From:	Alan Sutherland
To:	Jon.Rathjen@gov.scot
Cc:	Donna Very
Subject:	Re: [EXT] RE: Approval sought
Date:	03 November 2023 11:13:09

Jon

Thanks for your email. I am sorry that we had to come to you on these matters but appreciate you providing the retrospective approvals.

I have noted your words about novel or contentious expenditures and will ensure that we seek appropriate approval.

All best

Alan

On 3 Nov 2023, at 08:01, Jon.Rathjen@gov.scot wrote:

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Alan,

Thank you for bringing these two expenditures to my attention. As you note seeking retrospective approval is not ideal but I am grateful for the opportunity to comment.

On the Christmas gifts I accept this was an oversight and do not think it is proportionate to try and recover the balance but would highlight that any such gift going forward must be contained within then agreed threshold.

On the training costs, I rather agree that this is a unique training offering and can see why single tender was your approach and as such despite board being aware it would have been appropriate to inform the Scottish Government. As I imply had I been informed I would have agreed with the approach as I think this is not something where open tender would have returned better value given the very specific nature of courses in this field. Due diligence had been carried out and the most suitable product selected and as such, given the board was content with the appropriateness of the nature of the spend, I am content to agree retrospectively the procurement approach.

I see that you recognise the importance of seeking permissions for such expenditures in the future and I would also highlight novel or contentious expenditure is also something to raise regardless of cost threshold.

Jon

Jon Rathjen
Deputy Director
Water Policy & DECC Operations
Scottish Government
[redacted]

From: Donna Very [redacted]@wics.scot> **On Behalf Of** Alan Sutherland
Sent: Thursday, November 2, 2023 6:17 PM
To: Jon Rathjen <Jon.Rathjen@gov.scot>
Cc: Donna Very [redacted]@wics.scot>
Subject: Approval sought

Hi Jon

Audit Scotland has recently concluded the substantive work on the audit of our accounts. As we discussed, they have highlighted to me two areas where we should have obtained approval from Scottish Government. The first of these was an oversight on our part. The second reflects a different interpretation of appropriate rules – but, on reflection, we should have alerted you to the expenditure. These oversights are, of course, not ideal and I apologise for turning to you for this retrospective approval.

The first relates to a £100 gift voucher that we made to all staff last Christmas in recognition for their hard work given the efforts in delivering the consulting activities (well over £500K of revenue). This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. The total cost of these vouchers was £2,500 (25 x £100 Amazon gift vouchers).

As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office. Following a one-to-one with the Chief Operating Officer (COO) in autumn 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The COO researched a number of universities and this course was her preferred option and met the needs identified The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000 (approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for Campus modules. Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs are comparable to other business schools. An internal approvals process was completed and the course was approved. The Board were aware of the COO’s training.

Our procurement policy requires expenditure over £100k to be approved by the Scottish Government, and over £20k if it is a single supplier purchase. We did not seek approval for this purchase since it was below £100k and it wasn't the type of purchase that could be competitively tendered. Audit Scotland believe we should have sought approval. I now seek this retrospective approval from you.

I am, of course sorry for these oversights and will endeavour to ensure that going forward we ensure all necessary Scottish Government approvals are obtained in advance of the expenditure being incurred.

I am happy to provide further information or discuss if helpful.

Alan

From:	Alan Sutherland
To:	Donna Very
Subject:	FW:
Date:	02 November 2023 10:06:00

From: Donna Very [redacted]@wics.scot>
Sent: Thursday, November 2, 2023 9:35 AM
To: Alan Sutherland <[redacted]@wics.scot>
Subject: Fwd:

Did you manage to have look or do you want me just to send on to Jon?
Sent from my iPhone

Begin forwarded message:

> **From:** Donna Very [redacted]@wics.scot>
> **Date:** 30 October 2023 at 13:31:00 GMT
> **To:** Alan Sutherland <[redacted]@wics.scot>
>
> Hi Jon
>
> Audit Scotland has recently concluded the substantive work on the audit of our accounts. As we discussed, they have highlighted to me two areas where we should have obtained approval from Scottish Government. The first of these was an oversight on our part. The second reflects a different interpretation of appropriate rules – but, on reflection, we should have alerted you to the expenditure. These oversights are, of course, not ideal and I apologise for turning to you for this retrospective approval.
>
> The first relates to a £100 gift voucher that we made to all staff last Christmas in recognition for their hard work given the efforts in delivering the consulting activities (well over £500K of revenue). This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. The total cost of these vouchers was £2,500 (25 x £100 Amazon gift vouchers).
>
> As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office. Following a one-to-one with the Chief Operating Officer (COO) in autumn 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The COO researched a number of universities and this course was her preferred option and met the needs identified The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000

(approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for Campus modules. Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs are comparable to other business schools. An internal approvals process was completed and the course was approved. The Board were aware of the COO's training.

Our procurement policy requires expenditure over £100k to be approved by the Scottish Government, and over £20k if it is a single supplier purchase. We did not seek approval for this purchase since it was below £100k and it wasn't the type of purchase that could be competitively tendered. Audit Scotland believe we should have sought approval. I now seek this retrospective approval from you.

I am, of course sorry for these oversights and will endeavour to ensure that going forward we ensure all necessary Scottish Government approvals are obtained in advance of the expenditure being incurred.

I am happy to provide further information or discuss if helpful.

Donna Very

WICS, First Floor, Moray House, Forthside Way, Stirling FK8 1QZ
M: [redacted] | wics.scot | scotlandontap.gov.uk
<image001.png>
Twitter: @WICScotland **LinkedIn:** WICS

From: Alan Sutherland
To: Donna Very
Subject: Re:
Date: 27 October 2023 19:37:52

Unless this is being defined as a single party tender contract - it is fees not a contract???

On 27 Oct 2023, at 19:33, Donna Very <[redacted]@wics.scot> wrote:

But isn't it because it had a value of over £20,000. That's what it says on the approvals form.

[redacted]
Sent from my iPhone

On 27 Oct 2023, at 19:27, Alan Sutherland [redacted]@wics.scot> wrote:

Colin has been through our policies and we can see nothing that requires the Harvard thing to go to SG. The Amazon vouchers we are definitely wrong - should have gone to SG.

Perhaps there is something in Government rules that covers Harvard but it is not in ours. If in SH rules, it should have been in our policies but was not.

[redacted]

[redacted]

A

On 27 Oct 2023, at 17:02, Donna Very [redacted]@wics.scot> wrote:

Alan

Not sure about this and I am feeling a bit miserable about it so will look again on Monday

Hi Jon

Hope you are well.

Audit Scotland has been conducting an audit of our accounts and have highlighted two areas where we should have obtained approval from Scottish Government. This, of course, is not ideal and we apologise for these oversights.

As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office.
Following a one-to-one with the Chief Operating Officer (COO) at the end of 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000 (approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for the Campus modules. Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs was comparable to other business schools. An internal approvals process was completed and the course was approved. The Board were aware of the COO's training (AS – I cannot find anything just yet but finance reports must show or comment on it)

As this course was over £20,000, WICS should have sought approval. We apologise for this oversight and seek retrospective approval from you.

The other area where we should have sought approval was for £2,500 expenditure incurred for the purchase of 25 x £100 Amazon gift vouchers. This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. This was an oversight on our part and we seek retrospective approval for this.

We are of course sorry for these oversights and will endeavour to ensure that going forward we do not miss SG approval for such things.

I look forward to hearing from you.

Donna

From: Alan Sutherland
To: [redacted]
Cc: Donald MacRae; Robin Mcgill
Subject: Re: [EXT] CONFIDENTIAL - Water Industry Commission accounts
Date: 14 December 2023 14:12:07
Attachments: image001.gif
image002.png
image001.gif
image002.png
Accounts_22-23_WICS.pdf
s22_231220_WICS.pdf
Sensitivity: Confidential

Thank you [redacted]

All best

A

On 14 Dec 2023, at 12:54, [redacted]@audit-scotland.gov.uk> wrote:

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Alan,

For information, the Section 22 report on the 2022/23 audit of the Water Industry Commission for Scotland has now been finalised and issued to your sponsor division. This will accompany the audited accounts when they are laid at the Scottish Parliament which your sponsor division has advised is scheduled for next Wednesday 20th December.

Some changes were made to the draft version previously shared with you to reflect the comments you provided. However, following consideration, the Auditor General for Scotland has not removed the job title of the Chief Operating Officer as he feels this is relevant to the issue being reported.

The Section 22 report will be published on Audit Scotland's website next Wednesday to coincide with the accounts being laid at parliament. We would therefore ask you to treat this as a confidential document until then.

Kind regards,

[redacted]

From: [redacted]@audit-scotland.gov.uk>
Sent: Thursday, December 14, 2023 12:18 PM
To: [redacted]@gov.scot
Cc: [redacted]@gov.scot; [redacted]@audit-scotland.gov.uk>
Subject: Water Industry Commission accounts

Good afternoon,

Attached are the 2022/23 accounts for WICS along with the s22 report on the accounts and a letter from the Auditor General for Scotland, clearing them for laying in Parliament.

Kind regards

[redacted]

[redacted]
Audit and Business Assistant

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

ANNUAL REPORT AND ACCOUNTS 2022-23

WICS Economic regulation for Scotland's water

CONTENTS

SG/2023/298 For the period 1 April 2022 to 31 March 2023

Laid before the Scottish Parliament by the Scottish Ministers under Part 1, section 5(4) of the Water Industry (Scotland) Act 2002 (as amended).

Introduction

As the economic regulator of publicly owned Scottish Water, the Water Industry Commission for Scotland (WICS) works to ensure that the industry is internationally admired for excellence and is sustainable both for today's customers and for future generations.

This report outlines our work in 2022-23, the second year of a six-year regulatory control period. It is presented in three parts:

1. The performance report consisting of:

- The overview section, which explains our purpose, the outcomes we to achieve and our objectives. It provides a summary of our performance against delivering those outcomes and objectives and both the impact of and management of key risks.
- A performance analysis, providing a detailed review of our performance in the period.

2. The accountability report consisting of:

- The corporate governance report
- A remuneration and staff report
- A Parliamentary accountability report
- The independent auditor's report

3. The financial statements consisting of:

- Statement of comprehensive net expenditure for the year to 31 March 2023
- Statement of financial position at 31 March 2023
- Statement of cashflows for the year to 31 March 2023
- Statement of changes in equity for the year ended 31 March 2023
- Notes to the financial statements.

1. Performance report

1.1 Performance overview

This performance overview provides a summary of our purpose, the outcomes we aim to achieve, and the key challenges and risks that we face.

STATEMENT FROM THE CHAIR

I am pleased to present our annual report for 2022-23, the second year of the 2021-27 regulatory control period. The final determination of charges for the 2021-27 period set out the charges necessary to protect current and future generations of customers' access to high quality, resilient water services. The determination allowed for further investment by Scottish Water to adapt to climate change as it moves towards its 2040 net zero emissions target.

Last year, in the backdrop of the challenging economic environment, we began working with Scottish Water to understand how it plans to manage costs, revenue and charges during the remainder of the regulatory control period and likely impact on current and future customers. This important work will continue into the remainder of 2023 and will impact the way we monitor and report on Scottish Water's performance moving forward.

During the year we continued work to develop our approach for the next strategic review of charges, learning lessons from our experience during the 2021-27 Strategic Review of Charges and these first years of the regulatory control period.

This year, in our work to support the Scottish Government's Hydro Nation initiative, we have supported colleagues in New Zealand as they embark on a journey to reform their own water industry. Our employees benefited hugely from the learning and experience gained working in New Zealand and with a wide range of international partners.

Collaboration is an important aspect of the Scottish water industry and as such, I look forward to building on our already productive relationships with stakeholders both at home and abroad.

On behalf of WICS' Board, I would like to thank the Chief Executive and staff for their commitment this year; it has been a great pleasure to work together. Finally, I would like to welcome Alex Plant to his new role as Chief Executive of Scottish Water. We look forward to working with Alex as he leads Scottish Water in its transformation to secure a sustainable future for the industry.

Professor Donald MacRae OBE FRSE
Chairman
December 2023

SUMMARY PERFORMANCE STATEMENT FROM THE CHIEF EXECUTIVE AND ACCOUNTABLE OFFICER

I am pleased to present our annual report and to provide a summary of our performance for 2022-23. Our objective at all times is to establish the best outcomes for water and wastewater customers, communities, and the Scottish environment – an approach firmly rooted in doing what is right for both current and future customers. Our decisions are within the context of the Scottish Ministers' objective to transition to a net zero carbon industry by 2040 and to ensure the sustainable long-term future of the water industry.

Our key achievements this year in delivering our strategic objectives are summarised here, with more detailed information provided in the sections that follow.

Supporting the sector vision and ministerial objectives

Our first strategic objective is to support the sector to achieve its long-term vision and to deliver the Scottish Ministers' Objectives for Scottish Water.

This year was the second year covered by our final determination for the 2021-27 regulatory control period, which was published in December 2020. The determination considered the Ministers' final objectives for the industry and their Principles of Charging. It allowed for the investment necessary to improve water quality and the environment and to support economic growth. The determination outlined the need for a long-term, sustainable and innovative approach to replacing Scottish Water's assets.

In SRC 21-27 we recognised that levels of investment would have to increase significantly over the next two decades if the industry were to replace its aging assets and maintain levels of service in the face of climate change. As such, we set out our expectation that Scottish Water take ownership of a clear, well-defined strategy that covers what it plans to achieve in the short, medium and long term. Specifically, we expected Scottish Water to provide a clear picture of the future investment that could be required and an assessment of the likelihood and timing of this investment.

Throughout the SRC21 process, the industry recognised that addressing future challenges would involve a significant transformation of Scottish Water's business including taking early steps to develop the required organisational capabilities to prepare its strategy. This year, we have continued to work with Scottish Water as it begins to take some of the initial steps to transform its business.

Our final determination allowed for an average annual price change of 2% in real terms each year to facilitate Scottish Water's transformation. It has become clear that the cumulative price increase over the 2021-27 regulatory control period will not now be realisable. We have asked Scottish Water to prepare financial scenarios based on different combinations of price profiles, borrowing levels and time horizons. In August 2022, we received an initial information submission from Scottish Water and further work is ongoing to provide clarity over what can and cannot be delivered during the remainder of this regulatory control period.

Best in class levels of services

Our second strategic objective is to challenge Scottish Water to achieve best in class levels of service for its customers and communities. It is important that Scottish Water maintains a 'laser like' focus on its strategic prioritisation of investment and is able to take full account of the benefits and costs over the long-term when it undertakes its investment appraisals. This approach will help ensure best value for money for current and future customers.

Towards the end of the financial year, we published our report of Scottish Water's performance for 2021-22, the first year of the new regulatory control period. The report noted that whilst Scottish Water has broadly maintained its performance, there does appear to be some slippage in the delivery of its investment programme.

Alongside our report of Scottish Water's performance, we published a letter highlighting our concerns about the quality and completeness of Scottish Water's reporting. We highlighted slower than expected progress in providing appropriate visibility of future investment needs and progressing work on asset replacement. Scottish Water has committed to improving its progress across these areas and we will continue to monitor this carefully.

We are increasingly focused on making sure that the information we collect from Scottish Water, and its reporting to us and other stakeholders remains fit for purpose. This year, we have made some important changes and clarifications to the information we ask of Scottish Water. In addition to requiring a significant improvement in the quality of reporting included in Scottish Water's annual return, we further defined our expectations around how Scottish Water reports the revenue and costs of its core business and its reporting of potential future investment needs.

International leadership

Our third strategic objective is to become international leaders in the field of economic regulation, as part of our commitment to supporting the Scottish Government's Hydro Nation initiative. Our involvement helps ensure that we stay at the forefront of regulatory best practice while sharing our own expertise in water sector regulation with other countries. Our input brings a direct financial benefit by reducing the levy that we would charge Scottish Water. Furthermore, these international opportunities provide valuable learning experiences for our staff, thereby supporting our employee recruitment and retention.

During the year we have continued our work with the New Zealand Government's Department of Internal Affairs (DIA) as they prepare for the introduction of economic regulation and water reform. We participated in a small project to support New Zealand's Ministry of Transport which involved examining regulatory models and their application to New Zealand's state highway network.

Other projects included supporting the Romanian regulator (ANRSC) as part of a consortium with the consultancy BDO and working with Romanian operator Apa Vital to develop its business plans and supporting regulatory information.

More widely we have continued to build our relationships with other overseas regulators, including through presenting at international conferences and by working with international organisations.

Internal operations

In relation to our working arrangements, like many other organisations we have been considering options for our future as we emerge from the pandemic. This year we trialled a hybrid arrangement, based on part home working and the use of flexible office and meeting space. Our employees have continued to work effectively from home but have benefitted from meeting regularly with colleagues and stakeholders in central locations.

This year we held our first in-person assessment centre since before the pandemic and welcomed two new analytical staff to the team. We have continued to develop and improve our recruitment approach which now benefits from efficient online tools and face-to-face interactions with candidates.

We are pleased to have made progress this year in relation to our equality and diversity commitments. We have focused on offering mental health first aid training to all employees and now have 3 mental health first aiders in the organisation.

2022-23 has been a busy and challenging year. The office has risen well to the challenges. I would like to thank each and every member of the team for their continuing commitment to our work in driving improvements for Scotland's water and sewerage customers. The office is well placed for the remainder of this regulatory control period.

OUR PURPOSE AND STRATEGY

We are a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers. We do this by challenging Scottish Water to achieve long-term value and best-in-class levels of service for its customers and communities.

We published our Corporate Plan for the period 2021-27 in December 2020. The plan, which was agreed with Scottish Ministers, explains:

- our strategic objectives
- the outcomes we are setting out to achieve for customers, communities and other stakeholders
- the activities we will need to undertake to deliver these outcomes
- the resources necessary.

Our Corporate Plan is focused on ensuring that we continue to meet our statutory obligations to current and future customers. It will ensure that we contribute fully to the delivery of the water sector vision. This is particularly important given the need for Scottish Water to achieve net zero emissions by 2040 (on both an operational and an embodied basis) and to maintain service levels by repairing, refurbishing and replacing the industry's assets in a timely way. Climate change will often mean that there is too much water where we do not want it and too little in the places that we do. Scottish Water will have a crucial role in managing how we adapt to our changing climate.

We report our progress against the objectives set out in the Corporate Plan each year in our annual report.

OUR ORGANISATIONAL MODEL

We have 25 employees and are sponsored by the Scottish Government's Directorate for Environment, Climate Change and Land Reform.

