013-14, with all areas achieving a rating of 'on track' or better.

We particularly welcome the continuing improvement in levels of service to customers, as Scottish Water has now reached the target of achieving upper quartile performance that was set for the end of the regulatory control period. Scottish Water has outperformed its projections in the areas of levels of service to customers, leakage reduction and maintaining financial strength.

While overall performance on investment delivery remains good, there are some programme areas where Scottish Water has agreed to take action to address shortfalls, including completing one project that remains from the pre-2010 investment programme.

Developing our approach to monitoring

We are conscious of the need to review and develop the mechanisms by which we measure performance. During the course of the year we have begun to trial the new measure of 'asset health' that was developed last year. This will provide a long-term indication of whether or not assets are being replaced in a timely and effective manner.

Similarly, a new 'water available for supply index' will provide a more meaningful representation of supply resilience, expressed in terms of outcomes for customers over time.

Our work with other regulators and organisations from within both the UK and further afield forms part of our contribution to the Scottish Government's Hydro Nation commitments.

SUMMARY OF SCOTTISH WATER'S PERFORMANCE

KEY OUTCOMES FOR CUSTOMERS

Higher figure = better performance

Levels of service to customers

Overall Performance Assessment (OPA) index

Our rating:

Scottish Water has significantly exceeded the target to achieve a score of 380 by 2013-14, comparable with performance by leading water companies in England and Wales. The target going forward is to remain within the 380 to 400 range.

Delivery of 2010-15 investment programme

Overall Measure of Delivery (OMD) index

Our rating: on track

The OMD remains on target. Of the 48 programme areas, 40 are on, or ahead of, target while eight are behind. Action is under way to address those programmes with slippage.

Delivery of projects remaining from pre-2010 investment programmes

Number of completion projects delivered

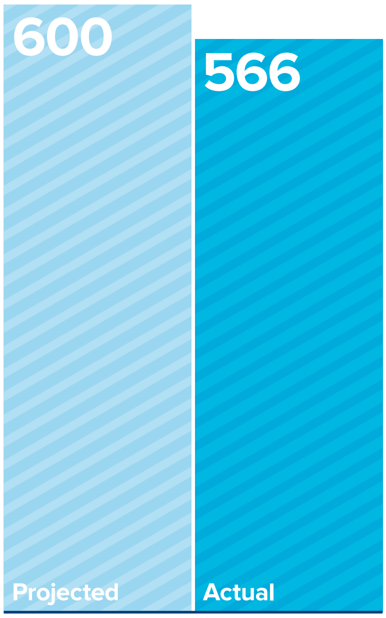
Our rating: on track

Scottish Water is broadly on target, having delivered 312 of the 313 projects. The last project is due for completion in 2015-16.

LEAKAGE

Lower figure = better performance

Performance against leakage target



Our rating:

Reduced leakage to 566 million litres per day, against a target of 600.

Key

Significant outperformance
Outperformance
on track — On track
Underperformance
Significant underperformance

COSTS

Lower figure = better performance

Investment costs

Our rating: on track

Investment costs were contained, even though Scottish Water's output delivery was ahead of planned levels overall.

Operating costs

Our rating: on track

Scottish Water's day-to-day costs were on track.

Use of borrowing

Our rating: on track

Borrowing of £85 million was taken as projected.

FINANCIAL STRENGTH

Higher figure = better performance

Cash interest cover ratio

Funds from operations as a percentage of net debt

Our rating:

Both ratios benefited from good control of costs. Financial outperformance limits the risk to future customers of increased bills to cover investment costs.

CHAPTER THREE

ACHIEVING GREATER VALUE AND CHOICE THROUGH COMPETITION

The non-household market for retail water and sewerage services was opened up to competition in April 2008.

Customers are able to pick and choose, determining the price and service level they consider to be most appropriate to them.

The competitive market in Scotland equates to around 150,000 non-household customers, with an annual gross market value of £330 million.

Competition in Scotland

Retail competition has empowered non-household customers and is a principal means of ensuring that they get the service they want at a price they can afford. It has also helped make Scottish Water, the wholesale business, much more directly accountable for both what and how it delivers for its customers.

The financial and environmental benefits to customers in Scotland have been substantial, and continue to rise.

We have been pleased to see more and more retailers entering the market this year, influenced by the prospect of a similar market developing in England. There are now 17 suppliers with licences to provide retail water and sewerage services in Scotland, and we expect this number to continue to grow. Furthermore, we have also seen new entrants increase their market share over the course of the year.

The Anglo-Scottish markets

The UK Government's Water Act introduces provisions to create a competitive market for retail water and sewerage services for all businesses and public sector organisations in England from April 2017.

We worked hard – both as the Act made its passage through Parliament and since it received Royal Assent in May – to ensure that the new arrangements would act in the best interests of Scottish customers.

We are keen to make sure that implementation of the Act works on a practical basis and delivers the aims of the future water and sewerage industry that all stakeholders would wish to see. We have been working closely with Ofwat and Defra to make sure that we maximise the interoperability between the two jurisdictions, for example by having a common set of market code documents. This will continue to require very close working and collaboration between the WICS and Ofwat boards and staff.

We will continue to work closely with Ofwat, Defra and Open Water as the market in England is developed.

CHAPTER FOUR
MANAGING OUR OFFICE

With a staff of fewer than 20 people we are responsible for regulating an industry with an annual turnover of more than £1 billion that provides a vital service to the Scottish people. We carry out our role at a cost of less than 40 pence per person in Scotland a year.

Being transparent and accountable

The Commission is a non-departmental public body with statutory responsibilities, which acts independently of Ministers. We consider that we are accountable to customers in Scotland; we achieve this through consultation and by being transparent in our work.

As part of our accountability, we must agree a corporate plan with Scottish Ministers as well as submitting an annual report and financial statements. The current plan ends in March 2015 and was for five years. It is intended that the next corporate plan will set out our work plans and budget projections for a six-year period.

Reducing our own costs

Along with all other public bodies we remain conscious of the need to maintain tight control of our own running costs.

During the past year, we continued to monitor and review contracts to ensure the delivery of value for money. There was an overall reduction in staff and Commission costs of 3% due to unfilled vacancies. Notwithstanding this focus on efficiency the office has coped well with what has been an extremely busy year in the regulatory cycle of the Commission.

The savings made during the year have allowed us to once again repay £347,000 to Scottish Water. In addition, our agreed budget for 2014-15 is £3,434,800, which is a reduction of 12% from what was agreed in our original corporate plan.

Communicating with our stakeholders

Two-way communication between this office and our wide-ranging stakeholders is an important part of what we do. During the year we have focused on explaining our developing regulatory approach, and on sharing our experience in preparing for the competitive retail market in Scotland in 2008.

In November 2013 we launched the new *Scotland on Tap* website (which is available at www.scotlandontap.gov.uk). Visitors now have the ability to contact some or all of the suppliers directly via an online enquiry form and interactive case studies have been created to demonstrate the benefits that can be gained through switching supplier.