Our Board comprises four non-executive members (including the Chair) and the Chief Executive Officer (CEO). The Board is responsible for overall governance. Further information about our Board Members and about the role of our Audit and Risk Committee (ARC) is covered in the governance statement within the Accountability Report.

We are funded through a levy on Scottish Water and on the retailers that participate in the competitive non-household market. The size of these levies is set by Scottish Ministers in light of the objectives and key targets agreed through the corporate planning process. Where resources allow, we seek to supplement that income with income derived from the external projects that we undertake as part of our international work.

OUR OPERATING ENVIRONMENT

We work closely with many stakeholders, and these relationships are summarised below.

Stakeholder	Interaction with our work
Scottish Parliament	We are accountable to the Scottish Parliament through Scottish Ministers.
Scottish Government	The Scottish Government sets the overall objectives and principles of charging for the water industry in Scotland.
Scottish Water	We have a duty to promote the interests of both current and future customers by making sure that: • Scottish Water is sustainably funded for the long-term and delivers value for money. • Scottish Water is as efficient and effective as it can be so that customers pay no more than is necessary.
Scottish Environment Protection Agency (SEPA)	SEPA regulates Scottish Water's performance regarding compliance with environmental standards and investment in improvements.
Drinking Water Quality Regulator (DWQR)	The DWQR regulates Scottish Water's compliance with drinking water quality and investment to protect public health.
Consumer Scotland	Consumer Scotland is the statutory, independent voice for consumers in Scotland. Its Board commenced their responsibilities in April 2022 and will take on the water consumer functions previously delivered by Citizens Advice Scotland.
Central Market Agency (CMA)	The CMA administers the competitive non-household retail market. It is a separate organisation from the Competition and Markets Authority, a UK body, that ensures markets deliver appropriately for consumers.
Scottish Public Services Ombudsman (SPSO)	With responsibility for complaints and dispute resolution in the water sector, the SPSO provides insights into levels of trust and confidence among consumers.

OUR KEY ACTIVITIES AND PRIORITIES

The three strategic objectives that were identified in our Corporate Plan 2021 are each underpinned by three outcomes. The objectives and outcomes are set out below. Each year we prepare an annual work plan which sets out the areas of focus and specific activities we will undertake during the year, to help us deliver our objectives.

OUR KEY CHALLENGES AND RISKS

The strategic risks the organisation faces were determined as part of the corporate planning process for the regulatory period.

Our principal strategic risk is around our failure to deliver our statutory duties. This would severely damage our credibility within the sector and impact our ability to regulate.

We strive to limit any exposure to a loss of reputation and aim to be respected across the industry both nationally and internationally. Our reputation provides a robust platform that is critical to our ability to engage in dialogue with diverse stakeholders and to further our Hydro Nation activities.

This risk is actively managed by adhering to public body governance best practice, including Board oversight of governance policies, independent internal and external audit, and organisation reporting requirements.

During the year, we have continued to manage our risks which are reviewed by our Board and Audit and Risk Committee and are discussed on a regular basis by an operational board.

Underpinning the principal risk are three strategic risks which focus on:

- Ensuring we are resourced appropriately and that succession plans are in place.
- Staying attuned to the external landscape of the water industry and the strategies of our stakeholders in order to respond to changes.
- Remaining compliant with all relevant laws, regulations and policies and demonstrating the standards expected of a non-departmental public body in Scotland.

The steps we have taken this year towards minimising the risks include further training and developing our leaders to ensure we have a capable team to take the organisation into the future. We will embark upon a review of roles and priorities for all employees and build upon our training and development programmes to ensure our staff have the skills required to support the needs of the organisation.

By engaging regularly with stakeholders and undertaking horizon-scanning activities we stay abreast of external developments impacting the sector.

We ensure compliance with legislation and policies by having policies and procedures for our operational functions in place, of a standard expected of a non-departmental public body. We ensure that our governance processes are up to date, in line with Scottish Government's good practice, by retaining legal support and a strong relationship with our Sponsor Team.

Finally, our Audit and Risk Committee oversees the production and ongoing review of our compliance report and associated actions.

More information on our key risks and the impact these have on delivering our outcomes can be found in the risk section of the performance analysis.

1.2 Performance analysis

PERFORMANCE AGAINST KEY OUTCOMES

The progress we have made against the nine outcomes is summarised below.

Outcome 1: Supporting Scottish Water to become sustainable over the long term

This year our focus has been on developing our approach for the next Strategic Review of Charges. We have been working with economics consultancy Oxera to develop the key areas of focus for our methodology and discussing these options with our Board.

Our methodology will take account of Scottish Water's progress on its transformation journey and aim to ensure that the industry continues towards a more sustainable future. We have been considering with stakeholders, the most appropriate timeline for the next price review in light of the change in revenue profile away from that set out in the 2021-27 final determination.

During the year Scottish Water begun work to develop a long-term strategy and investment baseline for the remainder of the regulatory control period. Scottish Water's August information submission to us represents a first step in understanding how it will manage costs and revenues to deliver the required investment. However, significant further work is required to inform discussions among industry stakeholders about what can be achieved within the financial envelope that is available.

Outcome 2: Incentivising an efficient and effective Scottish Water

We are continuing to work with Scottish Water on the development of its reporting mechanisms for the 2021-27 regulatory control period and beyond. This includes the information request noted above and the annual return to ensure that regulatory reporting remains fit for purpose.

This year, we made specific changes to the regulatory framework. We have requested additional information from Scottish Water on the revenue and costs of its core business and its reporting of potential future investment needs. A key feature of the regulatory information framework is now establishing a robust investment baseline for the remainder of the regulatory control period and developing a full picture of potential future investment needs.

We published our report of Scottish Water's 2021-22 performance in March 2023. This covered the first year of the new regulatory control period and concluded that Scottish Water broadly maintained its performance. The report does show some slippage in the delivery of Scottish Water's investment programme which is evident when comparing reported expenditure to that allowed for in the final determination. Together with other stakeholders, we have requested increased visibility of the investment programme in Scottish Water's reporting of both current and future investment requirements.

Scottish Water's progress in these areas will be critical and inform our overall approach and methodology for the next price review.

Outcome 3: Helping to ensure the retail market maximises benefits for customers

Following the pandemic, we initiated a process to review the financial resilience of retailers to protect the integrity of the market and make sure that it is sufficiently resilient to any future shocks. The failure of energy retailers demonstrated subsequently how important ensuring the financial resilience of market participants can be. During the year we concluded this important work with all active retailers now signed up to an additional licence condition. Scottish Water has now issued its methodology for how it will assess the financial strength of retailers moving forward.

We have taken further steps to introduce a 'market health check' process. Once established, this process will allow retailers to demonstrate they are operating in line with the principles of Ethical Business Practice. During the year, the industry stakeholder group appointed an interim Market Health Checker who proposed a practical set of options for the implementation of the process. Future work will develop a code of practice and a full methodology for the market health check.

During the reporting year, Scottish Water has embarked upon a strategic review of Business Stream and its governance arrangements. We are continuing to engage with Scottish Water and Business Stream on the future governance structure and the implications for the Governance Code. Further work will be required during the remainder of 2023.

Outcome 4: Supporting Scottish Water to become an analytically driven organisation that takes full account of benefit and costs in its option appraisals and decisions

In SRC21-27 we adapted the regulatory framework to move away from a fixed six-year investment programme. This change allows greater flexibility for Scottish Water to plan and prioritise its investment programme in a more dynamic way, thereby ensuring maximum long-term value. A key driver for this change in approach was to enable Scottish Water to address the investment challenges of climate change and asset replacement.

During the year we have continued to encourage the work of Professor Dr Bryan Adey of ETH Zurich as he assists Scottish Water in developing its Asset Management Transformation Plan (AMTR). We welcome the initial work that Scottish Water has embarked on to develop the capacity and capability to better manage its infrastructure on behalf of customers. However, we are concerned with the relatively slow progress in this area given the significance of the asset replacement challenge the organisation faces.

We expect Scottish Water to set out in a consistent and transparent way, what choices are being made, the implications of these choices and the evidence to support these decisions.

This year, we began further work to understand the sustainable level of long-term asset replacement, repair and refurbishment investment across different countries (Australia, England, New Zealand and Scotland). This analysis which included Northumbrian Water, Scottish Water, Sydney Water and Watercare in New Zealand ensured that the interactions and potential overlap of future enhancement, growth and asset replacement investment were being recognised and considered. The output of this work will contribute to Scottish Water's future reporting of asset replacement requirements and our thinking on asset replacement for the next Strategic Review of Charges.

Outcome 5: Acting as a hub of information and expertise to support decision making

An important element of our commenting on Scottish Water's performance is for us to have a wide and detailed understanding of regulatory frameworks and approaches in other countries and jurisdictions. This enables us to identify areas of best practice or innovation in asset-intensive industries, which we can then draw on in our work with Scottish Water.

This year we have continued to share knowledge and expertise with other regulatory organisations and regulated companies at home and abroad. This activity helps us to remain at the forefront of regulatory best practice and achieve better outcomes for customers and the environment in the water sector in Scotland. We have continued to build our relationships with a wide network of leading practitioners, academics and policy makers. We have attended workshops, discussion forums and other events sharing our experience with others.

Our CEO delivered training for a programme developed by InterAmerican Development Bank, the Lisbon International Centre for Water (LIS-Water) and the Association of water and sanitation regulators of Americas. The programme included more than 200 participants from regulators and policy makers from over 20 countries in Latin America and the Caribbean.

Outcome 6: Promoting customer-centric decision making

In the final determination we welcomed Scottish Water's commitment to carry out a 'world leading' national engagement programme with customer and communities. It is important that Scottish Water considers the kind of water industry that customers and society want and the impact of these options on future investment levels and performance over time.

Further work is required from Scottish Water to evidence that customers and communities' views have been considered in their assessment and prioritisation of current and future investment. We will consider Scottish Water's progress in determining our approach for the next strategic review of charges.

Outcome 7: Acting as a cutting-edge regulator that contributes to developing Scotland as a Hydro Nation

We support the Scottish Government's Hydro Nation initiative by building partnerships with others and sharing our regulatory expertise. This year, we have continued to support the DIA in New Zealand in preparing for the introduction of economic regulation and water sector reform. This involved providing advice and analysis to the DIA and Ministers on important considerations for water reform based on our experience in Scotland including the need for a properly managed transition.

Our international work provides useful opportunities for our employees to build knowledge and skills in interesting new areas and to train others in regulation – in turn contributing to their own development and progression. Our analysts benefitted from spending time living and working in Auckland to support Watercare to prepare its business plan and associated regulatory information tables.

We have participated in a series of workshops and events to strengthen our network of international project partners. This year, our CEO and Director visited Romania to build on existing relationships and explore future project opportunities. We met with BDO, Ministry Departments, ANRSC, European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB) and travelled to the three regional operating companies we worked with during our previous European Commission Structural Reform Support project – Suceava, Iasi and Cluj. As part of this, we hosted a one-day training workshop for Romanian colleagues in Edinburgh.

More widely we have continued to extend our links with other overseas regulators and organisations such as the European Water Regulators (WAREG), the Organisation for Economic Cooperation and Development's (OECD) Network of Economic Regulators, and development banks such as the EBRD. We continue to seek new opportunities for business development by building partnerships with international stakeholders and exploring links with potential contractors. This helps ensure that we can contribute to the Scottish Government's Hydro Nation strategy.

Outcome 8: Ensuring that the office operates as efficiently and effectively as possible

As a public body we are very conscious of our obligations to deliver value for money. This year, we have taken further steps to review the way we deliver our objectives to ensure our spending is as efficient as possible. We have begun work to review our operations, structure and roles to demonstrate we are operating as effectively as possible. We are working with the Scottish Government and others in the public sector to review the scope for further synergies including making use of shared services and increasing revenue generating activity through our international work.

We are continuing to benefit significantly from the reduced costs associated with moving to more flexible working arrangements. Our employees have been operating very effectively in a hybrid remote model which has removed the need for a large permanent office space.

During the year we have taken further steps to ensure appropriate technical security controls are in place to strengthen our defences in line with the Scottish Government's cyber resilience framework and Cyber Essentials Plus standards. This work has included continually training our employees, reviewing our business continuity arrangements, and appointing a cyber incident response specialist.

Outcome 9: Sustaining a high-performance team, with a focus on continuous improvement

In line with our graduate recruitment strategy, we are continuing our efforts to recruit a diverse range of individuals for our analytical team. To support our efforts, we are pleased to have been granted a visa sponsorship licence which will allow us to employ a wider pool of candidates with a range of nationalities.

This year we recruited two successful analytical graduates to our team and welcomed a summer intern who joined us as part of the Economic Futures programme. To further raise the profile of WICS as a graduate employer, we have increased our engagement with universities and plan to run a series of seminars on economic regulation for students across Scotland.

Our international work in New Zealand has provided an excellent learning opportunity for our employees with a number of staff having spent some time living and working abroad this year. We are committed to training and developing our employees. A key focus of training during the year related to cyber security and awareness.

KEY PERFORMANCE INDICATORS

Our Corporate Plan identified 11 key performance indicators (KPIs) against which we are measuring the success of delivering our nine outcomes over the regulatory control period. We identified the key KPIs for this financial year and our performance against each is described in detail in this section.

The KPIs that were identified for this financial year are outlined in the table below, with an analysis of how we performed against those indicators.

Outcome(s)	KPI	Performance during 2022-23
1-3	We will implement a regulatory framework that enables and supports Scottish Water to take full ownership of its relationship with customers and its decision making. We will report annually to the Board, and in our statutory annual report and accounts, on progress.	We have worked with Scottish Water as it begins to transform its business to support the new regulatory framework. We have reiterated our requirements and expectations in a series of regulatory letters to Scottish Water.
1-3	By December of each year we will publish our annual reports on Scottish Water's overall performance in delivering the requirements set out in the 2021-27 final determination and identify any gaps that have the potential to impact on the level of trust among its stakeholders.	Our assessment of Scottish Water's 2021-22 performance was published in March 2023. The delay to the publication was largely a result of Scottish Water's request to extend the annual return process.
4-6	Our annual reports on Scottish Water's overall performance will include an assessment of its progress in ensuring that project appraisals encompass a full assessment of the economic costs and benefits of investment. This assessment should include aspects such as the carbon impact, and of natural and social capital.	We have published our report of Scottish Water's 2021-22 performance. Alongside this report, we published a letter highlighting that further work is required to support the planning and prioritisation of investment.
4-6	Our annual reports on Scottish Water's overall performance will include an assessment of its progress in ensuring that customers and communities are involved in decision making. This will encompass assessing the extent to which customers could reasonably have confidence that their views are being heard and acted upon.	Whilst the 2021-22 performance report focused on information and reporting, we have reiterated that Scottish Water has committed to deliver the requirements set out in the Strategic Review of Charges 2021-27, including in relation to holding a 'national conversation'.
7	We will report annually on requests for regulatory advice and information and	We have responded to requests from international partners to provide advice

Outcome(s)	KPI	Performance during 2022-23
	expertise from industry stakeholders and international partners, and on the nature of support we have provided.	and information this year. The contributions we have made are summarised in this report.
7	We will support the Scottish Government's Hydro Nation initiative by delivering projects and assistance, providing a minimum annual net contribution to our income from this work of £300,000.	We delivered ongoing projects with the DIA and the New Zealand Ministry of Transport. We received a net contribution to income from these activities, excluding remuneration costs and overheads, of £817k.
8	Each year of the Corporate Plan period, we will set out in an annual workplan the activities which we will undertake during the year. In the following year our Annual Report will include information on progress against our workplan.	Our 2022-23 work plan was approved by the Board in April 2022. Regular updates against the work plan are provided to the Board at each board meeting. These updates have informed the summary of performance in this annual report.
8	We will ensure that our income and costs remain within budget targets over the regulatory control period and will report our financial performance on a regular basis to the Board.	We delivered our priorities in 2022-23 in line with the corporate plan and budget. For more information on the financial results for the year, see the section on financial performance.
9	We will achieve the desired structure for the office by 2025 and ensure that progress remains on track in the interim.	Recruitment efforts this year have resulted in two further analytical appointments. The focus during 2023-24 is to review our operations, structure and roles to demonstrate we are operating as effectively as possible.

KEY RISKS

Underpinning the principal risk of the overall failure of our statutory duties are three strategic risks. Operational risks are managed at a business area level, and these operational risks are linked to the three strategic risks.

Strategic risk 1

If we do not properly plan for the succession of key roles or adequately manage our resources and the retention of staff, then the organisation might lose focus and direction, causing significant business interruption.

As a small office, we need to make sure that we are able to attract and retain the best talent, ensure succession of senior roles, and that all employees have the skills, training and expertise they need. We will focus on ensuring that we have the resources, skills and experience in place to deliver the overall strategy and objectives now and in future.

Last year, we completed a succession planning exercise for our senior leadership team. We are continuing to support our leaders through individual and team coaching to ensure they have the skills to support the needs of the organisation now and into the future. We have begun work to review the roles and priority areas for each member of staff including a review of the development path for our analysts.

Strategic risk 2

If we are not attuned to the external landscape and the strategies of our stakeholders, there is a risk that we are unable to respond adequately to political, legislative or stakeholder driven changes within the industry.

Throughout the year we have maintained regular stakeholder liaison, including through our participation in a range of industry forums such as the Stakeholder Advisory Group (SAG), the Delivery Assurance Group (DAG) and the Investment Planning and Prioritisation Group (IPPG) and retail market forums.

We have worked closely with Scottish Water and the Scottish Government to progress the 2021-27 regulatory control period and options for the next strategic review, to further achievement of the industry vision.

We maintain contact with leading thinkers within the sector to ensure an innovative approach is maintained. This is developed through regular external engagement sessions with leading edge practitioners, academics and policy makers. Our Hydro Nation and horizon scanning activities provide a useful source of engagement, external benchmarking and assurance.

Strategic risk 3

If we are unable to act appropriately and proportionately within the expectations of public bodies as set out, from time to time, by the Scottish Government, in compliance with all relevant laws, regulations and policies then there is a risk that our activities are significantly disrupted, and reputation undermined.

We adopt the appropriate standards of corporate governance and put in place measures to ensure compliance. The policies and procedures of all operational functions of the organisation will be driven by applicable laws and regulations and the standards expected of a non-departmental public body.

Our governance processes are up to date, in line with Scottish Government’s good practice and reviewed regularly internally and by internal audit. During the year, we reviewed our business continuity arrangements and updated our business continuity plan. The Cyber and Fraud Centre - Scotland reviewed our updated plan and provided assurance that our arrangements are in line with industry best practice.