Sharing our experience

The Commission's work is being seen as a model for regulation of a public sector entity by organisations, academics and other commentators in the rest of the UK and abroad. We are taking the opportunity to share our experience and expertise with this wider audience (where appropriate) in line with the Scottish Government's 'Hydro Nation' commitments.

Freedom of Information

In 2013-14 we received 17 requests for information under the Freedom of Information (FOI) Act. No reviews were undertaken in relation to our FOI responses.

FINANCIAL STATEMENTS

YEAR ENDED 31 MARCH 2014

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The Accountable Officer authorised these financial statements for issue on 3 November 2014.

Strategic report

1. Introduction

The Water Industry Commission for Scotland (the Commission) presents the financial statements for the year from 1 April 2013 to 31 March 2014. The financial statements have been prepared in a form directed by the Scottish Ministers in accordance with the Water Industry Act 1999. The Commission is required to make a report to Scottish Ministers at the end of each year on its activities during the year and arrange for the report to be published.

2. History and statutory background

The Commission is a non-departmental public body sponsored by the Scottish Government Climate Change and Water Industry Directorate. The Commission was formed on 1 July 2005. The office of the Water Industry Commissioner for Scotland was dissolved at that time. The Water Services etc. (Scotland) Act 2005 transferred to the Commission the former Commissioner's function of promoting the interests of water customers. It also gave the Commission the functions of:

- **determining limits on Scottish Water's charges; and**
- **creating and managing the UK's first ever regime for licensing the provision of retail water services to the non-household sector.**

These functions are subject to scrutiny by the Competition and Markets Authority.

3. Performance activities

Goals

We set out our approach to the 2015-21 Strategic Review in our methodology document, *'Innovation and Choice'* in May 2013, explaining the changes we were making to the regulatory framework in order to ensure that Scottish Water would be equipped for future challenges. In March 2014 we published our draft determination of water and sewerage charges for 2015-21. The determination set out the price limits that will apply from April 2015. Under the proposals, all household customers' bills will increase below the rate of inflation across the six-year regulatory control period. There would also be no increase in the maximum charges payable by a non-household customer, unless there is a substantial increase in inflation. We consulted on the draft determination and have published the responses on our website. We are taking the responses into account and will publish our final decisions in November.

We have assessed Scottish Water's performance by comparing what was delivered in 2013-14 with Scottish Water's delivery plan projections for that year. We are pleased to report that Scottish Water continued to perform well in 2013-14, with overall performance on investment delivery remaining good.

With regards to retail competition, we have been pleased to see more and more retailers entering the market this year, influenced by the prospect of a similar market developing in England. With regards to the new arrangements for a competitive market in England we have worked hard, both as the Act made its passage through Parliament and since it received Royal Assent in May, to ensure any new arrangements would act in the best interests of Scottish customers.

Supplier payment performance

It is the Commission's policy to pay all invoices not in dispute within 30 days from receipt of the invoice or the agreed contractual terms if otherwise specified. However, the Commission aims to pay suppliers as soon as possible following receipt of an invoice. During 2013/14, the average length of time taken to pay an invoice was 7 days (2012/13: 7 days), which is in line with the Government's 10 day payment pledge.

Sustainability

Public bodies in Scotland are bound by the Climate Change Public Bodies Duties set out in Part 4 of the Climate Change (Scotland) Act 2009. These duties require that public bodies covered by the duties must, in exercising their functions,

- **contribute to carbon emissions reduction (climate change mitigation);**
- **contribute to climate change adaption; and**
- **act sustainably.**

The office continues to behave in a carbon aware manner, with our carbon footprint being around 5% lower than the previous year. Although the location of our office allows employees and visitors to have better access to sustainable forms of transport, the costs and consumption associated with transport and travel have increased as a result of the increased activity of the office this year. However, this has been more than off-set by a reduction in waste to landfill. This was the first full year of our new recycling policy and as a result we have a much lower output of general waste. Our energy consumption has decreased by 6% as the office continues to be careful about its use of heat and lighting. As a result of growing energy prices, this decrease has not translated into a cost saving. More details can be found in the table below.

	2013/14		2012/13	
Area	**Non-financial information**	**Financial information**	**Non-financial information**	**Financial information**
Energy	Electricity: 22 tonnes CO_2 Gas: 11 tonnes CO_2 Total carbon from energy: 33 tonnes CO_2	Electricity: £6,489 Gas: £2,567	Electricity: 23 tonnes CO_2 Gas: 12 tonnes CO_2 Total carbon from energy: 35 tonnes CO_2	Electricity: £5,381 Gas: £2,484
Waste	Waste to landfill: 13 tonnes CO_2 Paper waste recycled: 2 tonnes CO_2 Total carbon from waste: 15 tonnes CO_2	£1,207	Waste to landfill: 20 tonnes CO_2 Paper waste recycled: 2 tonnes CO_2 Total carbon from waste: 22 tonnes CO_2	£1,379
Water	0.2 tonnes CO_2	£2,154	0.2 tonnes CO_2	£2,032
Transport and travel	37 tonnes CO_2	£90,539	33 tonnes CO_2	£72,232

All of the information in the table is based on our best estimates. We used the following sources for the information:

Energy: all information based on actual usage as reported on gas and electricity invoices.
Waste: financial information taken from actual invoices received in relation to waste collection and shredding services; volume based on estimated average weekly volume of waste, multiplied by number of collections in year.
Water: financial information taken directly from invoices received; volume used based on billed water consumption, as supplied by Business Stream.
Transport and travel: financial information based on actual expenditure in the year; volume based on mileage estimates of journeys taken by employees during the year.

All conversions to carbon consumption are calculated using 'Conversion Factors', a Carbon Trust factsheet.

The Public Services Reform (Scotland) Act 2010

The Public Services Reform (Scotland) Act 2010 imposed new duties on the Scottish Government and on public bodies such as the Commission to publish specific information on their expenditure. The Act also requires us to publish two statements outlining the steps we have taken to promote and increase sustainable growth and to improve efficiency, effectiveness and economy. The duties to publish this information are intended to promote greater openness and transparency. A document which comprises our response to the requirements of the Act can be found on our website.

Risks

A strategic risk register is in place, overseen by the Commission and the Audit Committee, in accordance with the approved risk management strategy. Risks are managed by the Commission and the strategic risk register identifies the important role that employees have in the achievement of the Commission's objectives. The register explains the actions currently being taken by the Commission to retain, train and develop employees in order to limit staff turnover and ensure continuity of knowledge within the organisation. Also, during the year, the Commission's management of the risk register focused on the work being carried out in relation to our business continuity plan, including the successful testing of our IT solution and providing training to employees.

Employees

The Commission recognises the commitment of all employees in carrying out the functions of its Office, and seeks to be an equal opportunity employer in the recruitment, training and development of all staff. The Commission seeks to consult fully with employees on all matters that impact upon their employment within the office.

At the end of the financial year, the number of persons of each sex was as follows:

	Male	Female	Total
Directors and other employees	9	7	16

The average length of time that each employee was absent due to sickness was 15 days (2012/13: 9 days).

4. Financial overview

As set out in the financial statements, there was a retained net deficit for the year of £302,674 (2012/13: £150,480). During the year the work of the office was focused on producing the draft Strategic Review of Charges, which was published in March 2014, and on the significant developments in retail competition. This increased activity led to higher expenditure on consultancy costs, resulting in a larger deficit in the year compared to last year. The balance on the General Reserve as at 31 March 2014 was £232,051 (2012/13: £675,725). The net pension deficit increased due to falling real bond yields and other receivables decreased substantially as a result of timing of payments in relation to the Customer Forum.

Changes in non-current assets

Expenditure invested in terms of information technology, furniture and fittings and intangible assets totalled £34,519 for the year ended 31 March 2014 (2012/13: £17,408).

Pensions

Some employees and former employees of the Commission's office are members of the Local Government Superannuation Scheme administered by Falkirk Council. This scheme is a defined benefit scheme. In accordance with IAS 19 (Revised) – Employee Benefits, the Commission commissioned the Fund's actuaries to undertake a valuation as at 31 March 2014. This calculation was based on rolling forward valuation data at 31 March 2011 to 31 March 2014, on the basis of a number of financial assumptions. Falling real bond yields have resulted in increased pension liabilities. The increase is partially off-set by strong asset returns. Details on the pension scheme can be found in the remuneration report on page 25, the accounting policies listed from page 37 and in note 13 to the financial statements.

5. Future developments

As we are nearing the end of the Strategic Review of Charges for the period 2015-21 we are now beginning to review the approach that we took and the ways in which the regulatory framework may continue to evolve. A key element of our developing approach is our early work on 'innovation, risk and reward'. The objective of this work is to encourage more cost-effective, innovative solutions while protecting customers from risk. We also intend to work closely with Citizens Advice Scotland, Scottish Water, and the Scottish Government to decide whether and how the Customer Forum's role should develop.

With regards to developing our future approach to monitoring the performance of Scottish Water, we are conscious of the need to review and develop the mechanisms by which we measure performance. During the course of the year we have begun to trial the new measure of 'asset health' that was developed last year. This will provide a long-term indication of whether or not assets are being replaced in a timely and effective manner. Similarly, a new 'water available for supply index' will provide a more meaningful representation of supply resilience, expressed in terms of outcomes for customers over time.

Within retail competition we will work closely with Defra and Ofwat to ensure that the implementation of the UK Government's Water Act delivers the aims of the future water and sewerage industry that all stakeholders would wish to see.

3 November 2014

Alan D A Sutherland
Accountable Officer
Water Industry Commission for Scotland
Moray House, Forthside Way, Stirling FK8 1QZ

Directors' report

1. Principal activities

As the economic regulator of the Scottish water and sewerage industry we have a statutory duty to promote the interests of consumers and business customers. We do this by incentivising Scottish Water to maintain stable prices, by insisting on better service and by facilitating greater value and choice through the competitive retail framework for non-household customers.

2. The Commission

The Commission meets regularly throughout the year and currently comprises the Chairman, two further non-executive members, and the Chief Executive. Members of the Commission are appointed by Scottish Ministers. The length of appointments may vary to ensure continuity of Commission membership, but are usually three or four years. During the financial year there were no changes to the membership of the Commission. However, at the end of April 2014, John Reynolds resigned from his position as a member of the Commission.

3. Directors

The Directors during the year were Alan Sutherland, Katherine Russell and Ian Tait. As well as being the Accountable Officer, Alan Sutherland is also an executive member of the board of the Commission.

4. Interests held by the Commission

Neither the Commission, nor its members or directors, held interests in other bodies with which the Commission has dealings. The Commission has a register of interests which is available for inspection on our website.

5. Auditor

Audit appointments are made by the Auditor General, either to Audit Scotland or private firms for a five year term. For the financial year 2013/14, the auditor for the Commission is KPMG LLP. Their appointment is undertaken in accordance with the Code of Audit Practice approved by the Auditor General. The cost of these services for the year to 31 March 2014 amounted to £11,750 (2012/13: £11,750).

6. Disclosure of information to auditor

So far as the Accountable Officer is aware, there is no relevant audit information of which the Commission's auditor is unaware. The Accountable Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the Commission's auditor is aware of that information.

7. Significant events since the end of the financial year

There have been no significant events since the end of the financial year that require adjustment or disclosure under the terms of IAS 10: events after the reporting period. In accordance with the requirements of IAS 10, events are reviewed and considered up to the date on which the financial statements are authorised for issue. This is interpreted as the date on which the Independent Auditor's report is signed.

3 November 2014

Alan D A Sutherland
Accountable Officer
Water Industry Commission for Scotland
Moray House, Forthside Way, Stirling FK8 1QZ

Remuneration report

1. Background

The Chairman and Commission members are appointed by Scottish Ministers in line with the Code of Practice issued by the Scottish Commissioner for Public Appointments. Any future Chief Executive would be appointed by the Chairman of the Commission. The parameters for the remuneration of the Chief Executive, the Chairman and the members of the Commission are set by the Scottish Government's Public Sector Pay Policy for Senior Appointments, which is updated annually.

The Remuneration Committee was dissolved in December 2011 and it was decided that the non-executive members of the Commission would deal with remuneration issues as they arise. There have been no remuneration related issues arising since the dissolution of the Remuneration Committee. Performance pay and bonuses of all employees are in line with the Public Sector Pay Policy as defined by the Scottish Government on an annual basis.

2. Directors' salary and pension entitlements

This section of the remuneration report is subject to audit. The total remuneration of the Chief Executive in the year was £142,420 (2012/13: £142,420). The Chief Executive did not receive an increase in salary during the year. The total remuneration of the Directors was as follows:

		2013-14			2012-13	
	Gross Salary	**Pension benefits** (note 1)	**Total**	**Gross Salary**	**Pension benefits** (note 1)	**Total**
	£(000)	**£(000)**	**£(000)**	**£(000)**	**£(000)**	**£(000)**
Directors						
Alan Sutherland *Chief Executive*	140-145	20-25	165-170	140-145	10-13	155-160
Katherine Russell *Director of Corporate Affairs*	121-125	20-25	145-150	121-125	10-13	135-140
Ian Tait *Director of Investment*	90-95	15-20	105-110	90-95	10-13	105-110

Note 1: The value of pension benefits accrued during the year is calculated as the real increase in pensions and applying the HMRC methodology multiplier of 20 plus the real increase in any lump sum. The real increases exclude increases due to inflation and are net of contributions made by the individual. Pension benefits in 2012/13 relate to the real increase in the cash equivalent transfer value.

No bonus payments or benefits in kind were paid to the Chief Executive or Directors during 2013/14 (2012/13: £nil). The total remuneration of the Chief Executive and other Directors was £360k-£365k (2012/13: £455k-£460k, including Director of Analysis who left in February 2013). The Chief Executive and the Directors are also ordinary members of the Falkirk Council Pension Scheme.