FINANCIAL PERFORMANCE

We prepare a detailed annual budget, in line with our Corporate Plan, which is submitted to our Board for approval. We use a comprehensive budgeting and financial reporting system, which aligns with the Scottish Public Finance Manual (SPFM), to compare actual results to the budgets that our Board has approved. Management accounts are prepared each month, with significant variances from budget investigated and reported. Cash flow and other financial forecasts are prepared regularly throughout the year to ensure that we have sufficient cash to meet our operational needs.

Financial performance 2022-23

As set out in the financial statements, there was a net surplus for the year of £1,264,866 (2021-22: £610,268) before any adjustments for actuarial gains or losses. The use of surplus funds is outlined in our corporate plan for the period 2021-27.

Total income received for the year was £5,287,598 (2021-22: £4,480,585). Income received from Scottish Water and the licensed providers was in line with the corporate plan.

We received income of £1,185,029 (2021-22: £479,455) in relation to our work delivering projects in support of the Scottish Government's Hydro Nation initiative. The majority of this was received from the DIA in New Zealand, being a continuation of earlier work we carried out in support of water reform in the country.

We also received £105,551 (2021-22: £71,966) in relation to rent and service charge costs relating to the sub-lease of the corporate office.

Expenditure for the financial year 2022-23 was £4,036,890 (2021-22: £3,870,560). The main reason for this increase in expenditure of £166k (4%) was the additional travel, and associated costs, required for the project in New Zealand. This expenditure was reimbursed by the DIA and is included in the increased income.

The internal budget agreed at the start of the financial year by the Board was a net income position of £404,204. International projects resulted in additional net income of £447,813 compared to budgeted expectations. Excluding the IAS 19 adjustment to remuneration costs[1], remuneration costs were over £200k lower than the budget. These savings were the result of three employees leaving during the year who were not replaced. Further savings were made

[1] At the end of the financial year, an adjustment is made to replace actual employer contributions paid to the pension scheme with the current service cost, and associated interest. Current service costs represent our share of pension benefits accruing over the period, as calculated by the actuary.

against the budget in travel and expenses. As the majority of the travel during the year related to the project in New Zealand, the cost of which was reimbursed by the DIA, less travel costs were required for other activities.

The Reserve balance as at 31 March 2023 was an asset of £3,592,251 (2021-22: liability of £149,407). The main contributors to the improvement of this position are:

- The movement of the net pension liability from a liability of £2,201,000 at the end of 2021-22, to a liability of £34,000. The actuarial valuation of our pension obligations, at 31 March 2023, has decreased by £4.5m (33%). This change was driven by the assumption of the discount rate used to value the pension obligations. The corporate bond yield (upon which the discount rate is derived) has risen over the period which has led to an increase in discount rate from 2.75% to 4.75%. However, to comply with IFRIC 14 and IAS 19 the pension asset is restricted to reflect the amount the employer is entitled to as an unconditional refund of the surplus or reduction in future contributions to the pension fund. Actuarial advice was sought in relation to the benefit to us in the form of reduced future contributions. IAS 19 defined this to be the present value of future service costs, less the present value of projected future contributions (in respect of benefit accrual). As this was a negative figure, the net pension asset was restricted to zero. However, unfunded pension benefits of £34,000 are included as a liability at the end of the year.

- As a result of the work carried out in New Zealand, our cash balance has increased by over £1m and the year-end debtor balance by £473k, comprised of amounts due (and paid soon after the financial year-end) from the DIA.

Supplier payment policy

It is our policy to pay all supplier invoices that are not in dispute within the terms of the relevant contract and as soon as possible following receipt of an invoice. In line with the Scottish Government’s guidance, we aspire to a 10-working day target for paying bills to businesses in Scotland. Paying supplier bills promptly is seen as a key objective, and an important expression of our commitment to supporting business. The average time taken to pay suppliers in 2022-23 was 4 days (2021-22: 7 days).

The Public Services Reform (Scotland) Act 2010

The Public Services Reform (Scotland) Act 2010 imposed duties on the Scottish Government and on public bodies such as WICS to publish specific information about their expenditure. The Act 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. We publish a report on our website setting out our response to the requirements of the Act.

SOCIAL MATTERS

Our statutory purpose is designed to deliver environmental, social and economic success. We take our social responsibility seriously and ensure that all staff policies and procedures are up to date and comply with the most recent legislation.

ANTI-BRIBERY AND CORRUPTION

As part of our zero-tolerance approach towards fraud, bribery and corruption we have an employee code of conduct, whistleblowing policy and clear policies regarding acceptable levels of gifts and hospitality (both given and received). We actively encourage staff to be aware of appropriate behaviours with both customers and suppliers. We maintain a gifts and hospitality register.

No frauds were detected in 2022-23.

We take malpractice very seriously and are committed to conducting our business with honesty and integrity. We encourage open communication from all those who work for us, and we want everyone to feel secure about raising concerns. Our internal whistleblowing policy is in place to encourage and enable employees to raise concerns on a confidential basis. All staff are protected under whistleblowing laws if they raise concerns in the correct way.

We have an external whistleblowing policy which aims to assist contractors and the general public should they need to raise concerns about the water industry in Scotland.

We did not receive any whistleblowing cases during this reporting period.

TRANSPARENCY OF INFORMATION

We aim to be open in all that we do; our default approach is to publish information on our activities on our website whenever possible. We maintain frequent dialogue with industry stakeholders and regularly set out our approach and decisions in published papers.

COMPLAINTS

We value and recognise the learning that complaints can generate, and we use complaints information to help us improve the services we provide. During the year we did not receive any complaints (2021-22: nil).

OUR SUSTAINABILITY PERFORMANCE

Scotland has some of the most ambitious greenhouse gas reduction targets in the world and we wish to contribute as much as we can to help deliver this world-leading climate change action.

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

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

As a small office, we recognise that the extent to which we can continually reduce our carbon footprint is limited. That said, we do all that we can to make sure that our internal office functions are delivered in a sustainable and carbon aware manner. Our internal policies encourage employees to make carbon aware decisions in relation to procurement and travel.

Working from home has provided an opportunity to carry out our functions remotely, without the need to commute daily. We are continuing to sublease our office space from 1 July 2021 to 30 September 2024 with the option to extend this until March 2026.

Following the Covid-19 pandemic we resumed international travel in February 2022. However, our experience of remote working has allowed us to carry out much of our work for international partners from home. Overseas travel is sometimes required to support our international projects and some of our employees spent time working abroad in New Zealand during the year. We off-set our carbon footprint from international travel by funding tree planting in Scotland.

Details of our carbon footprint is provided in the following table.

	2022-23[2]		2021-22	
Area	**Non-financial information**	**Financial information**	**Non-financial information**	**Financial information**
Energy	Electricity: n/a Gas: n/a **Total carbon from energy:** **n/a**	Electricity: - Gas: -	Electricity: 0.3 tonnes CO_2 Gas: 0.2 tonnes CO_2 **Total carbon from energy:** **0.5 tonnes CO_2**	Electricity: £195 Gas: £374
Waste	Waste to landfill: negligible Total carbon from waste: **negligible**	-	Waste to landfill: negligible Total carbon from waste: **negligible**	£203
Water	**n/a**	-	**0.01 tonnes CO_2**	£344
Transport and travel	**14.2 tonnes CO_2**	£244,686	**5.2 tonnes CO_2**	£9,826

The information in this 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.
Water: information based on water consumption reports detailing water, sewage and drainage volume and financial charges.
Transport and travel: Financial and mileage volume relating to vehicles is based on mileage estimates of journeys taken by employees during the year and estimated expenditure.

All conversions to carbon consumption are calculated using data available from the Department for Environment, Food and Rural Affairs.

Alan D A Sutherland Alan Sutherland
Chief Executive Officer 07 December 2023

[2] We have transitioned to remote working therefore all energy, waste and water usage is inapplicable for 2022-23. We have not assessed the impact of home working.

2.Accountability report

2.1 Corporate governance report

2.1.1 DIRECTOR'S REPORT

The Board

Our Board is responsible for the overall direction and performance of our organisation, including our efficiency and effectiveness as a public body. Members come from a variety of business backgrounds and bring with them a wealth of knowledge and expertise.

Our Board currently comprises Donald MacRae (Chair), three further non-executive members, and the CEO, Alan Sutherland. Members of the Board are appointed by Scottish Ministers. The length of appointments may vary to ensure continuity of membership but is usually three or four years. There is the possibility of a further term, subject to evidence of effective performance and satisfying the skills, knowledge and personal qualities required on the Board at the time of re-appointment. The membership during the year is detailed below.

Name	Position	Initial appointment date	Re-appointment date	End date
Donald MacRae	Chair	01/07/2016*	01/05/2022	30/04/2026
Jo Armstrong	Member	01/07/2016	01/07/2020	30/06/2024
Ann Allen	Member	01/07/2020	-	30/06/2024
Robin McGill	Member	01/01/2020	-	31/12/2024

*Appointed as Chair on 1 May 2018

Directors

Alan Sutherland was the only Director equivalent during the financial year. As well as being the CEO and Accountable Officer, Alan Sutherland is also an executive member of our Board.

Interests held by the Board

We ask our Board Members and Directors to complete a declaration of interest and we publish a register of interests on our website. During the year, neither the Board Members nor Directors held interests in other bodies with which WICS has dealings.

Auditors

Under the Public Finance and Accountability (Scotland) Act 2000, our independent auditors are appointed by the Auditor General for Scotland. Audit Scotland has been appointed as our external auditors for a five-year period from 2022-23 to 2026-27.

The appointment is undertaken in accordance with the Code of Audit Practice approved by the Auditor General.

The fees paid to Audit Scotland in respect of the independent statutory audit for the financial year 2022-23 are £18,200 (2021-22: £13,940).

All relevant audit information has been made available to our auditors, and the Accountable Officer has taken steps to ensure that the auditors are aware of any relevant audit information.

Other information

In the year to 31 March 2023, we did not have any notifications of data breaches to the Information Commissioner's Office.

Significant events since the end of the financial year

There are no significant events to report after the end of the financial year.

2.1.2 STATEMENT OF ACCOUNTABLE OFFICER'S RESPONSIBILITIES

Under the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, Scottish Ministers have directed us 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 our state of affairs and our income and expenditure, statement of financial position 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 (FReM), and 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 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 Permanent Secretary has appointed the CEO as Accountable Officer of WICS. 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 our assets, are set out in the SPFM published by Scottish Ministers.

So far as the Accountable Officer is aware, there is no relevant audit information of which our auditors are 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 our auditors are aware of that information.

The Accountable Officer confirms that the annual report and accounts are fair, balanced and understandable and that he takes personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable.

2.1.3 GOVERNANCE STATEMENT

The Governance Framework

We are a non-departmental public body. The broad framework in which we operate is set out in a Framework Document, which defines key roles and responsibilities which underpin the relationship between us and the Scottish Government. While this document does not confer legal powers or responsibilities, it forms a key part of our accountability and governance framework.

Non-departmental public bodies are directed by Scottish Ministers to comply with the SPFM. The SPFM provides guidance on the proper handling of public funds to ensure:

- Compliance with statutory and parliamentary requirements.
- Value for money.
- High standards of propriety.
- Effective accountability and robust systems of internal control.

The SPFM is issued by 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.

The Accountable Officer is responsible for maintaining a sound governance framework that supports the achievement of the organisation’s policies, aims and objectives set by Scottish Ministers, while safeguarding the public funds and assets for which he is personally responsible, in accordance with the responsibilities assigned to him.

The purpose of the governance framework

The governance framework comprises the systems, processes, culture and values which govern our activities and behaviours. It enables us to monitor the achievement of our 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 our 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 for the full year ended 31 March 2023 and up to the date of approval of the annual report and accounts.

The Board

The role of the Board is to provide strategic leadership, direction, support and guidance to ensure that we deliver and are committed to delivering our functions effectively and efficiently and in accordance with the aims, policies and priorities of Scottish Ministers.

Board Members have corporate responsibility for ensuring that we fulfils our statutory duties, any targets agreed with Scottish Ministers and for promoting the efficient and effective use of staff and other resources in accordance with the principles of Best Value.

The Board meets regularly and during 2022-23 held five formal meetings. At each formal meeting the Board has a mandate to focus on strategic issues relating to monitoring Scottish Water's performance, the SRC and developments in the retail market. The Board held five further informal meetings to discuss current issues and matters arising.

A full description of our Board's role and responsibilities is detailed within its Scheme of Delegation. Board Members are required to comply with the Code of Conduct for Members of the Board. Board Members discharge their duties in accordance with the guidance set out in appointment letters and in On Board: a guide for members of statutory boards .

As well as attending Board meetings and strategy meetings, Board Members carry out non-executive engagement with stakeholders. Reports of engagement activity are provided at each subsequent Board meeting to ensure that the activity is noted and to give members and management the opportunity to discuss issues arising from this activity.

Corporate Plan

Our Corporate Plan reflects our strategic aims and objectives as agreed by the Scottish Ministers. The plan should include the key objectives and associated key performance targets for the period covered by the plan, and the strategy for achieving those objectives. It should set out how these will contribute towards the achievement of the Scottish Government's primary purpose and how they align with the National Performance Framework. We have developed a comprehensive plan for the current regulatory period (2021-27) which outlines the specific measures against which we will measure and report on our success against our objectives.

Risk management

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

Our risk management 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.

Risks are assessed in terms of the likelihood of them occurring, the impact they would have if they did occur, and their proximity (how soon they are likely to occur).

The Board is responsible for defining the organisation's risk appetite. The risk register is populated by contributions from 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 our Audit and Risk Committee (ARC) on a quarterly basis. The Accountable Officer reviews the register prior to its submission to the ARC. The Board is informed of significant changes to the register or new risks.

As part of the Corporate Plan for 2021-27, we have identified the risks associated with the delivery of the objectives set out in the Plan. During the year, the Board monitored the strategic risk register and the action plans set out by management to address the risks.

Audit and Risk Committee (ARC)

The Board has appointed the ARC to assist in fulfilling the Board's statutory and fiduciary responsibilities by reviewing the comprehensiveness and reliability of assurances on governance, risk management, the control environment and the integrity of financial statements and annual report. Members are appointed to the ARC by the Board. The ARC is governed by its Terms of reference and remit.

The ARC meets to receive reports from internal and external auditors and our employees. The internal and external auditors may attend all meetings of the ARC and they may contact the Chair of the ARC at any time to express specific concerns identified during audit work.

The ARC meets at least four times a year. During the year the ARC was chaired by Robin McGill. There are a further two non-executive members. The non-executive members are appointed by the Board based on the breadth of skill, knowledge and experience they can bring to the ARC.

The ARC operates independently and reports to the Board. The ARC presented the annual report of the ARC to the December Board meeting, which outlined the work undertaken by the ARC to review our control systems and financial reporting processes to measure and manage the risk inherent in the delivery of the organisation's objectives. The report reiterated the findings from Audit Scotland's 2022-23 audit in relation to the wider control issues identified as part of the annual audit. The report outlined the remedial actions agreed by the senior management team and the ARC has reprioritised future internal audit reviews to ensure the issues identified are addressed. The ARC also noted that it will monitor the action plan agreed with Audit Scotland. In light of this and based on the assurance provided by the Internal Auditor's Annual Report, the ARC recommended that the Board approve this annual report and financial statements.

Internal audit

Internal audit has been provided by Grant Thornton since April 2018. At the start of each financial year, a programme of work is agreed with the internal audit team to provide assurance that key risks are being managed effectively and value for money is being achieved. It is a risk-based plan, considering our risk management framework, our strategic objectives and priorities, and the views of senior managers and members of the ARC.

Before each audit, the scope of work is approved by the senior management team and the ARC. The auditors prepare a report for the ARC following each audit. We produce a quarterly report for the ARC explaining progress with management actions.

The overall audit opinion for the year was that "reasonable assurance can be given on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control".

Significant governance issues

There have been no governance issues identified during the year that are significant in relation to our overall governance framework. However, during the year, some weaknesses were identified in relation to our travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area.

There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.

Review of effectiveness

As Accountable Officer, I have responsibility for reviewing the effectiveness of the systems of internal control. My review of the effectiveness of these systems is informed by the work of the internal auditors and the executive managers within the organisation. The executive managers have responsibility for the development and maintenance of the internal control framework. I also rely on the comments made by the external auditors in their management letter and other reports. I have been advised on the effectiveness of the systems by the ARC.

2.2 Remuneration and staff report

REMUNERATION POLICY

The Board and CEO’s remuneration packages are agreed within the parameters set by the Scottish Government’s pay policy. The Scottish Government approves the daily fee to be paid to the Chair and members, as well as approving the CEO’s remuneration package.

Board Members contribute at least one day per week in support of our’ activities. The Chair devotes at least two days per week in support of our activities.

There is no separate remuneration committee and remuneration related issues are brought to the attention of the Board as they arise. No performance payments were made in 2022-23 in accordance with the Scottish Government pay policy.

DIRECTORS’ SALARY AND PENSION ENTITLEMENTS

The overall remuneration of the CEO in the year was £178,283 (2021-22: £183,240). The only other director of the organisation was Ian Tait, the Deputy Chief Executive, who retired on 2 May 2022. The total remuneration of the Directors, including accrued pension benefits was as follows:

AUDITED INFORMATION	2022-23 Gross salary £(000)	2022-23 Pension benefits £(000)	2022-23 Total £(000)	2021-22* Gross salary £(000)	2021-22* Pension benefits £(000)	2021-22* Total £(000)
Alan Sutherland, CEO	165 - 170	5 - 10	**175 - 180**	180 - 185	-	**180 - 185**
Ian Tait, Deputy Chief Executive	10 - 15	-	**10 - 15**	120 - 125	-	**120 - 125**

*The 2021-22 gross salary for Alan Sutherland included a payment of £14k in relation to untaken annual leave.

The 2022-23 CEO pension benefits disclosed in the table above relates to pension contributions paid in prior years that now count towards the pension benefits figure, due to the changes to Pension Lifetime Allowance announced in the March 2023 UK Government budget.

Both the CEO and the Deputy Chief Executive were ordinary members of the Falkirk Council Pension Scheme. The CEO withdrew from the Scheme on 31 March 2017 and the Deputy Chief Executive retired on 2 May 2022. Therefore, no payments were made to the scheme by or on behalf of the CEO during the year and only for the Deputy Chief Executive up until the date of retirement.