Directors	Accrued pension as at 31/03/14 £(000)	Lump sum as at 31/03/14 £(000)	Real increase in pension £(000)	Real decrease in lump sum £(000)	Value of increase (including Director's own contribution) £	Director's own contribution £
A Sutherland	20-25	25-30	0-2.5	0-2.5	38,484	14,947
K Russell	10-15	10-15	0-2.5	0-2.5	35,398	12,748
I Tait	15-20	20-25	0-2.5	0-2.5	24,169	8,921

Reporting bodies are required to disclose the relationship between the remuneration of the highest paid director in their organisation and the median remuneration of the organisation's workforce. The average banded remuneration of the highest paid Director of the Commission for the year to 31 March 2014 was £142,500 (2012/13: £142,500). This was 6 times (2012/13: 4 times) the annualised median remuneration of the workforce, which was £25,605 (2012/13: £34,634). The highest paid Director of the Commission is the Chief Executive.

	2013/14	2012/13
Highest paid Director's total remuneration (£000)	142.5	142.5
Median total remuneration (£)	25,605	34,634
Ratio	5.6	4.1

3. Commission remuneration

This section of the remuneration report is subject to audit. The remuneration of the Commission members, other than the Chief Executive, is determined by Scottish Ministers and subject to the Scottish Government's Public Sector Pay Policy for Senior Appointments. The remuneration of the Commission members, other than the Chief Executive, was as follows:

	2013/14 Total £(000)	2012/13 Total £(000)
Professor Gordon Hughes	36-40	36-40
Ross Finnie	11-15	6-10
Libby Gawith	11-15	11-15
John Reynolds	11-15	11-15

Commission members are not members of the pension scheme. The Commission also paid £2,542 on behalf of Commission members in the year in respect of PAYE and National Insurance contributions due on travel to work expenses in 2013/14 (2012/13: £2,811). No benefits in kind were paid in the year.

3 November 2014

Alan D A Sutherland
Accountable Officer

Statement of Accountable Officer's responsibilities

Under the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, the Scottish Ministers have directed the Water Industry Commission for Scotland to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The financial statements are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Water Industry Commission for Scotland and its income and expenditure, changes in equity and cash flows for the financial year.

In preparing the financial statements, the Accountable Officer is required to comply with the requirements of the Government Financial Reporting Manual, and in particular to:

- **observe the Accounts Direction issued by Scottish Ministers, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;**
- **make judgements and estimates on a reasonable basis;**
- **state whether applicable accounting standards, as set out in the Government Financial Reporting Manual (FReM), have been followed, and disclose and explain any material departures in the financial statements;**
- **prepare the financial statements on a going concern basis.**

The Scottish Ministers have appointed the Chief Executive as Accountable Officer of the Water Industry Commission for Scotland. The responsibilities of an Accountable Officer, including responsibility for the propriety and regularity of the public finances for which the Accountable Officer is answerable, for keeping proper records and for safeguarding the Water Industry Commission for Scotland's assets, are set out in the Scottish Public Finance Manual (SPFM) published by the Scottish Ministers.

Governance statement

1. Scope of responsibility

The SPFM is issued by the Scottish Ministers to provide guidance to the Scottish Government and other relevant bodies on the proper handling and reporting of public funds. It sets out the relevant statutory, parliamentary and administrative requirements, emphasises the need for economy, efficiency and effectiveness, and promotes good practice and high standards of propriety.

As Accountable Officer, I have responsibility for maintaining a sound governance framework that supports the achievement of the organisation's policies, aims and objectives set by Scottish Ministers, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me.

2. The purpose of the governance framework

The governance framework comprises the systems and processes, and culture and values, by which the Commission is directed and controlled. It enables the Commission to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost-effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an on-going process designed to identify and prioritise the risks to the achievement of the Commission's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place at the Commission for the year ended 31 March 2014 and up to the date of approval of the annual report and financial statements.

3. The Commission's governance framework and review of effectiveness

The Commission aims for the highest standards in corporate governance and details of the processes, significant developments and issues identified during the period are outlined below.

3.1 The Commission

The Commission members have corporate responsibility for ensuring that the Commission fulfils its statutory duties, any targets agreed with Scottish Ministers and for promoting the efficient and effective use of staff and other resources by the Commission in accordance with the principles of Best Value. There has been no change in the membership of the Commission during the year. However, at the end of April 2014, John Reynolds resigned from his post as a member of the Commission.

The Commission reviews our strategy and its implementation regularly. This includes assessing changing external economic, political, environmental and social factors and our capacity to deliver in light of any such changes. The Commission meets regularly and at least quarterly for general business, including a review of the risk register. At each meeting the Commission will also discuss strategic issues relating to the Strategic Review of Charges and developments in the retail market.

3.2 Audit Committee

The Audit Committee meets 4 times a year and monitors and reviews risk, control and corporate governance. During the year the Committee was chaired by John Reynolds. Ross Finnie took over as Chairman from 1 May 2014, following John Reynold's resignation. In addition, membership of the Committee includes two non-executive lay members who are not Commission members. The non-executive members are appointed internally by the Chief Executive and Chairman of the Committee based on the breadth of skill, knowledge and experience they can bring to the Committee. The external and internal auditors attend all meetings and are given the opportunity to speak confidentially to the Committee members. The Audit Committee operates independently and reports to the Commission. The Committee presented the annual report of the Audit Committee to the April 2014 Commission meeting, which concluded that the Committee was satisfied that the Commission has acted diligently to set in place effective control systems and financial reporting processes to measure and manage the risk inherent in the delivery of the organisation's objectives.

3.3 Internal audit

The work of the internal auditor is submitted to the organisation's Audit Committee and includes regular reports and the Head of Internal Audit's independent and objective opinion on the adequacy and effectiveness of the organisation's systems of internal control together with recommendations for improvement.

The work of internal audit only identified one medium and several low rated findings during the financial year 2013/14. Based on the internal audit work performed during the year, no specific areas of weakness were identified that should be reported in this governance statement.

3.4 Risk management

All bodies to which the SPFM is directly applicable must operate a risk management strategy in accordance with relevant guidance issued by the Scottish Ministers. The general principles for a successful risk management strategy are set out in the SPFM and the Commission has used this to derive its own risk management strategy.

The Commission has established a robust and effective framework for the management of risk, one that is proactive in understanding risk, builds upon existing good practice and is integral to all our decision making, planning, performance reporting and delivery processes. Our risk strategy makes clear the roles and responsibilities for achieving an effective control framework. The focus of our strategy is a risk register which identifies potential or actual risks to the achievement of the objectives set out in our corporate plan. It also documents the controls in place to manage these risks and any action being taken to reduce the risk rating.