The accrued pension benefits in the table above have been calculated as the real increase in pension multiplied by 20 plus the real increase in any lump sum less the contributions made by the individual. The real increases exclude increases due to inflation or any increase or decreases due to a transfer of pension rights. Retirement benefits of the Directors are as follows:

AUDITED INFORMATION				Cash equivalent transfer value**		
	Accrued pension as at 31 March 2023 and related lump sum £(000)	Accrued pension as at 31 March 2022 and related lump sum £(000)	Change in pension net of inflation and related lump sum £(000)	At 31 March 2023 £(000)	At 31 March 2022 £(000)	Increase net of members' contributions £(000)
Alan Sutherland	35 – 40 plus lump sum of 30 – 35	30 – 35 plus lump sum of 30 – 35	0 – 2.5 plus lump sum of 0 – 2.5	676	601	22
Ian Tait	-	40 – 45 plus lump sum of 30 – 35	-	-	692	-

**The cash equivalent transfer value (CETV) is the actuarially assessed value of the retirement scheme benefits accrued by a member at a point in time. The increase shown is the difference between the CETV value calculated at 31 March 2023 and 31 March 2022. As Alan Sutherland is a deferred pensioner, no contributions were paid during the year. There was no CETV to disclose for Ian Tait as at 31 March 2023 due to his retirement during the year.

The Directors' normal retirement age is 67, which is the earliest date at which the member can take full benefits without consent and without reduction. There are no other benefits to which the Directors would become entitled on early retirement.

No bonus payments or benefits in kind were paid to the CEO during 2022-23 (2021-22: £nil). The total remuneration of the CEO and other Director was £190k - £195k (2021-22: £300k - £305k). This decrease is due to the retirement of the other Director in May 2022. The Director was not replaced directly.

BOARD REMUNERATION

The remuneration of the Board Members, other than the CEO , was as follows:

AUDITED INFORMATION	2022-23 Total £(000)	2021-22 Total £(000)
Donald MacRae	35 – 40	35 – 40
Jo Armstrong	15 – 20	15 – 20
Robin McGill	15 – 20	15 – 20
Ann Allen	15 – 20	15 – 20

Board Members are not members of the pension scheme. No benefits in kind were paid in the year.

NON-SALARY REWARDS (AUDITED INFORMATION)

Each staff member received a £100 gift voucher during 2022-23, which is treated as a taxable benefit. The total amount paid directly to employees was £2,600 (2021-22: £2,900). The tax and national insurance payments due on this benefit, £1,133 (2021-22: £1,299) was paid on behalf of the employees by WICS.

FAIR PAY DISCLOSURE (AUDITED INFORMATION)

The range of staff remuneration is £25k-30k to £165k-£170k (2021-22: £20-25k to £180-£155k). Our highest paid director is the CEO at £165k-£170k (2021-22: £180k - £185k), a decrease of 7% from the previous year. The average salary for all employees, excluding the CEO, is £70k -£75k (2021-22: £65k -£70k), representing a 5% increase from the previous year.

Reporting bodies are required to disclose the relationship between the remuneration of the highest paid director in their organisation and other employees. Total remuneration of the CEO, the highest earner in the organisation, has decreased from the previous year. Together with the general increase of salaries of other employees, this has resulted in the ratio between employees at all salary ranges and the CEO to be lower compared to the previous year. This is demonstrated in the table below.

AUDITED INFORMATION	2022-23 £(000)	2021-22 £(000)
Highest paid Director's total remuneration (£)	165k – 170k	180k – 185k
Salary: 25th percentile (£)	34,682	32,004
25th percentile pay ratio	4.9	5.7
Salary: 50th percentile (£)	42,268	42,038
50th percentile pay ratio	4.0	4.3
Salary: 75th percentile (£)	96,835	98,555
75th percentile pay ratio	1.8	1.9

AVERAGE NUMBER OF PERSONS EMPLOYED

The average number of full-time equivalent persons employed during the year was 26 (2021-22: 28), including the CEO. These were employed in the following areas:

AUDITED INFORMATION	Year ended 31 March 2023	Year ended 31 March 2022
CEO and Directors	1	2
Other employees	25	26

Staff composition

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

	Male	Female	Total
Directors	1	-	1
Other employees	12	12	24

Total staff costs for the year were £2,691,278 (2021-22: £2,946,372). Staff costs are outlined in more detail in note 3.5.4 of the financial statements. All employees hold permanent (UK) employment contracts, with the exception of the equivalent of 0.5 FTE relating to agency staff. The cost during the financial year of agency staff was £26,649 (2021-22: £35,167).

EQUALITY AND DIVERSITY IN OUR WORKPLACE

We are committed to valuing and promoting equal opportunities and diversity in all areas of recruitment, employment, training and managing people and to providing benefits to our employees. We are also committed to complying with our general public-sector duty to eliminate unlawful discrimination and promote equality of opportunity. In this respect, we promote and support a culture where all employees can develop their full potential, irrespective of any protected characteristics they may have. Our staff handbook outlines our policy regarding equal opportunities.

Our performance and activities in the area of mainstreaming equality are set out in the Equality Mainstreaming Report 2019-21 on our website. This year we have focused our attention on raising awareness by offering equality, diversity and inclusion training to all our employees. We held an in-person session in September 2022, supported by external professionals. The session generated a lot of good conversation and engagement between employees. We have been working on the outputs from the session and will continue doing so throughout the next year. We are continuing to promote flexible working and have started to take steps to consider the ‘right to disconnect’ and what more can be done to support our staff in their employment.

We follow the Scottish Government’s Pay Policy. This has prioritised protecting those on low pay through a progressive approach delivered through the application of tiered pay increases.

We offer a free, confidential Employee Assistance Programme to all staff. This service provides counselling, signposting and information to help staff with personal or work-related problems that may be affecting their health, wellbeing or performance. It is accessed either online or through a 24-hour Freephone service.

HEALTH, SAFETY AND WELL-BEING

It is our policy to safeguard the health, safety and welfare of all employees by providing healthy and safe working conditions. We consider a positive health and safety culture to be an essential part of the way we conduct our business. We acknowledge that, as a business, we have a responsibility to suppliers and other stakeholders in relation to health and safety matters. Our health and safety policy outlines the responsibilities we have toward employees and provides guidance on health and safety issues.

Our employee handbook outlines the procedures in place for managing staff in a supportive way. We are committed to supporting employees who are absent due to sickness, and we have flexible policies relating to the return to work for employees who have been absent for health and other personal reasons or following maternity or paternity leave.

We actively encourage education and training for all employees. Our performance management and development policy are used to identify training needs and opportunities for development.

SICKNESS ABSENCE AND STAFF TURNOVER

The average length of time that each employee was absent due to sickness was 1 day (2021-22: 4.7 days). We have found that employee sickness rates have reduced significantly since the office moved to a home working model. This will be considered when looking at the future model for the working environment.

Staff turnover in the year was 20% (2021-22: 3.6%). Due to the low number of employees in the organisation, turnover can vary considerably. There was little staff turnover during COVID-19. Of the five leavers during 2022-23, one related to a retirement and another a fixed term contract.

EXIT PACKAGES

There were no voluntary exit packages or compulsory redundancies in the year.

2.3 Parliamentary Accountability Report

FUNDING

We have a Corporate Plan in place, agreed with Scottish Ministers and published on our website. We agree with the Scottish Government the issues to be addressed in the plan and the timetable for its preparation and review. The finalised plan reflects our strategic aims and objectives as agreed by Scottish Ministers, indicative budgets and any priorities set by Scottish Ministers.

Under the 2002 Act as amended by the 2005 Act, we are funded by a levy paid by Scottish Water. Following approval by Scottish Ministers of our Corporate Plan, the Sponsor Directorate instructs Scottish Water to pay the amount determined to us on a monthly basis. Fees are payable by licensed providers on a cost recoverable basis, sufficient to meet the costs we incur in exercising our functions relating to water services and sewerage services.

The Corporate Plan, or elements thereof, is updated between Strategic Reviews as and when considered necessary and a copy is provided to the sponsor unit prior to the start of the Strategic Review period.

LOSSES AND SPECIAL PAYMENTS

There were no losses or special payments in the year (2021-22: £nil).

GIFTS

A gift of £100 was made to each employee during the year. The total value of the benefit was £2,600 (2021-22: £2,900).

CONTINGENT LIABILITIES

At the time of signing the report and financial statements, we were in the process of dealing with the Inland Revenue Department in New Zealand in relation to taxation obligations arising from the work being carried out on the Three Waters Reform Programme in New Zealand. Although no liabilities are expected to arise from this work, the work with the IRD was not concluded. More information on this work can be found in note 3.5.12 (iii) Contingent liabilities.

Alan Sutherland

Alan D A Sutherland
Accountable Officer

07 December 2023

2.4 Independent Auditor's Report

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

REPORTING ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion on financial statements

I have audited the financial statements in the annual report and accounts of the Water Industry Commission for Scotland for the year ended 31 March 2023 under the Water Industry (Scotland) Act 2002, as amended by the Water Services (Scotland) Act 2005. The financial statements comprise the Statement of Comprehensive Net Expenditure, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Equity and notes to the financial statements, including significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, as interpreted and adapted by the 2022/23 Government Financial Reporting Manual (the 2022/23 FReM).

In my opinion the accompanying financial statements:

- give a true and fair view of the state of the body's affairs as at 31 March 2023 and of its net expenditure for the year then ended;
- have been properly prepared in accordance with UK adopted international accounting standards, as interpreted and adapted by the 2022/23 FReM; and
- have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002, as amended by the Water Services (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers.

Basis for opinion

I conducted my audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the Code of Audit Practice approved by the Auditor General for Scotland. My responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of my report. I was appointed by the Auditor General on 2 December 2022. My period of appointment is five years, covering 2022/23 to 2026/27. I am independent of the body in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and I have fulfilled my other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the body. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Conclusions relating to going concern basis of accounting

I have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work I have performed, I have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the body's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

These conclusions are not intended to, nor do they, provide assurance on the body's current or future financial sustainability. However, I report on the body's arrangements for financial sustainability in a separate Annual Audit Report available from the Audit Scotland website.

Risks of material misstatement

I report in my separate Annual Audit Report the most significant assessed risks of material misstatement that I identified and my judgements thereon.

Responsibilities of the Accountable Officer for the financial statements

As explained more fully in the Statement of Accountable Officer's Responsibilities, the Chief Executive, as the Accountable Officer, is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Accountable Officer is responsible for assessing the body's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention to discontinue the body's operations.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. I design procedures in line with my responsibilities outlined above to detect material misstatements in respect of irregularities, including fraud. Procedures include:

- using my understanding of the central government sector to identify that the Water Industry (Scotland) Act 2002, as amended by the Water Services (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers are significant in the context of the body;
- inquiring of the Accountable Officer as to other laws or regulations that may be expected to have a fundamental effect on the operations of the body;
- inquiring of the Accountable Officer concerning the body's policies and procedures regarding compliance with the applicable legal and regulatory framework;

- discussions among my audit team on the susceptibility of the financial statements to material misstatement, including how fraud might occur; and
- considering whether the audit team collectively has the appropriate competence and capabilities to identify or recognise non-compliance with laws and regulations.

The extent to which my procedures are capable of detecting irregularities, including fraud, is affected by the inherent difficulty in detecting irregularities, the effectiveness of the body's controls, and the nature, timing and extent of the audit procedures performed.

Irregularities that result from fraud are inherently more difficult to detect than irregularities that result from error as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of my auditor's report.

REPORTING ON REGULARITY OF EXPENDITURE AND INCOME

Opinion on regularity

In my 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.

Responsibilities for regularity

The Accountable Officer is responsible for ensuring the regularity of expenditure and income. In addition to my responsibilities in respect of irregularities explained in the audit of the financial statements section of my report, I am responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

REPORTING ON OTHER REQUIREMENTS

Opinion prescribed by the Auditor General for Scotland on audited parts of the Remuneration and Staff Report

I have audited the parts of the Remuneration and Staff Report described as audited. In my opinion, the audited parts of the Remuneration and Staff Report have been properly prepared in accordance with the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers.

Other information

The Accountable Officer is responsible for the other information in the annual report and accounts. The other information comprises the Performance Report and the Accountability Report excluding the audited parts of the Remuneration and Staff Report.

My responsibility is to read all the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or my knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If I identify such material inconsistencies or apparent material misstatements, I am required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on the Performance Report and Governance Statement to the extent explicitly stated in the following opinions prescribed by the Auditor General for Scotland.

Opinions prescribed by the Auditor General for Scotland on Performance Report and Governance Statement

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers; and
- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers.

Matters on which I am required to report by exception

I am required by the Auditor General for Scotland to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to my responsibilities for the annual report and accounts, my conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in my Annual Audit Report.

USE OF MY REPORT

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 108 of the Code of Audit Practice, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Richard Smith

Richard Smith CPFA
Senior Audit Manager
Audit Scotland
4th Floor, 8 Nelson Mandela Place
Glasgow, G2 1BT

07 December 2023

3. Financial statements

3.1 Statement of comprehensive net expenditure for the year ended 31 March 2023

The notes on pages 47 - 71 form part of these financial statements	Notes	31 March 2023 £	31 March 2022 (Restated) £
Income			
Income from activities	3.5.2	5,287,598	4,480,585
Expenditure			
Staff costs	3.5.4	(2,691,278)	(2,946,372)
Depreciation	3.5.6	(12,576)	(24,364)
Other expenditure	3.5.5	(1,333,036)	(899,824)
		(4,036,890)	(3,870,560)
Operating surplus		1,250,708	610,025
Interest receivable		14,158	243
Net surplus for the year after interest		**1,264,866**	**610,268**
Corporation tax payable		(1,208)	(1,447)
Other comprehensive net income			
Actuarial gain	3.5.13	2,478,000	2,185,000
Total comprehensive net income		**3,741,658**	**2,793,820**

All income and expenditure relates to continuing activities.

3.2 Statement of financial position as at 31 March 2023

The notes on pages 47 - 71 form part of these financial statements	Notes	31 March 2023 £	31 March 2022 (Restated) £
Non-current assets			
Property, plant, and equipment	3.5.6	25,841	22,745
Property lease	3.5.7	158,728	-
Long term lease payments receivable	3.5.7	58,509	-
Total non-current assets		**243,078**	**22,745**
Current assets			
Other receivables	3.5.8	647,964	72,107
Cash and cash equivalent		3,457,039	2,451,590
Total current assets		**4,105,003**	**2,523,697**
Current liabilities			
Trade payables and other current liabilities	3.5.9	(388,127)	(420,881)
Total current liabilities		**(388,127)**	**(420,881)**
Non-current liabilities			
Provisions	3.5.10	(114,793)	(73,968)
Long term lease payments payable		(218,910)	-
Total net assets, excluding pension liabilities		**3,626,251**	**2,051,593**
Pension scheme liability	3.5.13	(34,000)	(2,201,000)
Net assets		**3,592,251**	**(149,407)**
General reserve		3,626,251	2,051,593
Pension reserve		(34,000)	(2,201,000)
Total equity		**3,592,251**	**(149,407)**

The financial statements were approved by the Board on 7 December 2023.
The Accountable Officer authorised these financial statements for issue on 7 December 2023.

Alan D A Sutherland Alan Sutherland
Accountable Officer 07 December 2023

3.3 Statement of cashflows for the year to 31 March 2023

The notes on pages 47 – 71 form part of these financial statements	Notes	31 March 2023	31 March 2022 (Restated)
Cash flows from operating activities		**£**	**£**
Operating surplus		1,250,708	610,025
Adjustments for non-cash items			
Difference in pension costs compared to contributions	3.5.13	247,000	380,000
Depreciation on tangible non-current assets	3.5.6	12,576	24,364
Finance costs		64,000	85,000
Gain on disposal of fixed assets	3.5.6	-	6,011
Increase in provision	3.5.10	40,825	4,268
Movements in working capital			
(Increase)/Decrease in other receivables	3.5.8	(634,366)	71,960
Increase/(Decrease) in trade payables and other liabilities	3.5.9	186,156	(1,242,482)
Net cash inflow/(outflow) from operating activities		**1,166,899**	**(60,854)**
Cash flows from investing activities			
Purchase of property, plant, and equipment	3.5.6	(15,671)	(11,910)
Recognition of lease asset	3.5.7	(158,728)	-
Net cash outflow from investing activities		**(174,399)**	**(11,910)**
Cash flows from financing activities			
Interest received		14,158	243
Corporation tax payable		(1,208)	(1,447)
Net inflow/(outflow) from financing activities		**12,950**	**(1,204)**
Net increase/(decrease) in cash and cash equivalents		**1,005,449**	**(73,969)**
Cash as at 1 April		2,451,590	2,525,559
Cash as at 31 March		3,457,039	2,451,590
Net increase/(decrease) in cash and cash equivalents		**1,005,449**	**(73,969)**

3.4 Statement of changes in equity for the year ended 31 March 2023

The general reserve is analysed in note 11	£
Balance at 1 April 2021 (restated)	**(2,943,227)**
Total comprehensive net expenditure for the year 2021-22 (restated)	2,793,820
Balance as at 31 March 2022 (restated)	**(149,407)**
Total comprehensive net income for the year 2022-23	3,741,658
Balance as at 31 March 2023	**3,592,251**

The notes on pages **47 – 71** form part of these financial statements.

3.5 Notes to the financial statements

3.5.1 ACCOUNTING POLICIES

The financial statements are prepared in a form determined by 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 Scottish Ministers and prepared in accordance with the 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 our circumstances 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 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 Board and Accountable Officer have considered the budget for 2023-24, including the statutory contribution from Scottish Water and Licensed Provider levies, and consider that we have adequate resources to continue in operational existence for the foreseeable future. The financial statements are therefore prepared on a going concern basis.

(i) Accounting Convention

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

(ii) 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. We make 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.

Pension

The present value of the pension obligations depends on several 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. We are ultimately responsible for the financial and demographic accounting assumptions adopted, based on actuarial advice. We determine the appropriate discount rate at the end of each year, considering information provided by actuaries. 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, we consider 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 3.5.13.

(iii) Prior year adjustment

During the current year's financial statement preparation, an error was identified in the financial statements relating to the incorrect recognition of income from Zero Waste Scotland for the purchase of office furniture.

The sum received was £6,000 and was classified as “other income”. This amount should have been recognised within accumulated depreciation. Another small amount of £174 was adjusted in relation to a historic error within fixed assets which was adjusted through reserves.

As a result, the financial statements for the prior year have been restated to correct this error. The impact of the restatement on the opening balances of equity and the comparative figures for the prior year are as follows:

Impacted area	2021-22 restated (£)	2021-22 as previously reported (£)	Difference (£)
Income from activities	4,480,585	4,486,585	6,000
Property, plant and equipment	22,919	28,919	6,000

This adjustment has been classified as an overhead cost for the purposes of note *3.5.3 Analysis of net expenditure by segment.*

The restatement has been applied retrospectively, with adjustments made to the affected line items in the financial statements. This correction has been made to ensure the accuracy and reliability of the comparative information and to provide users with a corrected financial picture.