The Commission actively champions the risk management process and has defined the organisation's risk appetite. The risk register is populated by contributions from the Commission and all staff, and each risk is scored and set a realistic target to reduce the level of the risk. The action plans in place to reduce risk ratings are subject to continual review. They are monitored by staff internally and reviewed by the Commission's Audit Committee on a quarterly basis. I, as the Accountable Officer, also review the register prior to its submission to the Audit Committee. The Commission is informed of significant changes to the register or new risks.

4. Significant governance issues

The review of effectiveness of the Commission's governance framework, as detailed above, provides good assurance of the effectiveness of the Commission's system of internal control. There have been no governance issues identified during the year that are significant in relation to the Commission's overall governance framework. Specific, but not significant, opportunities for improvement in governance and internal controls identified as part of the assurance processes detailed above have been addressed.

3 November 2014

Alan D A Sutherland
Accountable Officer

Independent auditor's report to the members of the Water Industry Commission for Scotland, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of the Water Industry Commission for Scotland for the year ended 31 March 2014 set out on pages 33 to 50. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Government Financial Reporting Manual 2013-14.

This report is made solely to the Water Industry Commission for Scotland and to the Auditor General for Scotland in accordance with sections 21 and 22 of the Public Finance and Accountability (Scotland) Act 2000. Our audit work has been undertaken so that we might state to those two parties those matters we are required to state to them in an auditor's report and for no other purpose. In accordance with the Code of Audit Practice approved by the Auditor General for Scotland, this report is also made to the Scottish Parliament, as a body. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Water Industry Commission for Scotland and the Auditor General for Scotland, for this report, or the opinions we have formed.

Respective responsibilities of Accountable Officer and auditor

As explained more fully in the Statement of the Accountable Officer's Responsibilities set out on page 27, the Accountable Officer is responsible for the preparation of financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accountable Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements, and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing our audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- **give a true and fair view of the state of the body's affairs as at 31 March 2014 and of its retained net deficit for the year then ended;**
- **have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as interpreted and adapted by the Government Financial Reporting Manual 2013-14; and**
- **have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers.**

Opinion on regularity prescribed by the Public Finance and Accountability (Scotland) Act 2000

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Opinion on other matters prescribed by the Public Finance and Accountability (Scotland) Act 2000

In our opinion:

- **the part of the Remuneration Report to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers; and**
- **the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.**

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Public Finance and Accountability (Scotland) Act 2000 requires us to report to you if, in our opinion:

- **adequate accounting records have not been kept; or**
- **the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or**
- **we have not received all the information and explanations we require for our audit; or**
- **the Governance Statement does not comply with guidance from the Scottish Ministers.**

Andrew Shaw

3 November 2014

Andrew Shaw
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
191 West George Street
Glasgow
G2 2LJ

Statement of comprehensive income

For the year ended 31 March 2014

	Note	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Income			
Income from activities	2	3,116,640	3,033,590
Finance income	2	-	15,000
		3,116,640	**3,048,590**
Expenditure			
Staff costs	4	1,260,304	1,300,034
Depreciation and amortisation	6/7	53,949	59,524
Other expenditures	5	2,106,513	1,841,090
		3,420,766	3,200,648
Operating deficit		(304,126)	(152,058)
Interest receivable		1,452	1,578
Retained net deficit for the year		**(302,674)**	**(150,480)**
Other comprehensive income			
Actuarial losses		(141,000)	(240,000)
Total comprehensive income for the year		**(443,674)**	**(390,480)**

All income and expenditure relates to continuing activities.

The notes on pages 37–50 form part of these financial statements.

Statement of financial position

As at 31 March 2014

	Note	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Non-current assets			
Property plant and equipment	6	149,376	169,067
Intangible assets	7	-	-
Other receivables	8	2,734	5,434
Total non-current assets		152,110	174,501
Current assets			
Other receivables	8	128,165	408,775
Cash and cash equivalent		821,690	780,335
Total current assets		949,855	1,189,110
Total assets		1,101,965	1,363,611
Current liabilities			
Trade payables and other current liabilities	9	(184,004)	(192,946)
Total current liabilities		(184,004)	(192,946)
Non-current assets plus net current assets, excluding pension liabilities		917,961	1,170,665
Pension scheme liability	13	(665,000)	(481,000)
Non-current assets plus net current assets, including pension liabilities		252,961	689,665
Non-current liabilities			
Provisions	10	(20,910)	(13,940)
Net assets		232,051	675,725
Equity			
General Reserve		232,051	675,725

3 November 2014

Alan D A Sutherland
Accountable Officer

The notes on pages 37–50 form part of these financial statements.

Statement of cash flows

For the year ended 31 March 2014

	Note	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Cash flows from operating activities			
Operating (deficit)/surplus		(304,126)	(152,058)
Adjustments for non-cash items			
Difference in pension costs compared to contributions	13	21,000	(33,000)
Depreciation on tangible and intangible non-current assets	6/7	53,949	59,524
Loss on disposal of non-current assets	5	261	4,449
Finance income		-	(15,000)
Finance costs		22,000	-
Increase in provision	10	6,970	13,940
Movements in working capital			
Decrease in trade and other receivables	8	283,310	20,638
Increase/(decrease) in trade payables	9	(8,942)	60,510
Net cash inflow/(outflow) from operating activities		**74,422**	**(40,997)**
Cash flows from investing activities			
Purchase of property, plant and equipment	6	(34,519)	(17,408)
Net cash outflow from investing activities		**(34,519)**	**(17,408)**
Cash flows from financing activities			
Interest received		1,452	1,578
Net inflow from financing activities		**1,452**	**1,578**
Net increase/(decrease) in cash and cash equivalents		**41,355**	**(56,827)**
Cash as at 1 April		780,335	837,162
Cash as at 31 March		821,690	780,335
Net increase/(decrease) in cash and cash equivalents		**41,355**	**(56,827)**

The notes on pages 37–50 form part of these financial statements.

Statement of changes in equity (SCE)
For the year ended 31 March 2014

	£
Balance at 1 April 2012	1,066,205
Total comprehensive income for the year	(390,480)
Balance as at 31 March 2013	675,725
Total comprehensive income for the year	(443,674)
Balance as at 31 March 2014	**232,051**

The general reserve is analysed in note 11.

The notes on pages 37–50 form part of these financial statements.

Notes to the financial statements

1. Accounting policies

The financial statements are prepared in a form determined by the Scottish Ministers, in accordance with the Water Industry Act 1999, as amended by the Water Industry (Scotland) Act 2002 and the Water Services etc (Scotland) Act 2005.

The financial statements are prepared as required by the Accounts Direction issued by the Scottish Ministers and prepared in accordance with the Government FReM issued by HM Treasury.

The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of the Commission for the purpose of giving a true and fair view has been selected. The policies adopted are described below. They have been applied consistently in dealing with items that are considered material in relation to the financial statements.

The preparation of the financial statements in conformity with the FReM requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed below in "Critical accounting estimates and key judgements".

The Commission and Accountable Officer have considered the budget for 2014/15, comprising the statutory contribution from Scottish Water and licensed provider levies, and consider that the Commission has adequate resources to continue in operational existence for the foreseeable future. The financial statements are therefore prepared on a going concern basis.