(iv) Newly adopted IFRS - Leases

IFRS 16, "Leases", supersedes IAS 17 Leases and is being applied by HM Treasury in the Government Financial Reporting Manual (FreM) from 1 April 2022. IFRS 16 introduces a single lessee accounting model that results in a more faithful representation of a lessee's assets and liabilities and provides enhanced disclosures to improve transparency of reporting on capital employed.

IFRS16 Leases became effective for periods beginning on or after 1 January 2019, however the FReM deferred adoption until 2021. The cumulative catch-up method has been mandated by the FReM. Consequently, the comparatives for 2021-22 reflect the requirements of IAS17.

Under IFRS 16, lessees and lessors are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. While no standard definition of 'low value' has been mandated, we have elected to utilise the capitalisation threshold of £500 to determine the assets to be disclosed.

All existing operating leases fall within the scope of IFRS 16 under the 'grandfathering' rules mandated in the FReM for the initial transition to IFRS 16. New contracts and contract renegotiations will be reviewed for consideration under IFRS 16 as implicitly identified right-of-use assets. Assets recognised under IFRS 16 will be held on the Statement of Financial Position as (i) right of-use assets which represent the Board's right to use the underlying leased assets; and (ii) lease liabilities which represent the obligation to make lease payments.

The value of lease payments will generally be assumed to be a fair proxy for the economic benefits that will be derived from the related right-of-use asset and used to depreciate the asset over the life of the lease.

Upon transition, the accounting policy choice to apply IFRS 16 retrospectively to each prior period presented in accordance with IAS 8 has been withdrawn under the FReM. The cumulative effects of initially applying IFRS 16 are recognised at the date of initial application as an adjustment to the opening reserves balance.

(v) Adopted IFRS not yet applied

In these financial statements, there are no adopted IFRSs which have not yet been applied.

(vi) 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 calculated monthly and 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.

We consider that all 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.

(vii) Financial assets

Classification

We classify financial assets as 'loans and receivables.' We do 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 WICS becomes party to the contractual provisions of the financial instrument. Financial assets are no longer recognised when the rights to receive cash flows from the asset have expired or we have transferred 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 we 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 using 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.

(viii) Financial liabilities

Classification

We classify 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. Our other financial liabilities comprise trade and other payables in the balance sheet.

Recognition and measurement

Financial liabilities are recognised when WICS 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.

(ix) Cash and cash equivalents

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

(x) Provisions

Provisions are recognised when we have a present legal or constructive obligation because 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 several similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations. 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 the passage of time is recognised as an interest expense.

(xi) Income and expenditure

Funding is by way of a statutory contribution paid by Scottish Water, as directed by Scottish Ministers. Licensing activity is funded by a levy charged to Licensed Providers. Income is also received from the beneficiaries of support provided by us in relation to Hydro Nation activities.

From 1 July 2021, we sub-leased our premises in Stirling. Rental income from the property is recorded as other income.

Purchases of goods and services are recorded as expenditure when the goods or services are received rather than when payments are made.

All income and expenditure is recognised in the statement of comprehensive net expenditure in the period to which it relates.

(xii) Value added tax

Most of our activities are outside the scope of Value Added Tax (VAT) and, in general, we are not required to declare output tax to HMRC on the income that it receives. Correspondingly, we are not entitled to recover VAT that it incurs on costs (input tax) in relation to these activities that fall outside the scope of VAT. Such irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets.

(xiii) Corporation tax

Similarly, most of our activities are outside the scope of Corporation Tax. However, Corporation tax is payable on bank interest received from cash deposits held. We submit a corporation tax return to HMRC each year to declare this tax obligation. Income received and expenditure incurred relating to the sub-lease of the main office is included in the tax return. However, no taxation was due on this activity in 2022-23.

(xiv) Employee benefits

Our employees are members of the Local Government Pension Scheme (the Scheme) administered by Falkirk Council. The Scheme is a tax approved, defined benefit occupational pension scheme and the scheme regulations are made under the Public Service Pension Schemes Act 2013 and, in the case of the Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014, under the Superannuation Act 1972. The Scheme is contracted out of the State Second Pension scheme and meets the government's standards under the automatic enrolment provisions of the Pensions Act 2008.

The Scheme is accounted for on a defined benefit basis under IAS 19 Employee Benefits (IAS 19). Assets and liabilities of the Scheme are held separately from those of WICS. 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 to spread the cost of pensions over employees' working lives. The contributions are determined by an actuary based on triennial valuations using the Age Attained Method. The actuaries 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 expenditure on a systematic basis over the expected average remaining lives of members of the funds in accordance with IAS 19 and recognises retirement benefits as the benefits are earned and not when they are due to be paid. The statement of comprehensive expenditure 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 we have 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 net expenditure 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 (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

(xv) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. We recognise termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(xvi) Segmental reporting

Operating segments are identified based on internal reports about components of WICS that are regularly reviewed by the chief operating decision makers in order to allocate resources to the segments and assess their performance.

3.5.2 INCOME

	31 March 2023	31 March 2022 (Re-stated)
	£	£
Scottish Water statutory contribution	2,279,005	2,256,440
Levy on licensed providers	1,718,013	1,672,724
Hydro Nation income	1,185,029	479,455
Rental income	88,533	-
Other income	17,018	71,966
Total income	**5,287,598**	**4,480,585**

3.5.3 ANALYSIS OF NET EXPENDITURE BY SEGMENT

The purpose of activity reporting is to analyse costs by income stream, allowing for a better understanding of how (and against which activities) resources are being deployed. A summary of the full year report is detailed below.

Contribution to overheads by activity	31 March 2023	31 March 2022 Restated
	£	£
Network Regulation	1,175,339	1,156,148
Retail	1,384,631	1,440,003
Hydro Nation	352,874	173,308
Total contribution to overheads	**2,912,844**	**2,769,459**
Overheads	(1,662,136)	(2,159,434)
Net surplus for the year before interest and taxation	**1,250,708**	**610,025**

3.5.4 STAFF RELATED COSTS

	31 March 2023	31 March 2022
	£	**£**
Wages and salaries	2,031,370	1,898,545
Social security costs	224,269	218,446
Pension costs	435,639	829,381
Staff costs per statement of comprehensive net expenditure	**2,691,278**	**2,946,372**

The cash contributions made to the pension scheme are disclosed in note 3.5.13.

3.5.5 OTHER EXPENDITURE

	31 March 2023	31 March 2022
	£	**£**
Travel and subsistence	372,488	16,572
Office accommodation	(74,125)	101,404
Payment of lease liabilities	88,549	-
General operating costs	313,712	248,587
Regulation and licensing costs	412,874	285,927
Recruitment	34,992	8,172
Information technology	103,307	154,503
Finance charges	81,239	84,659
	1,333,036	**899,824**

The operating costs for the year are stated after charging the external audit fee of £18,200 (2021-22: £13,940). Payment of lease liabilities represents the rent payments made during the year for office space at Moray House in Stirling. For full details of lease disclosures, see note 3.5.7. Other accommodation expenditure relates to service charge payments and provision for office dilapidations. As a result of the adoption of IFRS 16, rental costs are no longer accrued on a straight-line basis. Therefore, the rent accrual was reversed, creating a credit within office accommodation.

Services categorised under regulation and licensing costs are provided by external consultants.

Finance charges principally relate to the net interest cost of the pension scheme for the year (see note 3.5.13).

3.5.6 PROPERTY, PLANT AND EQUIPMENT

	Information technology	Furniture and fittings	Total
Cost	**£**	**£**	**£**
At 31 March 2022	116,404	171,084	287,487
Additions	15,671	-	15,671
Disposals	(324)	-	(324)
At 31 March 2023	131,751	171,084	302,835
Depreciation			
At 31 March 2022	94,534	170,035	264,569
Charge for the year	11,528	1,048	12,576
Eliminated on disposals	(151)	-	(151)
At 31 March 2023	105,910	171,084	276,994
Net book value at 31 March 2023	**25,841**	**-**	**25,841**
Net book value at 31 March 2022	21,870	1,048	22,919

	Information technology (Restated)	Furniture and fittings (Restated)	Total (Restated)
Cost	**£**	**£**	**£**
At 31 March 2021	117,061	274,011	391,072
Additions	11,910	-	11,910
Disposals	(12,568)	(102,927)	(115,495)
At 31 March 2022	116,403	171,084	287,488
Depreciation			
At 31 March 2021	84,348	265,514	349,862
Charge for the year	22,753	1,611	24,364
Eliminated on disposals	(12,568)	97,090	(109,658)
At 31 March 2022	94,533	170,035	264,568
Net book value at 31 March 2022	**21,870**	**1,049**	**22,920**
Net book value at 31 March 2021	32,713	8,497	41,210

3.5.7 LEASES

Right-of-use asset

We have one lease for an office building. The lease is reflected on the statement of financial position as a right-of-use asset. At 1 April 2022, the asset is valued as the amount due to the landlord, Stirling Council, until the expiry of the lease (13 March 2026). The amounts due are recorded on the statement of financial position as a lease liability.

Payments made to the landlord during the year reduces both the value of the asset and the lease creditor. Payments we make to Stirling Council will decrease the lease creditor to zero over the life of the lease agreement.

Sub-lease of right-of-use asset

Since 1 July, we have sub-let the office to Zero Waste Scotland (ZWS). The lease agreement is for the term to 30 September 2024, with the option to extend to 13 March 2026. This sub-lease reduces the value of the right-of-use asset on the statement of financial position by the value of the amounts due in relation to rent by ZWS to the end of the current lease term (30 September 2024) to reflect the economic benefits from the right-of-use asset that are transferred from us to ZWS.

Payments due by ZWS are recorded on the statement of financial position as a lease debtor. Payments made to us from ZWS will decrease the lease debtor to zero over the life of the sub-lease agreement.

Depreciation of right-of-use asset

Deprecation will not be charged on the right-of-use asset during the period of the sub-lease agreement as the economic benefits have already been written down for that period to reflect the transfer of the asset to ZWS.

For the period beyond the sub-lease agreement, the value of the lease payments to Stirling Council will be used as a fair proxy for the economic benefits that will be derived from the related right-of-use asset and used to depreciate the asset over the life of the lease.

If ZWS take up the option to extend the lease to 13 March 2026 at the end of the current sub-lease agreement, then we will be required to write down the right-of-use asset to zero in its 2023-24 financial statements and recognise a lease debtor for the value of lease payments due from ZWS over that period.

Right-of-use asset	Note	Property £
Cost at 1 April 2022		-
Recognition of lease asset		408,703
Write down to reflect transfer of asset to ZWS		(249,975)
Cost at 31 March 2023		158,728
Depreciation at 1 April 2022		-
Depreciation at 31 March 2023		-
Carrying amount at 31 March 2023		**158,728**
Carrying amount at 1 April 2022		-

Total future lease payments due under the office building are outlined in the table below.

Payments due by WICS, as lessee	Year ended 31 March 2023
	£
Not later than one year	101,244
Later than one year and not later than five	218,910
Total	**320,154**

Total future lease payments receivable from ZWS are outlined in the table below.

Payments receivable by WICS, from lessor	Year ended 31 March 2023
	£
Not later than one year	102,917
Later than one year and not later than five	58,509
Total	**161,426**

3.5.8 OTHER RECEIVABLES

Current receivables	31 March 2023	31 March 2022
By category:	**£**	**£**
Prepayments	61,774	61,520
Lease payments due < 1 year	102,917	-
Other receivables	483,273	10,587
Total other receivables	**647,964**	**72,107**

The increase in other receivables from the previous year is largely as a result of invoices due from the Department of Internal Affairs, New Zealand of £461k which were settled soon after the end of the financial year 2022-23.

Intra-government receivables	31 March 2023	31 March 2022
	£	**£**
Central Government	-	7,498
Local Authorities	14,713	13,601
Bodies external to government	633,251	51,008
Total other receivables	**647,964**	**72,107**

3.5.9 CURRENT LIABILITIES

Current payables	31 March 2023	31 March 2022
By category	**£**	**£**
Trade payables	45,360	85,399
Taxation and Social Security	58,911	57,848
Accruals	137,810	227,450
Lease payments due < 1 year	101,244	-
Pension	44,802	50,184
Total current liabilities	**388,127**	**420,881**

Intra-government payables	31 March 2023	31 March 2022
	£	**£**
Local Authorities	164,759	67,964
Central Government	79,255	51,024
Bodies external to government	144,113	301,893
Total current liabilities	**388,127**	**420,881**

3.5.10 PROVISIONS FOR LIABILITIES AND CHARGES

	31 March 2023	31 March 2022
	£	**£**
Balance at 1 April 2022	73,968	69,700
Provided in the year	40,825	4,268
Balance at 31 March 2023	**114,793**	**73,968**

The provision for dilapidation costs relates to our 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 end of the financial year. The estimation of costs was reassessed to account for increasing inflation and other cost increases. However, the valuation of potential dilapidations will be reviewed in 2023-24 to ensure they are of a reasonable valuation.

3.5.11 NOTE TO STATEMENT OF CHANGE IN EQUITY

	Note	General reserve	Pension reserve	Re-stated total reserve
		£	**£**	**£**
Balance at 1 April 2021		977,773	(3,921,000)	(2,943,227)
Changes in reserves 2021-22				
Actuarial gains		-	974,000	974,000
Change in assumptions underlying the present value of the scheme liabilities		-	1,211,000	1,211,000
Net surplus/(deficit) for the year		1,073,820	(465,000)	608,820
Balance as at 31 March 2022		2,051,593	(2,201,000)	(149,407)
Changes in reserves 2022-23				
Actuarial gains	3.5.13	-	(3,017,000)	(3,017,000)
Change in assumptions underlying the present value of the scheme liabilities	3.5.13	-	5,495,000	5,495,000
Net surplus/(deficit) for the year		1,574,658	(311,000)	1,263,658
Balance as at 31 March 2023		**3,626,251**	**(34,000)**	**3,592,251**

3.5.12 COMMITMENTS AND CONTINGENT LIABILITIES

(i) Capital commitments

There were no capital commitments at 31 March 2023 (2021-22: £nil).

(ii) Contingent liabilities

We entered a contract with the DIA in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of our extended presence in New Zealand, it was decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, we do not undertake projects with an intention to make profit and instead budgets project activity to reach a break-even position.

From the 1 June 2023, we registered as an employer in New Zealand (IRD No. 139-863-402). On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided us with a Special Tax Rate Certificate confirming that no corporation tax would be due.

The services we provide to the DIA would likely be liable to Goods and Services Tax at a rate of 15%. As the DIA is able to reclaim GST paid, there would be no financial gain for any parties in charging GST on invoices from us to the DIA. Therefore, we submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in these financial statements exclude GST.

There are no other contingent liabilities to disclose in the year.

3.5.13 PENSION

(i) Background

Most of our employees, and some former employees, are members of the Local Government Superannuation Scheme administered by Falkirk Council. This scheme is a defined benefit scheme.

In the period we paid contributions totalling £440k (2021-22: £466k) 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 2023-24 will be 29.4% (2021-22: 29.4%).

In accordance with IAS 19 we commissioned the Fund's actuaries to undertake a valuation as at 31 March 2021. This calculation was based on rolling forward valuation data at 31 March 2020 (the last formal valuation) to 31 March 2023 based on several financial assumptions.

The main financial assumptions used included:

Financial assumptions	Year ended 31 March 2023 % p.a.	Year ended 31 March 2022 % p.a.
Pension Increase Rate (CPI)	2.95	3.15
Salary Increase Rate	3.55	3.75
Discount rate	4.75	2.75

The average future life expectancies at age 65 are summarised below.

Financial assumptions	Males	Females
Current pensioners (years)	20.0	22.7
Future pensioners (years)	21.2	24.7

(ii) Change in the fair value of plan assets, defined benefit obligation and net liability for the year ended 31 March 2023 (continued on next page)

	Assets	Obligations	Net (liability)/ asset
	£(000)	**£(000)**	**£(000)**
Fair value of employer assets	11,271		11,271
Present value of funded liabilities	-	13,432	(13,432)
Present value of unfunded liabilities	-	40	(40)
Opening position as at 31 March 2022	**11,271**	**13,472**	**(2,201)**
Current service cost	-	687	(687)
Total service cost	**-**	**687**	**(687)**
Net interest			
Interest income on plan assets	315	-	315
Interest cost on defined benefit obligation	-	379	(379)
Total net interest	**315**	**379**	**(64)**
Total defined benefit cost recognised in profit	**315**	**1,066**	**(751)**
Cashflows			

	Assets	Obligations	Net (liability)/ asset
Participants' contributions	125	125	-
Employer contributions	437	-	437
Estimated benefits paid	(148)	(148)	-
Estimated unfunded benefits paid	(3)	(3)	-
Estimated contributions in respect of unfunded benefits paid	3	-	3
Expected closing position	**12,000**	**14,512**	**(2,512)**
Re-measurements			
Asset ceiling adjustment	(2,802)	-	(2,802)
Change in financial assumptions	-	(6,250)	6,250
Change in demographic assumptions	-	(89)	89
Other experience	-	844	(844)
Return on assets excluding amounts included in net interest	(215)	-	(215)
Total re-measurements recognised in Other Comprehensive Income (OCI)	**(3,017)**	**(5,495)**	**2,478**
Fair value of employer assets	**9,017**	-	9,017
Present value of funded liabilities	-	9,017	(9,017)
Present value of unfunded liabilities	-	34	(34)
Closing position as at 31 March 2023	**9,017**	**9,051**	**(34)**

Pension assets and liabilities recognised in the statement of financial position

The amount included in the statement of financial position arising from our obligation in respect of the pension scheme is normally the net liability represented by the present value of the defined benefit obligation and the fair value of the plan assets. However, for 2023, the actuarial gains arising from changes in the financial assumptions have resulted in a net asset position.

IAS 19 requires that the net defined benefit asset recognised in the statement of financial position is measured at the lower of the net asset position in the defined benefit fund and the asset ceiling. The asset ceiling is defined as "the present value of any economic benefits available in the form of refunds from the plan, or reductions in future contributions to the plan". As a result, the net pension asset to be recognised in the statement of financial position has been revised to reflect the asset ceiling adjustment advised by our actuaries, Hyman Robertson.

	2022-23	2021-22
	£(000)	**£(000)**
Present value of the defined benefit obligation	(9,017)	(13,472)
Fair value of plan assets	11,785	11,271
Asset ceiling adjustment	(2,802)	-
Net liability arising from defined benefit obligation	**(34)**	**(2,201)**

The liability of £34,000 represents the present value of unfunded pension liabilities as at 31 March 2023.

Asset ceiling adjustment

In accordance with IAS 19 and the guidance issued under the International Financial Reporting Interpretations Commission – Interpretation 14 (IFRIC 14), the asset ceiling has been determined as follows:

	2022-23	2021-22
	£(000)	**£(000)**
Net present value of estimated future service costs	2,391	n/a
Net present value of future contributions	(4,283)	n/a
	(1,892)	**n/a**

As the present value of future contributions are greater than the present value of future service costs, the net asset is restricted zero at 31 March 2023. However, the present value of unfunded pension liabilities are required to be disclosed at the end of the financial year, totalling £34k, as disclosed above.

(iii) Change in the fair value of plan assets, defined benefit obligation and net liability for the year ended 31 March 2022 (continued on next page)

	Assets	Obligations	Net (liability)/ asset
	£(000)	**£(000)**	**£(000)**
Fair value of employer assets	9,660	-	9,660
Present value of funded liabilities	-	13,539	(13,539)
Present value of unfunded liabilities	-	42	(42)
Opening position as at 31 March 2021	**9,660**	**13,581**	**(3,921)**
Current service cost	-	846	(846)
Total service cost	**-**	**846**	**(846)**
Net interest			
Interest income on plan assets	202	-	202
Interest cost on defined benefit obligation	-	287	(287)
Total net interest	**202**	**287**	**(85)**
Total defined benefit cost recognised in deficit	**202**	**1,133**	**(931)**
Cashflows			
Participants' contributions	132	132	-
Employer contributions	463	-	463
Estimated benefits paid	(160)	(160)	-
Estimated unfunded benefits paid	(3)	(3)	-
Estimated contributions in respect of unfunded benefits paid	3	-	3
Expected closing position	**10,297**	**14,683**	**(4,386)**
Re-measurements			
Change in financial assumptions	-	(1,179)	1,179
Change in demographic assumptions	-	(70)	(70)
Other experience	-	38	(38)

	Assets	Obligations	Net (liability)/ asset
Return on assets excluding amounts included in net interest	974	-	974
Total re-measurements recognised in Other Comprehensive Income (OCI)	**974**	**(1,211)**	**2,185**
Fair value of employer assets	**11,271**	-	11,271
Present value of funded liabilities	-	13,432	(13,432)
Present value of unfunded liabilities	-	40	(40)
Closing position as at 31 March 2022	**11,271**	**13,472**	**(2,201)**

(iv) Fair value of plan assets for the period ended 31 March 2023

The below asset values are at bid value as required under IAS 19

Asset category	Quoted prices in active markets £(000)	Quoted prices not in active markets £(000)	Total £(000)	Percentage of total assets
Equity securities:				
Consumer	719.6	-	719.6	6%
Manufacturing	631.2	-	631.2	5%
Energy and utilities	410.5	-	410.5	3%
Financial institutions	857.1	-	857.1	7%
Health and care	385.7	-	385.7	3%
Information technology	955.0	-	955.0	8%
Other	115.2	-	115.2	1%
Debt securities:				
UK Government	482.4	-	482.4	4%
Other	219.9	-	219.9	2%
Private equity:				
All	-	142.0	142.0	1%
Real estate:				
UK property	-	730.0	730.0	6%
Overseas property	-	1.0	1.0	0%
Investment funds and unit trusts:				
Equities	3,042.6	-	3,042.6	26%
Bonds	626.3	-	626.3	5%
Infrastructure	-	1,281.4	1,281.4	11%
Other	456.6	242.8	699.4	6%
Cash and cash equivalents:				
All	485.7	-	485.7	4%
Totals	**9,388**	**2,397**	**11,785**	**100%**

The asset value, at bid value, for the period ended **31 March 2022** are outlined in the table below.

Asset category	Quoted prices in active markets £(000)	Quoted prices not in active markets £(000)	Total £(000)	Percentage of total assets
Equity securities:				
Consumer	841.6	-	841.6	7%
Manufacturing	605.8	-	605.8	5%
Energy and utilities	399.1	-	399.1	4%
Financial institutions	936.4	-	936.4	8%
Health and care	309.7	-	309.7	3%
Information technology	1,033.7	-	1,033.7	9%
Other	59.5	-	59.5	1%
Debt securities:				
UK Government	158.4	-	158.4	1%
Private equity:				
All	-	164.3	164.3	1%
Real estate:				
UK property	-	623.9	623.9	6%
Overseas property	-	1.0	1.0	0%
Investment funds and unit trusts:				
Equities	2,777.9	-	2,777.9	25%
Bonds	706.9	-	706.9	6%
Infrastructure	-	1,100.2	1,100.2	10%
Other	1,038.0	253.3	1,291.3	11%
Cash and cash equivalents:				
All	261.3	-	261.3	2%
Totals	**9,128**	**2,143**	**11,271**	**100%**

(v) Projected defined benefit cost for the period to 31 March 2024

The table below provides an analysis of the projected amount to be charged to operating profit for the period to 31 March 2024.

	Assets	Obligations	Net (liability)/ asset	% of pay
Projected current service cost	-	244	(244)	(16.4%)
Total service cost	**-**	**244**	**(244)**	**(16.4%)**
Interest income on plan assets	569	-	569	38.3%
Interest cost on defined benefit obligation	-	433	(433)	(29.1%)
Total net interest cost	**569**	**433**	**136**	**9.2%**
Total included in income statement	**569**	**677**	**(108)**	**(7.2%)**

Employer's contributions for the period to 31 March 204 will be approximately £437,000.

(vi) Sensitivity analysis

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

Change in assumptions at 31 March 2023	Approximate % increase to employer	Approximate monetary amount £(000)
0.1% decrease in Real Discount Rate	2%	210
0.1% increase in the Salary Increase Rate	0%	14
0.1% increase in the Pension Increase Rate (CPI)	2%	199
1 year increase in member life expectancy	4%	361

3.5.13 RELATED PARTY TRANSACTIONS

As we are a non-departmental public body sponsored by the Scottish Government, the Scottish Government is regarded as a related party. There have been no transactions between us and the Scottish Government.

We have had transactions with other central and local government bodies: Scottish Water, Falkirk Council, Stirling Council and Audit Scotland.

A levy is received from each licensed provider to fund any licensing activity we carry out. Business Stream is a licensed provider and provided us with water and wastewater services up to 30 June 2021. Therefore Business Stream is considered a related party.

All Board Members and Directors complete and update a register of interests on an annual basis. During the year 202-23, no Board Member, Director or other related party has undertaken any material transactions with us.

4. Accounts Direction

WATER INDUSTRY COMMISSION FOR SCOTLAND
DIRECTIONS BY THE SCOTTISH MINISTERS

1. The Scottish Ministers give the following directions to the Water Industry Commission for Scotland ("WICS") in exercise of powers conferred by section 1(3) of the Water Industry (Scotland) Act 2002 (the "2002 Act"), as amended by section 1(1) of the Water Services etc. (Scotland) Act 2005. In accordance with section 1(3) of the 2002 Act, the Scottish Ministers have consulted WICS.

2. The statement of accounts for the financial year ended 31 March 2018, 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. These directions shall be reproduced as an appendix to the statement of accounts.

5. The direction given by the Scottish Ministers to WICS, in relation to statements of accounts, dated 3 October 2006 is revoked.

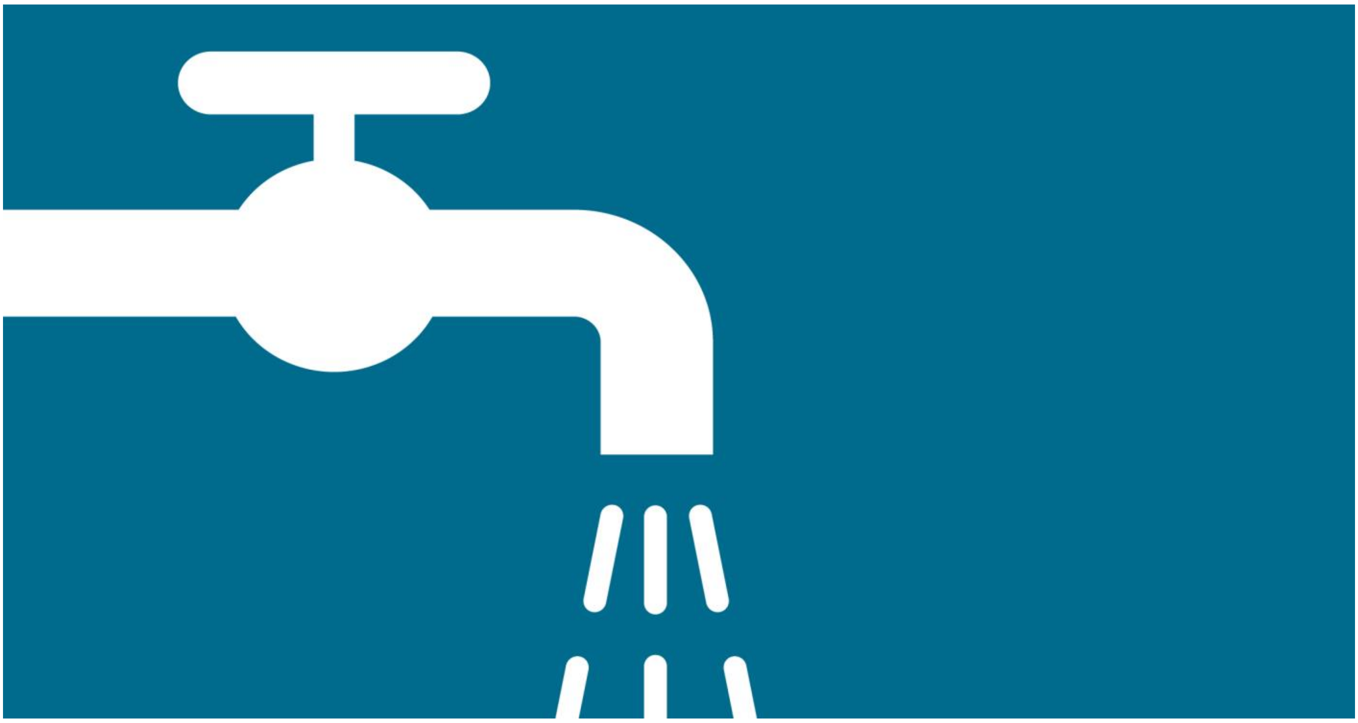
Signed by the authority of the Scottish Ministers
Dated: 31 July 2018

WICS
Moray House
Forthside Way
Stirling
FK8 1QZ

T: 01786 430 200
E: enquiries@wics.scot

WICS Economic regulation for Scotland's water

The 2022/23 audit of the Water Industry Commission for Scotland



Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2022/23. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on the Commission's financial statements for 2022/23. I have prepared this report to draw the Scottish Parliament's attention to significant weaknesses in the governance and financial management arrangements identified by the auditor. I am concerned that the current culture within the Commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds.

Key messages

- The Commission incurred two items of expenditure during 2022/23 that required Scottish Government approval. This was only received from the sponsor team retrospectively following audit intervention.
- This included retrospective approval of expenditure for the Chief Operating Officer's participation in an advanced management course, over a number of months, at Harvard Business School in Boston at a total cost of £77,350.
- The auditor identified widespread issues with the expenses reimbursement process; including claims not supported by itemised receipts, exceeding the approved subsistence rates, and, on occasion, the reimbursement of the purchase of alcohol.

- The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.

Background

3. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. It also works to ensure that the industry is internationally recognised and sustainable through its role in supporting the Scottish Government's Hydro Nation ambition.

4. The Commission employs 26 staff and incurred expenditure of £4.036 million during 2022/23 (with 67 per cent relating to staff costs). It received income of £5.288 million during the year, including levy income of £2.279 million from Scottish Water and £1.718 million from licensed providers, and £1.185 million from international work related to the Scottish Government's Hydro Nation strategy. This resulted in the Commission reporting an operating surplus of £1.251 million for the year ended 31 March 2023.

5. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

The Commission demonstrated poor governance over the approval of expenditure, including insufficient engagement with its Scottish Government sponsor division

6. In 2022/23, the Chief Operating Officer attended a training course at Harvard Business School in Boston at a total cost, including flights, of £77,350. Scottish Government approval is required for any service above £20,000 that has not been awarded via a competitive tender exercise.

7. Further, the Commission purchased a £100 gift voucher for each member of staff as a Christmas gift at a total cost of £2,600 (a similar arrangement was in place in 2021/22 when the total cost was £2,900). This exceeded the Commission's delegated limit of £75 for gifts and should have been approved by the Scottish Government. Due to the nature of this payment to each member of staff, it also represented a non-salary reward and should have been treated as a taxable benefit. This was not the case and the associated £1,133 of tax and national insurance payments were paid by the Commission to His Majesty's Revenue and Customs (HMRC).

8. No approval was sought from the Scottish Government, or the Board, prior to the above payments being made. It was only once the issues were identified and reported by the auditor that retrospective approval was sought and received from the sponsor team within the Scottish Government, and the Board were advised that retrospective approval had been given.

9. I am concerned that this amount of public money was spent without due process being followed or a clear assessment being undertaken to demonstrate that this expenditure represented value for money. All expenditure should be incurred in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual. If there is any dubiety as to whether planned expenditure is permissible, approval should be sought from the sponsor division prior to the expenditure being incurred.

There were weaknesses in the financial control arrangements for the approval of expense claims

10. The Commission's Finance Policies and Guidelines outline the expectations and approved rates for expense claims. The auditor identified widespread issues with expense claims being submitted and approved without supporting itemised receipts, including items submitted by the Chief Executive, and exceeding the approved rates.

11. In their annual audit report, the auditor highlights a specific example where the cost per head claimed for a dinner, attended by the Chief Executive, exceeded £200 per person despite the approved non-city limit being £25. This, and other claims, also included the purchase of alcohol. Unusually for a public body, the Commission's existing policies do not explicitly prohibit the purchase of alcohol as a business expense. The Commission should introduce clear guidance on what is deemed to be acceptable in this regard.

12. Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. The use of approved rates ensures that value for money has been considered when incurring such expenditure.

13. The governance statement in the Commission's 2022/23 annual report and accounts includes the following disclosure: 'There have been no governance issues identified during the year that are significant in relation to WICS' overall governance framework. However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area. There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again, the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.'

Lack of adequate arrangements resulted in public funds being used to settle personal tax costs

14. A PAYE settlement agreement (PSA) with HMRC allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits for its employees.

15. Following a review by management, payments dating back to 2018/19 were identified that should have been treated as taxable benefits to staff. The Commission made a payment of £3,384 in October 2023 to settle its 2022/23 obligation (this included the £1,133 detailed at paragraph 7 above). The Commission has submitted a voluntary disclosure for the period 2018/19 to 2021/22 but has estimated that a further payment of £5,435 will be required for those years.

16. The Commission needs to ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

Conclusions

17. The auditor concluded that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. Value for money should be a key consideration for all expenditure incurred by public bodies and the findings of the auditor highlight unacceptable behaviour, by senior officials within the Commission, in the use of public funds.

18. I recognise that management has accepted the findings and recommendations from the auditor and has committed to specific actions to address them as a matter of urgency.

19. I will continue to monitor progress on these matters and report further in public as necessary.

The 2022/23 audit of the Water Industry Commission for Scotland

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

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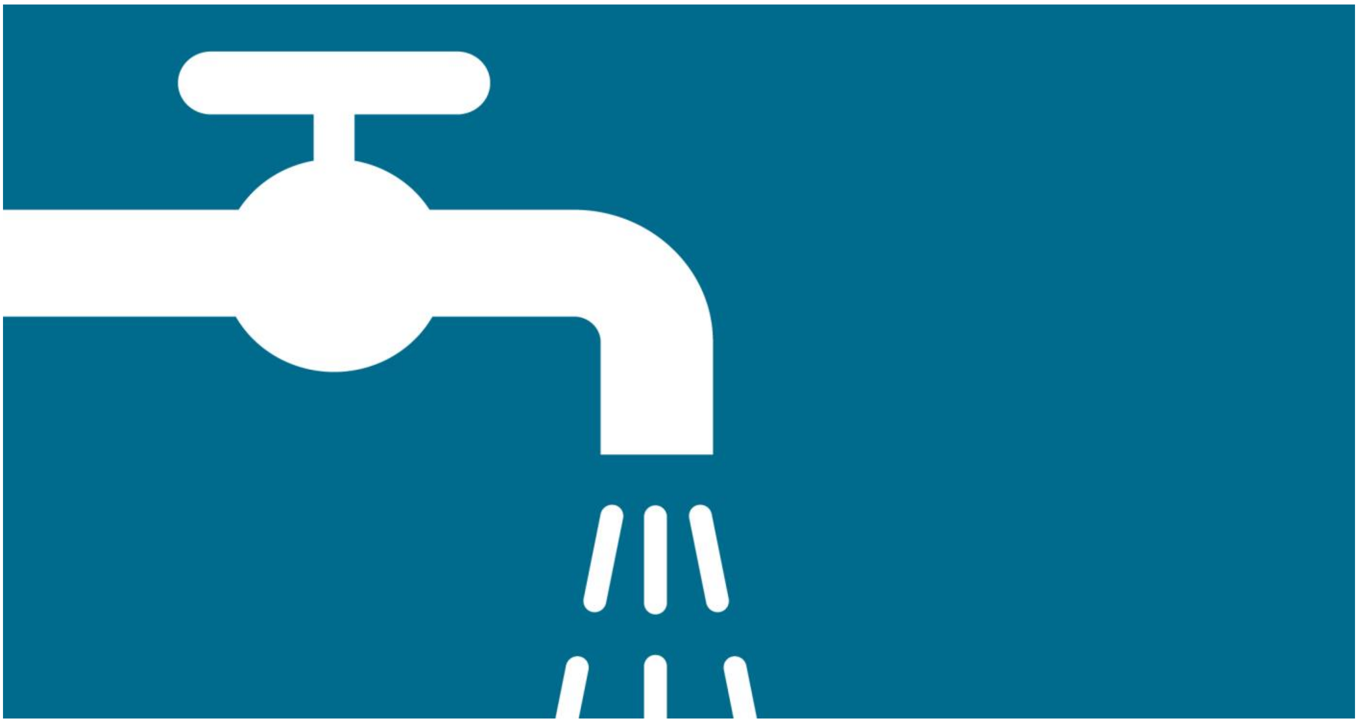
The 2022/23 audit of the Water Industry Commission for Scotland



AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

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19. I will continue to monitor progress on these matters and report further in public as necessary.