1.1 Accounting Convention

These financial statements have been prepared under the historical cost convention modified to account for the revaluation of property, plant and equipment and intangible assets.

1.2 Critical accounting estimates and key judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Commission makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost/(income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

The Commission determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Commission considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in note 13.

1.3 Newly adopted IFRS

The Commission has adopted IAS 19 which is effective for the first time in these financial statements. The adoption has been applied retrospectively. The effect of the change in IAS 19 on the statement of comprehensive income for the year ended 31 March 2013/14 is an increase in costs of £28k. The impact of this is not considered to be material to the financial statements and therefore, there has been no restatement of the comparatives.

1.4 Adopted IFRS not applied

The following Adopted IFRSs have been issued but have not been applied in these financial statements. Their adoption is not expected to have a material effect on the financial statements unless otherwise indicated:

- **IFRS 10 "Consolidated Financial Statements";**
- **IFRS 11 "Joint Arrangement";**
- **IFRS 12 "Disclosure of Interests in Other Entities";**
- **IFRS 13 "Fair Value Measurement";**
- **IAS 27 "Separate Financial Statements; and**
- **IAS 28 "Investments in Associates and Joint Ventures".**

1.5 Furniture and fittings and information technology

Furniture and fittings and information technology are recorded in the financial statements at depreciated replacement cost because their fair market value is not readily available.

Depreciation is charged on cost less estimated residual value on a straight line basis over the expected useful lives of up to a maximum of:

- **furniture and fittings: 10 years, which is not more than the lease term of the building in which the furniture and fittings are located; and**
- **information technology: 4 years.**

The Commission considers that all of the assets in these categories have short useful lives and the depreciation rates provide a realistic reflection of consumption and reduction in carrying value. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

A full year's depreciation is provided in the year of acquisition and none in the year of disposal.

1.6 Intangible assets

Intangible assets relate to software licences and externally developed software. They are recorded at depreciated replacement cost because their fair value is not readily available. Amortisation is charged on cost less estimated residual value on a straight line basis over the expected useful lives of up to a maximum of four years, or less where the licence term is less than four years.

1.7 Financial assets

Classification

The Commission classifies its financial assets as 'loans and receivables'. The Commission does not hold any financial assets that would be classified as 'available for sale' or 'held-to-maturity'. The classification depends on the purpose for which the financial assets were acquired and is determined at initial recognition.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets. Loans and receivables comprise other receivables and cash and cash equivalents.

Recognition and measurement
Financial assets are recognised when the Commission becomes party to the contractual provisions of the financial instrument. Financial assets are derecognised when the rights to receive cash flows from the asset have expired or the Commission has transferred substantially all risks and rewards of ownership.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Commission will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the loan and receivable is impaired. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the comprehensive statement of income and expenditure. When a loan or receivable is uncollectible it is written off against the provision account. Subsequent recoveries of amounts previously written off are credited in the comprehensive statement of income and expenditure.

1.8 Financial liabilities

Classification
The Commission classifies its financial liabilities on initial recognition as other financial liabilities. Other financial liabilities are included in current liabilities, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current liabilities. The Commission's other financial liabilities comprise trade and other payables in the balance sheet.

Recognition and measurement
Financial liabilities are recognised when the Commission becomes party to the contractual provisions of the financial instrument. A financial liability is removed from the balance sheet when it is extinguished, that is when the obligation is discharged, cancelled or expired. Other financial liabilities are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.9 Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks.

1.10 Provisions

Provisions are recognised when: the Commission has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax interest rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as an interest expense.

1.11 Income

Funding is by way of the statutory contribution paid by Scottish Water, as directed by Scottish Ministers. Licensing activity is funded by a levy charged to licensed providers. All income is recognised in the statement of comprehensive income in the period to which it relates.

1.12 Value added tax

Most of the activities of the Commission are outside the scope of Value Added Tax (VAT) and, in general, output tax does not apply and input tax on purchases is not recoverable. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets.

1.13 Operating leases

Leases where most of the risks and rewards of ownership of the asset remain with the lessor are classified as operating leases. Operating lease payments are recognised in the comprehensive statement of income and expenditure on a straight line basis over the lease term. The benefit of any lease incentive is recognised as a reduction in rental expense on a straight line basis over the life of the lease.

1.14 Employee benefits

Employees of the Commission are members of the Local Government Superannuation Scheme administered by Falkirk Council. The scheme is a defined benefit pension scheme, providing benefits based on final pensionable pay, which are contracted out of the State Earnings-Related Pension Fund.

The Scheme is accounted for on a defined benefit basis under IAS 19: Employee Benefits. Assets and liabilities of the Scheme are held separately from those of the Commission. The Scheme's assets are measured using market values and the Scheme's liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Contributions to the Scheme are calculated so as to spread the cost of pensions over employees' working lives. The contributions are determined by an actuary on the basis of triennial valuations using the Age Attained Method. The actuaries also review the progress of the Scheme in each of the intervening years. Variations from regular cost are spread over the expected average remaining working lifetime of members of the Scheme after making allowances for future withdrawals.

The expected cost of providing staff pensions to employees contributing to the Scheme is recognised in the statement of comprehensive income and expenditure on a systematic basis over the expected average remaining lives of members of the funds in accordance with IAS 19: Employee Benefits and recognises retirement benefits as the benefits are earned and not when they are due to be paid. The statement of comprehensive income and expenditure also includes the net impact of returns on the Scheme's assets and interest on the Scheme's liabilities, which is disclosed (net) as other finance income or interest payable. A pension scheme asset is recognised on the balance sheet only to the extent the surplus may be recovered by reduced further contributions or to the extent that the trustees have agreed a refund from the scheme at the balance sheet date. A pension scheme liability is recognised to the extent that the Commission has a legal or constructive obligation to settle the liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income and expenditure, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

1.15 Segmental reporting

Operating segments are identified on the basis of internal reports about components of the Commission that are regularly reviewed by the chief operating decision makers (the Chief Executive and Commission) in order to allocate resources to the segments and assess their performance.

2. Income

	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Scottish Water statutory contribution	1,733,340	1,733,340
Levy on licensed providers	1,383,300	1,300,250
Finance income	-	15,000
	3,116,640	**3,048,590**

3. Analysis of net expenditure by segment

The purpose of activity reporting is to analyse the Commission's costs and income by team and by the key work streams of the organisation. This allows the Commission to have a better understanding of how resources are being deployed and against which activities. The full year report is detailed below. The format of this report has changed during the year and therefore there is no prior year comparative information. This is the same information as is presented at meetings of the Commission and of the Audit Committee.

The figures in this analysis do not include the IAS 19 pension adjustments, being a debit of £21k to staff costs and finance costs of £22k.