The 2022/23 audit of the Water Industry Commission for Scotland

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AUDIT SCOTLAND

14 December 2023

[redacted]
Head of Water Policy
Scottish Government
3F South
Victoria Quay
EDINBURGH
EH6 6QQ

Dear [redacted]

Water Industry Commission for Scotland
Accounts for year ended 31 March 2023

Please find enclosed the audited accounts of Water Industry Commission for Scotland for the 12 months ended 31 March 2023. These also incorporate the auditor's report. I also enclose a copy of my report on the accounts prepared under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000.

Section 22(5) of the Public Finance and Accountability (Scotland) Act 2000 requires Scottish Ministers to lay a copy of the accounts, the auditor's report and the s22 report before the Parliament and to publish the accounts and auditor's report. The legislation also requires the accounts and auditor's report to be laid by no later than 31 December 2023. I would be grateful if you could make the necessary arrangements for this to take place.

If you have any questions regarding this letter, please contact [redacted], Senior Manager [redacted]) within the Performance Audit and Best Value Group of Audit Scotland.

Yours sincerely

Stephen Boyle
Auditor General for Scotland

Enc

From: Alan Sutherland
To: [redacted]
Subject: Re: [EXT] Water Industry Commission for Scotland 2022/23 Certified Annual Report and Accounts / Annual Audit Report
Date: 07 December 2023 20:53:29
Attachments: image001.png
image002.png
image001.png
image002.png
WICS_Annual_Report_and_Accounts_2022-23 (Certified).pdf
WICS_2022-23_AAR_Issued.pdf

Thank you.

Alan

> On 7 Dec 2023, at 20:34, [redacted]@audit-scotland.gov.uk> wrote:
>
> **CAUTION:** This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.
>
> Good Evening Alan,
>
> Following the approval of the Water Industry Commission for Scotland 2022/23 Annual Report and Accounts at the Borad earlier today, please now find attached the certified accounts and the final issued version of our Annual Audit Report for your records.
>
> Our report will be published on Audit Scotland's website after the accounts are laid at the Scottish Parliament. As previously discussed, the accounts are expected to be laid on Tuesday 19th December and will be accompanied by a Section 22 Report from the Auditor General for Scotland on the 2022/23 audit.
>
> We would like to thank all management and staff for their cooperation and assistance during the audit.
>
> Kind regards,
>
> [redacted]
>
> [redacted]
> **Senior Audit Manager**
>
> [redacted]
>
> Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
> 8 Nelson Mandela Place, Glasgow, G2 1BT
> **T:** [redacted]@audit-scotland.gov.uk
> **www.audit-scotland.gov.uk**
>
> ***Please note that my current working pattern is 8:45am-5pm Monday to Friday***

Water Industry Commission for Scotland

2022/23 Annual Audit Report

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor’s report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor’s professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Reverse the previous rent accounting entries. • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2022. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Appropriate disclosures were also added to the governance statement in relation to the control weaknesses identified during the year. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total

overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit was £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified an accrual of £8,818 relating to an obligation for a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments dating back as far as 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,818. The Commission settled its 2022/23 obligation in October 2023 and are awaiting a response to the voluntary disclosure for prior years.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure. However, it also included the purchase of the £100 gift vouchers for Commission staff, detailed at issue 5 in Exhibit 3.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Management has accepted the findings from the audit and agreed actions to address the weaknesses reported

44. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported, as detailed in Appendix 1.

45. Management advised that it recognises that some of the processes that worked well when they were based in Moray House lapsed when the Commission started to work remotely. They have relied on the new Approvals Max system for review of expenditures and there was insufficient discussion of these expenditures. They acknowledge that this was clearly an oversight on their part. Previously, an approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. They also note that there is an opportunity to use the approvals panel to review potential future expenditures and ensure that they are aligned to the corporate plan and international activities.

46. Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than they could reasonably have foreseen. What they thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management has committed to conducting a lessons learned exercise on what they could and should have done differently. This review will include the personal tax implications of staff working internationally for prolonged periods of time and will also review the financial and legal disclosures required to be in place for staff prior to delivering such contracts. They will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussions with Scottish Government officials to determine how the Commission should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of the Commission in this area. Management is working closely with officials and the policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Director of Corporate and International Affairs **Agreed date:** December 2023

Issue/risk	Recommendation	Agreed management action/timing
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20,000 which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Chief Executive **Agreed date:** Approvals Panels will be implemented immediately and the minutes shared with the board / Audit and Risk Committee at all subsequent meetings. Training will be provided by the end of January 2024. Three months after the passing of the government's water bill for agreeing and implementing the appropriate arrangements for international activities.

Issue/risk	Recommendation	Agreed management action/timing
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence, and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee and the Board. With immediate effect, management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the Audit and Risk Committee. Management will revise the expense policy to ensure that there is a separate policy relating to hospitality and events so that there is sufficient distinction made between this type of expenditure and regular subsistence expenses. This will help ensure that a retirement dinner, as referenced in paragraph 32, is treated differently to a subsistence allowance. Management commits to ensuring that all staff are appropriately trained in this area, including how to tag and describe expenses to ensure that there is clarity between subsistence expenses and expenditure relating to business development or hospitality / events. Management also commits to sharing the minutes of our approvals panel with the Audit and Risk Committee. **Responsible officer:** Director of Strategy and Governance **Agreed date:** Training to be completed by 30 January 2024.

Issue/risk	Recommendation	Agreed management action/timing
4. Identification of taxable benefits to staff The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will take further advice to establish appropriate rules and procedures. Management will ensure that this advice is implemented in full and ensure adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Chief Executive **Agreed date:** 30 January 2024 for the advice and March 2024 for its implementation.
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Management accept that it is likely that Zero Waste Scotland may not contribute towards the dilapidation charge. When the contract next comes up for renewal, we will again explore the dilapidations question with Zero Waste Scotland. Management's focus at the time was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. **Responsible officer:** Chief Executive **Agreed date:** Contract renewal September 2024

Water Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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From: Alan Sutherland
To: Jon Rathjen
Subject: Fwd: [EXT] External audit - Section 22 report for clearance
Date: 06 December 2023 14:46:46
Attachments: image001.png
image002.png
WICS s22 DRAFT for clearance.docx
Sensitivity: Confidential

Begin forwarded message:

From: [redacted]@audit-scotland.gov.uk>
Date: 6 December 2023 at 10:38:48 GMT
To: Alan Sutherland [redacted]@wics.scot>, Donald MacRae [redacted]@wics.scot>, Robin Mcgill [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: [EXT] External audit - Section 22 report for clearance

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Morning Alan, Donald and Robin,

Please find attached the draft Section 22 report from the Auditor General for Scotland on the 2022/23 audit of the Water Industry Commission for Scotland. I would be grateful if you could review the document to confirm the factual accuracy of the contents and send back any comments you have by close of business on Tuesday next week (12th December), to enable the Commission's 2022/23 Annual Report and Accounts to be laid at the Scottish Parliament on Tuesday 19th December.

I would also ask you to share it with your sponsor division to ensure they are aware of the issues being reported by the AGS within the report.

Regards,

[redacted]

[redacted]
Senior Audit Manager

[redacted]

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
8 Nelson Mandela Place, Glasgow, G2 1BT
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

The 2022/23 audit of the Water Industry Commission for Scotland

DRAFT – IN CONFIDENCE

AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2022/23. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on the Commission's financial statements for 2022/23. I have prepared this report to draw the Scottish Parliament's attention to significant weaknesses in the governance and financial management arrangements identified by the auditor. I am concerned that the current culture within the Commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds.

Key messages

- The Commission incurred expenditure during 2022/23 that required Scottish Government approval. This was only received from the sponsor team retrospectively following audit intervention.
- The retrospective approval included for expenditure on the Chief Operating Officer's attendance at a training course at Harvard Business School in Boston at a total cost of £77,350.
- The auditor identified widespread issues with the expenses reimbursement process; including claims not supported by itemised receipts, exceeding the approved subsistence rates, and, on occasion, the reimbursement of the purchase of alcohol.

- The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.

Background

3. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. It also works to ensure that the industry is internationally recognised and sustainable.

4. The Commission employs 26 staff and incurred expenditure of £4.036 million during 2022/23 (with 67 per cent relating to staff costs). It received income of £5.288 million during the year, including levy income of £2.279 million from Scottish Water and £1.718 million from licensed providers, and £1.185 million from international work related to the Scottish Government's Hydro Nation strategy. This resulted in the Commission reporting an operating surplus of £1.251 million for the year ended 31 March 2023.

5. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

The Commission demonstrated poor governance over the approval of expenditure, including insufficient engagement with its Scottish Government sponsor division

6. In 2022/23 the Chief Operating Officer attended a training course at Harvard Business School in Boston at a total cost, including flights, of £77,350. Scottish Government approval is required for any service above £20,000 that has not been awarded via a competitive tender exercise.

7. Further, the Commission purchased a £100 gift voucher for each member of staff as a Christmas gift at a total cost of £2,600 (a similar arrangement was in place in 2021/22 when the total cost was £2,900). This exceeded the Commission's delegated limit of £75 for gifts and should have been approved by the Scottish Government. Due to the nature of this payment to each member of staff, it also represented a non-salary reward and should have been treated as a taxable benefit. This was not the case and the associated £1,133 of tax and national insurance payments were paid by the Commission to His Majesty's Revenue and Customs (HMRC).

8. No approval was sought from the Scottish Government, or the Board, prior to the above payments being made. It was only once the issues were identified and reported by the auditor that retrospective approval was sought and received from the sponsor team within the Scottish Government, and the Board were advised that retrospective approval had been given.

9. I am concerned that this amount of public money was spent without due process being followed or a clear assessment being undertaken to demonstrate that this expenditure represented value for money. All expenditure should be incurred in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual. If there is any dubiety as to whether planned expenditure is permissible, approval should be sought from the sponsor division prior to the expenditure being incurred.

There were weaknesses in the financial control arrangements for the approval of expense claims

10. The Commission's Finance Policies and Guidelines outline the expectations and approved rates for expense claims. The auditor identified widespread issues with expense claims being submitted and approved without supporting itemised receipts, including items submitted by the Chief Executive, and exceeding the approved rates.

11. In their annual audit report, the auditor highlights a specific example where the cost per head claimed for a dinner, attended by the Chief Executive, exceeded £200 per person despite the approved non-city limit being £25. This, and other claims, also included the purchase of alcohol. Unusually for a public body, the Commission's existing policies do not explicitly prohibit the purchase of alcohol as a business expense. The Commission should introduce clear guidance on what is deemed to be acceptable in this regard.

12. Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. The use of approved rates ensures that value for money has been considered when incurring such expenditure.

13. The governance statement in the Commission's 2022/23 annual report and accounts includes the following disclosure '*There have been no governance issues identified during the year that are significant in relation to WICS' overall governance framework. However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area. There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.*'

Lack of adequate arrangements resulted in public funds being used to settle personal tax costs

14. A PAYE settlement agreement (PSA) with HMRC allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits for its employees.

15. Following a review by management, payments dating back to 2018/19 were identified that should have been treated as taxable benefits to staff. The Commission made a payment of £3,384 in October 2023 to settle its 2022/23 obligation (this included the £1,133 detailed at paragraph 7. above). The Commission has submitted a voluntary disclosure for the period 2018/19 to 2021/22 but has estimated that a further payment of £5,435 will be required for those years.

16. The Commission needs to ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

Conclusions

17. The auditor concluded that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. Value for money should be a key consideration for all expenditure incurred by public bodies and the findings of the auditor highlight unacceptable behaviour, by senior officials within the Commission, in the use of public funds.

18. I recognise that management has accepted the findings and recommendations from the auditor and has committed to specific actions to address them as a matter of urgency.

19. I will continue to monitor progress on these matters and report further in public as necessary.

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www.audit-scotland.gov.uk

From: Alan Sutherland
To: Directors
Subject: FW: [EXT] External audit - Draft 2022/23 Annual Audit Report
Date: 06 November 2023 16:41:00
Attachments: image001.png
image002.png
WICS_2022-23_AAR_Draft.docx

I have a feeling that [redacted] is correct. We will have to make HN a separate business unit…

A

From: [redacted]@audit-scotland.gov.uk>
Sent: Monday, November 6, 2023 3:40 PM
To: Alan Sutherland [redacted]@wics.scot>; [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: [EXT] External audit - Draft 2022/23 Annual Audit Report

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Alan / [redacted]

Please find attached our draft 2022/23 Annual Audit Report. I would be grateful if you could review this document to confirm the factual accuracy of the contents and provide actions and timescales for each of the recommendations set out in Appendix 1.

Our report is due to be considered along with the audited 2022/23 Annual Report and Accounts at the next ARC meeting on Tuesday 21st November so I would appreciate if you could provide your response by close of business on Friday (10th November) to enable us to finalise the document in time for the ARC papers being issued next week.

Kind regards,

[redacted]

[redacted]
Senior Audit Manager

[redacted]

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Please note that my current working pattern is 8:45am-5pm Monday to Friday

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

AUDIT SCOTLAND

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288

million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Issue/risk	Recommendation	Agreed management action/timing
and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Paragraphs 31. to 33.	
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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www.audit-scotland.gov.uk

From: Alan Sutherland
To: Donna Very
Subject: Re:
Date: 27 October 2023 19:35:42

Not in the policies!

> On 27 Oct 2023, at 19:33, Donna Very <[redacted]@wics.scot> wrote:
>
> But isn't it because it had a value of over £20,000. That's what it says on the approvals form.
>
> [redacted]
> Sent from my iPhone
>
>> On 27 Oct 2023, at 19:27, Alan Sutherland [redacted]@wics.scot> wrote:
>>
>> Colin has been through our policies and we can see nothing that requires the Harvard thing to go to SG. The Amazon vouchers we are definitely wrong - should have gone to SG.
>>
>> Perhaps there is something in Government rules that covers Harvard but it is not in ours. If in SH rules, it should have been in our policies but was not.
>>
>> [redacted]
>>
>> [redacted]
>>
>> A
>>
>>> On 27 Oct 2023, at 17:02, Donna Very [redacted]@wics.scot> wrote:
>>>
>>> Alan
>>>
>>> Not sure about this and I am feeling a bit miserable about it so will look again on Monday
>>>
>>> Hi Jon
>>>
>>> Hope you are well.
>>>
>>> Audit Scotland has been conducting an audit of our

accounts and have highlighted two areas where we should have obtained approval from Scottish Government.   This, of course, is not ideal and we apologise for these oversights.

As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office.
  Following a one-to-one with the Chief Operating Officer (COO) at the end of 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000 (approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for the Campus modules. Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs was comparable to other business schools.   An internal approvals process was completed and the course was approved. The Board were aware of the COO's training (AS – I cannot find anything just yet but finance reports must show or comment on it)

As this course was over £20,000, WICS should have sought approval. We apologise for this oversight and seek retrospective approval from you.

The other area where we should have sought approval was for £2,500 expenditure incurred for the purchase of 25 x £100 Amazon gift vouchers. This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. This was an oversight on our part and we seek retrospective approval for this.

We are of course sorry for these oversights and will endeavour to ensure that going forward we do not miss SG approval for such things.

I look forward to hearing from you.

Donna

From:	Alan Sutherland
To:	Donna Very
Subject:	Re:
Date:	27 October 2023 17:10:22

It's a good draft. The timing of discussions on this went back much further, I think.

Worth circulating?

A

> On 27 Oct 2023, at 17:02, Donna Very [redacted]@wics.scot> wrote:
>
> Alan
>
> Not sure about this and I am feeling a bit miserable about it so will look again on Monday
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> Hi Jon
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> Hope you are well.
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>
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>
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We are of course sorry for these oversights and will endeavour to ensure that going forward we do not miss SG approval for such things.

I look forward to hearing from you.

Donna

From: [redacted]
To: [redacted]
Subject: FW: [EXT] External audit - Draft 2022/23 Annual Audit Report
Date: 06 November 2023 14:55:20
Attachments: image001.png
image002.png
WICS_2022-23_AAR_Draft.docx
image003.png

H[redacted]

[redacted] sent me a copy of the audit report. Let me know what you think,
Thanks
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: [redacted]@audit-scotland.gov.uk>
Sent: Monday, November 6, 2023 2:26 PM
To: [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: [EXT] External audit - Draft 2022/23 Annual Audit Report

[redacted]

Apologies for the delay in sending this through but we were just updating the report for the figures in the latest version of the annual accounts. If there are any further changes then we can reflect these in the final issued version of the report.

As discussed on Thursday last week I would be grateful if you could get back with any comments by the end of today to enable us to issue the draft report to Alan.

Give me or [redacted] a shout if there is anything that it is easy to discuss over a Teams call.

[redacted]

[redacted]
Senior Audit Manager

[redacted]

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8 Nelson Mandela Place, Glasgow, G2 1BT
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

AUDIT SCOTLAND

Prepared for the Water Industry Commission for Scotland and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23. We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3

Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23. We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total

overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not have any immediate concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.174 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income. However, management should ensure that there are contingency plans to respond to any unexpected decrease in Hydro Nation income and prevent unnecessary expenditure for the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Issue/risk	Recommendation	Agreed management action/timing
and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Paragraphs 31. to 33.	
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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From: [redacted]
To: [redacted]
Subject: FW: [EXT] News release for information - Auditor General report
Date: 19 December 2023 17:04:00
Attachments: image001.png

For info – here is the news release for tomorrow,
Kind regards
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: [redacted]@wics.scot>
Sent: Tuesday, December 19, 2023 11:03 AM
To: [redacted]@wics.scot>
Subject: FW: [EXT] News release for information - Auditor General report

Sorry [redacted] I meant to include you too.

Thanks
[redacted]

From: enquiries
Sent: Tuesday, December 19, 2023 11:02 AM
To: OpsBoard <[redacted]@watercommission.co.uk>
Cc: [redacted]@wics.scot>; [redacted]@wics.scot>
Subject: FW: [EXT] News release for information - Auditor General report

Hi all

Please see below email from Audit Scotland with their intended news release. Please could you share with me any response, including any prepared media response, and I will get that sent to [redacted]

Also, please let me know if there is a comms plan for replying to any media enquiries.

Thanks
[redacted]

From: [redacted]@audit-scotland.gov.uk>

Sent: Tuesday, December 19, 2023 10:51 AM
To: enquiries <enquiries@wics.scot>
Subject: [EXT] News release for information - Auditor General report

Good morning,

As promised, here is the news release that will accompany the publication of the Auditor General's s22 report on WICS.