Activity		Determination of prices and monitoring of performance	Managing and developing the competitive framework	Office administration and other corporate costs	TOTAL
Income received (£)		1,733,340	1,383,300	-	3,116,640
Team	**Analysis**	638,324	4,558	238,026	880,908
	Investment	345,125	–	66,608	411,733
	Competition	49,467	1,060,163	279,712	1,389,342
	Corporate	13,790	15,777	581,921	611,488
Total costs (£)		**1,046,706**	**1,080,498**	**1,166,267**	**3,293,471**
Reallocation of office administration and corporate costs		609,842	430,195	(1,166,267)	(126,230)
(Deficit)/surplus (£)		76,792	(127,393)	-	(50,601)
(Deficit)/surplus (%)		2%	(4%)	-	(2%)

Reconciliation to statement of comprehensive income:

	Year ended 31 March 2014
Net deficit for the year per statement of comprehensive income	(302,674)
Cost of secondments	210,525
Interest receivable	(1,452)
Staff costs: IAS 19 adjustment	21,000
Finance income: IAS 19 adjustment	22,000
Retained net deficit for the year per statement of comprehensive income	**(50,601)**

4. Staff numbers and related costs

Staff costs comprise:

	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Wages and salaries	981,856	1,029,829
Social security costs	97,370	108,239
Pension costs	181,078	161,966
Staff costs per statement of comprehensive income	1,260,304	1,300,034

The cash contributions made to the pension scheme are disclosed in note 13.1.

Average number of persons employed:

The average number of whole-time equivalent persons employed during the year was 16 (2012/13: 16), including the Chief Executive. These were employed in the following areas:

	Year ended 31 March 2014	Year ended 31 March 2013
Chief Executive and Directors	3	4
Corporate Affairs	7	8
Analysis	6	4

All employees are employed on permanent contracts.

5. Other expenditure

	Year ended 31 March 2014 £	Year ended 31 March 2013 £
Staff travel and subsistence	184,221	142,322
Office accommodation	107,353	110,876
General operating costs	449,250	350,748
Regulation and licensing costs	1,312,694	945,443
Customer Forum	(64,482)	210,000
Recruitment	19,101	44,881
Information project and IT support	73,943	30,302
Finance charges	24,172	2,069
Loss on disposal of non-current assets	261	4,449
	2,106,513	1,841,090

The operating costs for the year are stated after charging the external audit fee of £11,750 (2012/13: £11,750) and, within office accommodation, an operating lease rental of £49,176 (2012/13: £49,176).

6. Property, plant and equipment

	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2013	178,334	258,853	437,187
Additions	4,470	30,049	34,519
Disposals	(7,909)	(11,246)	(19,155)
At 31 March 2014	174,895	277,656	452,551
Depreciation			
At 31 March 2013	140,943	127,177	268,120
Charge for the year	29,753	24,196	53,949
Eliminated on disposals	(7,856)	(11,038)	(18,894)
At 31 March 2014	162,840	140,335	303,175
Net book value at 31 March 2014	12,055	137,321	149,376
Net book value at 31 March 2013	37,391	131,676	169,067

	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2012	163,769	259,277	423,046
Additions	17,408	-	17,408
Disposals	(2,843)	(424)	(3,267)
At 31 March 2013	178,334	258,853	437,187
Depreciation			
At 31 March 2012	108,991	103,257	212,248
Charge for the year	34,795	24,344	59,139
Eliminated on disposals	(2,843)	(424)	(3,267)
At 31 March 2013	140,943	127,177	268,120
Net book value at 31 March 2013	37,391	131,676	169,067
Net book value at 31 March 2012	54,778	156,020	210,798

7. Intangible assets

	Software licences £	Information technology £	Total £
Cost			
At 31 March 2013 and 31 March 2014	38,253	-	38,253
Amortisation			
At 31 March 2013 and 31 March 2014	38,253	-	38,253
Net book value at 31 March 2014	-	-	-

	Software licences £	Information technology £	Total £
Cost			
At 31 March 2012	38,253	193,429	231,682
Disposals	-	(193,429)	(193,429)
At 31 March 2013	38,253	-	38,253
Amortisation			
At 31 March 2012	37,868	188,980	226,848
Charge for the year	385	-	385
Eliminated on disposals	-	(188,980)	(188,980)
At 31 March 2013	38,253	-	38,253
Net book value at 31 March 2013	-	-	-
Net book value at 31 March 2012	385	4,449	4,834

8. Other receivables

	As at 31 March 2014 £	As at 31 March 2013 £
Current receivables		
Prepayments	128,165	405,926
Other receivables	-	2,849
	128,165	408,775
Long-term receivables		
Prepayments	2,734	5,434
	2,734	**5,434**
Total other receivables	**130,899**	**414,209**

Intra-government receivables:	As at 31 March 2014 £	As at 31 March 2013 £
Central Government	-	210,000
Bodies external to government	130,899	204,209
Total other receivables	**130,899**	**414,209**

9. Trade payables and other current liabilities

	As at 31 March 2014 £	As at 31 March 2013 £
Trade payables	10,565	22,738
Taxation and Social Security	27,509	35,586
Accruals	145,930	134,622
Total trade payables and other current liabilities	**184,004**	**192,946**

Intra-government payables:	As at 31 March 2014 £	As at 31 March 2013 £
Local Authorities	2,112	2,100
Central Government	37,830	43,419
Bodies external to government	144,062	147,427
Total trade payables and other current liabilities	**184,004**	**192,946**

10. Provisions for liabilities and charges

	As at 31 March 2014 £	As at 31 March 2013 £
Balance at 1 April 2013	13,940	-
Provided in the year	6,970	13,940
Provision utilised in the year	-	-
Balance at 31 March 2014	**20,910**	**13,940**

The provision for dilapidation costs relates to the Commission's contractual duty to repair leasehold property on termination of the lease. Provision is made for the estimated costs of fully repairing leasehold properties at the balance sheet date.

11. Note to the statement of changes in equity

The general reserve is analysed below to highlight that element which relates to pensions.

	Note	Operations £	Pension reserve £	General £
Balance at 1 April 2012		1,355,205	(289,000)	1,066,205
Changes in reserves 2012/13				
Actuarial gains		-	326,000	326,000
Change in assumptions underlying the present value of the scheme liabilities		-	(566,000)	(566,000)
Net surplus for the year		(198,480)	48,000	(150,480)
Balance as at 31 March 2013		1,156,725	(481,000)	675,725
Changes in reserves 2013/14				
Actuarial gains	13	-	89,000	89,000
Change in assumptions underlying the present value of the scheme liabilities	13	-	(230,000)	(230,000)
Net retained surplus for the year		(259,674)	(43,000)	(302,674)
Balance as at 31 March 2014		**897,051**	**(665,000)**	**232,051**

12. Commitments and contingent liabilities

12.1 Capital commitments

There were no capital commitments at 31 March 2014 (2012/13: £nil).

12.2 Commitments under operating leases

Total future minimum lease payments under operating leases are given in the table below for each of the stated periods. The amounts relate entirely to the Commission's office accommodation.

	2013/14 £	2012/13 £
Later than 5 years:	344,232	393,408

12.3 Contingent liabilities

The Commission had no contingent liabilities at 31 March 2014 (2012/13: £nil).

13. Pension

13.1 Background

Some employees and former employees of the Commission's office are members of the Local Government Superannuation Scheme administered by Falkirk Council. This scheme is a defined benefit scheme. In the period the Commission paid contributions totalling £182,000 (2012/13: £193,000) into the Fund. Under the Superannuation Regulations, contributions are set to meet 100% of the overall liabilities of the Fund. We have been advised that specific (minimum) rates for employer contributions in 2014/15 will be 21.9%.

In accordance with IAS 19 – employee benefits the Commission commissioned the Fund's actuaries to undertake a valuation as at 31 March 2014. This calculation was based on rolling forward valuation data at 31 March 2011 (the last formal valuation) to 31 March 2014 on the basis of a number of financial assumptions. The main financial assumptions used included:

13.2 Financial assumptions

	Year ended 31 March 2014 %	Year ended 31 March 2013 %
Pension increase rate	2.8	2.8
Salary increase rate	5.1	5.1
Discount rate	4.3	4.5

Life expectancy is based on the SAPS year of birth tables with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin.

	Males	Females
Current pensioners	23.0 years	25.8 years
Future pensioners	24.9 years	27.7 years

13.3 Change in the fair value of plan assets, defined benefit obligation and net liability for the year end 31 March 2014

	Assets	Obligations	Net (liability)/ asset
	£(000)	**£(000)**	**£(000)**
Fair value of employer assets	3,694	-	3,694
Present value of funded liabilities	-	4,130	(4,130)
Present value of unfunded liabilities	-	45	(45)
Opening position as at 31 March 2013	**3,694**	**4,175**	**(481)**
Service cost			
Current service cost	-	203	(203)
Total service cost	**-**	**203**	**(203)**
Net interest			
Interest income on plan assets	171	-	171
Interest cost on defined benefit obligation	-	193	(193)
Total net interest	**171**	**193**	**(22)**
Total defined benefit cost recognised in deficit	**171**	**396**	**(225)**
Cashflows			
Plan participants' contributions	69	69	-
Employer contributions	180	-	180
Contributions in respect of unfunded benefits	2	-	2
Benefits paid	(50)	(50)	-
Unfunded benefits paid	(2)	(2)	-
Expected closing position	**4,064**	**4,588**	**(524)**
Re-measurements			
Change in financial assumptions	-	232	(232)
Other experience	-	(2)	2
Return on assets excluding amounts included in net interest	89	-	89
Total re-measurements recognised in Other Comprehensive Income (OCI)	**89**	**230**	**(141)**
Fair value of employer assets	4,153	-	4,153
Present value of funded liabilities	-	4,772	(4,772)
Present value of unfunded liabilities	-	46	(46)
Closing position as at 31 March 2014	**4,153**	**4,818**	**(665)**

13.4 Change in the fair value of plan assets, defined benefit obligation and net liability for the year end 31 March 2013

	Assets	Obligations	Net (liability)/ asset
	£(000)	£(000)	£(000)
Fair value of employer assets	2,973	-	2,973
Present value of funded liabilities	-	3,262	(3,262)
Opening position as at 31 March 2012	**2,973**	**3,262**	**(289)**
Service cost			
Current service cost	-	160	(160)
Total service cost	**-**	**160**	**(160)**
Net interest			
Interest income on plan assets	148	-	148
Interest cost on defined benefit obligation	-	161	(161)
Total net interest	**148**	**161**	**(13)**
Total defined benefit cost recognised in deficit	**148**	**321**	**(173)**
Cashflows			
Plan participants' contributions	77	77	-
Employer contributions	191	-	191
Contributions in respect of unfunded benefits	2	-	2
Benefits paid	(49)	(49)	-
Unfunded benefits paid	(2)	(2)	-
Expected closing position	**3,340**	**3,609**	**(269)**
Re-measurements			
Change in financial assumptions	-	572	(572)
Other experience	-	(6)	6
Return on assets excluding amounts included in net interest	354	-	354
Total re-measurements recognised in Other Comprehensive Income (OCI)	**354**	**566**	**(212)**
Fair value of employer assets	3,694	-	3,694
Present value of funded liabilities	-	4,130	(4,130)
Present value of unfunded liabilities	-	45	(45)
Closing position as at 31 March 2013	**3,694**	**4,175**	**(481)**

13.6 Projected defined benefit cost for the period to 31 March 2015

	Assets	Obligations	Net (liability)/ asset	% of pay
	£(000)	£(000)	£(000)	
Current service cost	-	216	(216)	(28%)
Total service cost	**-**	**216**	**(216)**	**(28%)**
Interest income on plan assets	182	-	182	23.6%
Interest cost on defined benefit obligation	-	212	(212)	(27.5%)
Total net interest cost	**182**	**212**	**(30)**	**(3.9%)**
Total included in income statement	**182**	**428**	**(246)**	**(31.9%)**

Employer's contributions for the period to 31 March 2015 will be approximately £169,000.

13.7 Sensitivity analysis

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

	Approximate % increase to employer	Approximate monetary amount £(000)
Change in assumptions at 31 March 2014		
0.5% decrease in Real Discount Rate	13%	626
1 year increase in member life expectancy	3%	145
0.5% increase in the salary increase rate	4%	170
0.5% increase in the pension increase rate	9%	447

14. Related party transactions

The Commission is a non departmental public body sponsored by the Scottish Government Climate Change and Water Industry Directorate. The Directorate is regarded as a related party, as is Scottish Water, which is required by Scottish Ministers to provide a funding contribution. In addition, the licensed provider, Business Stream (a Scottish Water company), is also considered as a related party. During the year, the Commission has had material transactions with Scottish Water and Business Stream.

Below is a breakdown of all related party transactions in the year.

Related party	Income (£)	Expenditure (£)	Year-end receivable (£)	Year-end payable (£)
Scottish Water	1,733,340	–	–	–
Business Stream	1,291,035	2,432	2,178	–

All Commission members and Directors complete and update a register of interests on an annual basis. During the year 2013/14, no Commission member, Director or other related party has undertaken any material transactions with the Commission.

15. Losses and special payments

There were no losses or special payments made during this period (2012/13: £nil).

WATER INDUSTRY COMMISSION FOR SCOTLAND

DIRECTION BY THE SCOTTISH MINISTERS

1. The Scottish Ministers, in pursuance of The Water Industry Act 1999, hereby give the following direction.

2. The statement of accounts for the financial year ended 31 March 2006, and subsequent years, shall comply with the accounting principles and disclosure requirements of the edition of the Government Financial Reporting Manual (FReM) which is in force for the year for which the statement of accounts are prepared.

3. The accounts shall be prepared so as to give a true and fair view of the income and expenditure and cash flows for the financial year, and of the state of affairs as at the end of the financial year.

4. This direction shall be reproduced as an appendix to the statement of accounts.

Signed by the authority of the Scottish Ministers

Dated 03 October 2006

November 2014

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