The news release is for information.

I'd be grateful if WICS could share any media lines worked up in response to the report.

I will copy this email address into the distribution to media contacts tomorrow morning, once the reports have been laid in Parliament.

We're expecting media interest in the story and I will let you know if we receive any broadcast bids.

[redacted]

News release

For immediate release, 20 December 2023

Unacceptable financial management at water industry watchdog

Auditors have found unacceptable use of public funds by senior officials at the Water Industry Commission for Scotland.

The Commission is the economic regulator of Scottish Water. Its job is to ensure long-term value and excellent levels of service for customers and communities.

Auditors reported that, in 2022/23, the Commission needed retrospective approval from the Scottish Government for around £80,000 of spending. This included:

- £77,350 for the chief operating officer to attend a training course at Harvard Business School

- £2,600 on £100 Christmas gift vouchers for each member of staff.

Expenses claims exceeding set rates were also found to have been submitted and approved without itemised receipts, including by the Chief Executive. One claim was for a dinner where the cost per head exceeded £200 per person. This, and other claims, included the purchase of alcohol.

Stephen Boyle, Auditor General for Scotland, said:

“Value for money should always be central to public bodies’ spending decisions.

“But these findings highlight unacceptable behaviour by senior Commission officials in the use of public funds.

“I expect appropriate action to be taken to address the issues reported by the auditor.”

For further information contact [redacted] @audit-scotland.gov.uk or media@audit-scotland.gov.uk

Notes to Editor:

- The Auditor General has prepared the report on the Scottish Water Commission for Scotland’s 2022/23 under Section 22 of the Public Finance and Accountability (Scotland) Act 2000. This allows the Auditor General to bring to the Parliament’s and the public's attention matters of public interest related to the financial statements of public bodies.

- Section 22 reports are submitted to Scottish Ministers for laying in the Parliament along with the accounts of the relevant body. While there are statutory deadlines for these reports, the actual timing of publication is determined by when the report is laid in the Scottish Parliament by Scottish Ministers.

- The Water Industry Commission for Scotland requires Scottish Government approval for any service above £20,000 that has not been awarded via a competitive tender exercise.

- The Commission’s delegated limit for gifts is £75, which is the requirement of the Scottish Public Finance Manual. Gifts over this amount should have been approved by the Scottish Government. The Christmas gift vouchers also represented a non-salary reward and should have been treated as a taxable benefit.

- Unusually for a public body, the Commission’s existing policies do not explicitly prohibit the purchase of alcohol as a business expense.

Audit Scotland has prepared this report for the Auditor General for Scotland. All Audit Scotland reports published since 2000 are available at www.audit-scotland.gov.uk

The Auditor General for Scotland appoints auditors to Scotland's central government and NHS bodies; examines how public bodies spend public money; helps them to manage their finances to the highest standards; and checks whether they achieve value for money. The Auditor General for Scotland is independent and is not subject to the control of the Scottish Government or the Scottish Parliament

Audit Scotland is a statutory body set up in April 2000, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission for Scotland.

From: [redacted]
To: [redacted]
Subject: FW: WICS_s22_DRAFT for clearance_WICS_edits
Date: 12 December 2023 12:29:12
Attachments: image001.png
WICS_s22_DRAFT for clearance_WICS_edits.docx
WICS_s22_DRAFT for clearance_WICS_edits_v2_3.docx

Here is the original section 22 with their comments, some of my comments below (I sent a much harsher email to Alan, Robin and Donald) and the version they ended up using to send to Donald.

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: [redacted]@wics.scot>
Sent: Friday, December 8, 2023 6:27 PM
To: Colin McNaughton [redacted]@wics.scot>; David Satti[redacted]@wics.scot>; Donna Very [redacted]@wics.scot>
Cc: Alan Sutherland [redacted]@wics.scot
Subject: RE: WICS_s22_DRAFT for clearance_WICS_edits

Hi Colin,

A couple of points from me:

- The dinner being referred to is not the retirement dinner. It was a meal at Champany's on 9 October 2022, for Alan and [redacted]. [redacted]
- I am not sure Audit Scotland will accept the point about the Christmas Parties and HMRC. They were very clear that HMRC rates do not equate to value for money, particularly in the context of public sector.
- I'm not sure highlighting the fact that we removed the subsistence rates was a good thing. The report specifically states that allowances should be used to ensure value for money.

Are we sending these comments to Audit Scotland? I think the comments represent a step back from the conversations we had yesterday and come across to be quite defensive. Have you sent this over to the Board yet?

Thanks
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: Colin McNaughton <[redacted]@wics.scot>
Sent: Friday, December 8, 2023 4:51 PM
To: David Satti [redacted]@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@wics.scot>
Cc: Alan Sutherland <[redacted]@wics.scot>
Subject: WICS_s22_DRAFT for clearance_WICS_edits

Hi all

Here's the version with comments that Alan and I added. You should've received a link too

We were going to just send it to the Board now

Thanks
Colin

The 2022/23 audit of the Water Industry Commission for Scotland

DRAFT – IN CONFIDENCE

AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2022/23. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on the Commission's financial statements for 2022/23. I have prepared this report to draw the Scottish Parliament's attention to significant weaknesses in the governance and financial management arrangements identified by the auditor. I am concerned that the current culture within the Commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds.

Key messages

- The Commission incurred expenditure during 2022/23 that required Scottish Government approval. This was only received from the sponsor team retrospectively following audit intervention.
- The retrospective approval included for expenditure on the Chief Operating Officer's attendance at a training course at Harvard Business School in Boston at a total cost of £77,350.
- The auditor identified widespread issues with the expenses reimbursement process; including claims not supported by itemised receipts, exceeding the approved subsistence rates, and, on occasion, the reimbursement of the purchase of alcohol.

[redacted]

[redacted]

[redacted]

[redacted]

- The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.

[redacted]

Background

3. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. It also works to ensure that the industry is internationally recognised and sustainable.

4. The Commission employs 26 staff and incurred expenditure of £4.036 million during 2022/23 (with 67 per cent relating to staff costs). It received income of £5.288 million during the year, including levy income of £2.279 million from Scottish Water and £1.718 million from licensed providers, and £1.185 million from international work related to the Scottish Government's Hydro Nation strategy. This resulted in the Commission reporting an operating surplus of £1.251 million for the year ended 31 March 2023.

[redacted]

5. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

The Commission demonstrated poor governance over the approval of expenditure, including insufficient engagement with its Scottish Government sponsor division

6. In 2022/23 the Chief Operating Officer attended a training course at Harvard Business School in Boston at a total cost, including flights, of £77,350. Scottish Government approval is required for any service above £20,000 that has not been awarded via a competitive tender exercise.

[redacted]

7. Further, the Commission purchased a £100 gift voucher for each member of staff as a Christmas gift at a total cost of £2,600 (a similar arrangement was in place in 2021/22 when the total cost was £2,900). This exceeded the Commission's delegated limit of £75 for gifts and should have been approved by the Scottish Government. Due to the nature of this payment to each member of staff, it also represented a non-salary reward and should have been treated as a taxable benefit. This was not the case and the associated £1,133 of tax and national insurance payments were paid by the Commission to His Majesty's Revenue and Customs (HMRC).

[redacted]

[redacted]

8. No approval was sought from the Scottish Government, or the Board, prior to the above payments being made. It was only once the issues were identified and reported by the auditor that retrospective approval was sought and received from the sponsor team within the Scottish Government, and the Board were advised that retrospective approval had been given.

9. I am concerned that this amount of public money was spent without due process being followed or a clear assessment being undertaken to demonstrate that this expenditure represented value for money. All expenditure should be incurred in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual. If there is any dubiety as to whether planned expenditure is permissible, approval should be sought from the sponsor division prior to the expenditure being incurred.

There were weaknesses in the financial control arrangements for the approval of expense claims

10. The Commission's Finance Policies and Guidelines outline the expectations and approved rates for expense claims. The auditor identified widespread issues with expense claims being submitted and approved without supporting itemised receipts, including items submitted by the Chief Executive, and exceeding the approved rates.

[redacted]

11. In their annual audit report, the auditor highlights a specific example where the cost per head claimed for a dinner, attended by the Chief Executive, exceeded £200 per person despite the approved non-city limit being £25. This, and other claims, also included the purchase of alcohol. Unusually for a public body, the Commission's existing policies do not explicitly prohibit the purchase of alcohol as a business expense. The Commission should introduce clear guidance on what is deemed to be acceptable in this regard.

[redacted]

12. Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. The use of approved rates ensures that value for money has been considered when incurring such expenditure.

13. The governance statement in the Commission's 2022/23 annual report and accounts includes the following disclosure '*There have been no governance issues identified during the year that are significant in relation to WICS' overall governance framework. However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area. There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.*'

Lack of adequate arrangements resulted in public funds being used to settle personal tax costs

14. A PAYE settlement agreement (PSA) with HMRC allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits for its employees.

15. Following a review by management, payments dating back to 2018/19 were identified that should have been treated as taxable benefits to staff. The Commission made a payment of £3,384 in October 2023 to settle its 2022/23 obligation (this included the £1,133 detailed at paragraph 7. ~~7~~ above). The Commission has submitted a voluntary disclosure for the period 2018/19 to 2021/22 but has estimated that a further payment of £5,435 will be required for those years.

[redacted]

16. The Commission needs to ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

Conclusions

17. The auditor concluded that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. Value for money should be a key consideration for all expenditure incurred by public bodies and the findings of the auditor highlight unacceptable behaviour, by senior officials within the Commission, in the use of public funds.

[redacted]

18. I recognise that management has accepted the findings and recommendations from the auditor and has committed to specific actions to address them as a matter of urgency.

19. I will continue to monitor progress on these matters and report further in public as necessary.

AUDIT SCOTLAND

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

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The 2022/23 audit of the Water Industry Commission for Scotland

DRAFT – IN CONFIDENCE

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2022/23. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on the Commission's financial statements for 2022/23. I have prepared this report to draw the Scottish Parliament's attention to significant weaknesses in the governance and financial management arrangements identified by the auditor. I am concerned that the current culture within the Commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds.

Key messages

- The Commission incurred expenditure during 2022/23 that required Scottish Government approval. This was only received from the sponsor team retrospectively following audit intervention.
- The retrospective approval included for expenditure on the Chief Operating Officer's attendance at a training course at Harvard Business School in Boston at a total cost of £77,350.
- The auditor identified widespread issues with the expenses reimbursement process; including claims not supported by itemised receipts, exceeding the approved subsistence rates, and, on occasion, the reimbursement of the purchase of alcohol.

Commented [WICS1]: During the period following the Audit Report going to the ARC we have spent time looking at expenses incurred by the office during the financial year in question. Over 1 April 2022 to 31 March 2023, WICS estimates that for Directors, there were 111 items of expenditure at a value of £6,692 without an itemised receipt or other receipt. This represents 5.6% of the office's items of expenditure by volume and 0.9% of expenditure by value over the period.

In our letter to the Auditor General on 1 December, we articulated a wider focus of the organisation in our pursuit of value for money.

Commented [WICS2]: It would be useful if the text could recognise that there were two such instances. We recognise that these oversights were regrettable

Commented [WICS3]: As additional context, would it be more useful to the reader to note that this was an advanced management course that lasted five months?

Commented [WICS4]: We are taking steps to strengthen our categorisation and explanation of expenditures, ensuring that they are comprehensive.

Commented [WICS5]: We are redrafting an expenses policy to address these points

- The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.

Commented [WICS6]: We had hoped that the explanation provided in our letter dated Friday 1 December would help provide context on value for money.

Background

3. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. It also works to ensure that the industry is internationally recognised and sustainable.

Commented [WICS7]: It would be useful to recognise WICS activities internationally. WICS has a duty to support the Scottish Government's Hydro Nation ambition as well as its regulation of Scottish Water and administration of the retail market.

4. The Commission employs 26 staff and incurred expenditure of £4.036 million during 2022/23 (with 67 per cent relating to staff costs). It received income of £5.288 million during the year, including levy income of £2.279 million from Scottish Water and £1.718 million from licensed providers, and £1.185 million from international work related to the Scottish Government's Hydro Nation strategy. This resulted in the Commission reporting an operating surplus of £1.251 million for the year ended 31 March 2023.

[redacted]

5. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

The Commission demonstrated poor governance over the approval of expenditure, including insufficient engagement with its Scottish Government sponsor division

6. In 2022/23 the Chief Operating Officer attended a training course at Harvard Business School in Boston at a total cost, including flights, of £77,350. Scottish Government approval is required for any service above £20,000 that has not been awarded via a competitive tender exercise.

7. Further, the Commission purchased a £100 gift voucher for each member of staff as a Christmas gift at a total cost of £2,600 (a similar arrangement was in place in 2021/22 when the total cost was £2,900). This exceeded the Commission's delegated limit of £75 for gifts and should have been approved by the Scottish Government. Due to the nature of this payment to each member of staff, it also represented a non-salary reward and should have been treated as a taxable benefit. This was not the case and the associated £1,133 of tax and national insurance payments were paid by the Commission to His Majesty's Revenue and Customs (HMRC).

Commented [WICS9]: Going forward, we have committed to ensuring staff pay for any taxable benefits received in excess of HMRC allowances.

8. No approval was sought from the Scottish Government, or the Board, prior to the above payments being made. It was only once the issues were identified and reported by the auditor that retrospective approval was sought and received from the sponsor team within the Scottish Government, and the Board were advised that retrospective approval had been given.

9. I am concerned that this amount of public money was spent without due process being followed or a clear assessment being undertaken to demonstrate that this expenditure represented value for money. All expenditure should be incurred in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual. If there is any dubiety as to whether planned expenditure is permissible, approval should be sought from the sponsor division prior to the expenditure being incurred.

There were weaknesses in the financial control arrangements for the approval of expense claims

10. The Commission's Finance Policies and Guidelines outline the expectations and approved rates for expense claims. The auditor identified widespread issues with expense claims being submitted and approved without supporting itemised receipts, including items submitted by the Chief Executive, and exceeding the approved rates.

11. In their annual audit report, the auditor highlights a specific example where the cost per head claimed for a dinner, attended by the Chief Executive, exceeded £200 per person despite the approved non-city limit being £25. This, and other claims, also included the purchase of alcohol. Unusually for a public body, the Commission's existing policies do not explicitly prohibit the purchase of alcohol as a business expense. The Commission should introduce clear guidance on what is deemed to be acceptable in this regard.

Commented [WICS10]: It could be useful if the text recognises that this was a Business Development dinner to support the international activities of the office in New Zealand.

12. Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. The use of approved rates ensures that value for money has been considered when incurring such expenditure.

13. The governance statement in the Commission's 2022/23 annual report and accounts includes the following disclosure '*There have been no governance issues identified during the year that are significant in relation to WICS' overall governance framework. However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area. There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.*'

Lack of adequate arrangements resulted in public funds being used to settle personal tax costs

14. A PAYE settlement agreement (PSA) with HMRC allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits for its employees.

15. Following a review by management, payments dating back to 2018/19 were identified that should have been treated as taxable benefits to staff. The Commission made a payment of £3,384 in October 2023 to settle its 2022/23 obligation (this included the £1,133 detailed at paragraph 7. ~~7~~ above). The Commission has submitted a voluntary disclosure for the period 2018/19 to 2021/22 but has estimated that a further payment of £5,435 will be required for those years.

16. The Commission needs to ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

Conclusions

17. The auditor concluded that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. Value for money should be a key consideration for all expenditure incurred by public bodies and the findings of the auditor highlight unacceptable behaviour, by senior officials within the Commission, in the use of public funds.

18. I recognise that management has accepted the findings and recommendations from the auditor and has committed to specific actions to address them as a matter of urgency.

19. I will continue to monitor progress on these matters and report further in public as necessary.

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AS.4.0

From: [redacted]
To: [redacted]
Subject: FW: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report
Date: 14 November 2023 09:43:22
Attachments: WICS_2022-23_AAR_Proposed_final_comments.docx
image001.png

Hello,

This is almost the final audit report, with management comments. Thought you would like to see it before it got issued for the ARC meeting.
Give me a shout if you have any comments,
Thanks
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: David Satt [redacted]@wics.scot>
Sent: Tuesday, November 14, 2023 9:01 AM
To: [redacted]@audit-scotland.gov.uk>; Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancin [redacted]@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@audit-scotland.gov.uk>
Subject: RE: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report

[redacted]

Good morning. Thanks for the call yesterday and for the summary of the changes.

We have some final additions if we may after reflecting on the call yesterday. As Alan highlighted yesterday, we want to ensure that our remedial actions are as comprehensive as can be and acted on ahead of the audit next year.

When you are happy with the report, I'll add it to the pack for the ARC. We aim to get the papers out by close of play tonight.

Regards
David

From: [redacted]@audit-scotland.gov.uk>

Sent: Monday, November 13, 2023 3:34 PM
To: Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@audit-scotland.gov.uk>
Subject: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report

Afternoon Alan,

Further to our meeting this morning, please find attached a revised version of our 2022/23 Annual Audit Report which has been updated as detailed below:

- Final key message revised to include a sentence stating: 'Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.'

- Paragraphs 44-46 included to capture the narrative provided by management in response to our draft AAR.

- The agreed actions for the 5 recommendations have been included in the action plan at Appendix 1.

- Other revisions made after our consideration of the comments and clarifications provided by [redacted] last week. The only significant change was at paragraphs 34-36 where we have revised the wording to reflect the most up-to-date information on the PSA payment and prior year submission.

I would be grateful if you could provide any further comments by 12pm tomorrow (Tuesday) to enable us to finalise the report for issue and inclusion in the ARC papers by close of business.

Kind regards,

[redacted]

From: Donna Very [redacted]@wics.scot>
Sent: Friday, November 10, 2023 3:01 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@audit-scotland.gov.uk>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Alan Sutherland [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>
Subject: External audit - Draft 2022/23 Annual Audit Report

[redacted]

Please find attached a copy of the WICS response on the Draft 2022/23 Annual Audit Report. We look forward to discussing this with you on Monday.

Kind regards

[redacted]

WICS, First Floor, Moray House, Forthside Way, Stirling FK8 1QZ
[redacted] [redacted] | wics.scot | scotlandontap.gov.uk

Twitter: @WICScotland **LinkedIn:** WICS

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

AUDIT SCOTLAND

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland
7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3~~Exhibit 3~~. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

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timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1~~Exhibit 1~~.

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Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2~~Exhibit 2~~ sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

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Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3~~Exhibit 3~~ for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3~~Exhibit 3~~ for details.

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Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3~~Exhibit 3~~ for details.

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We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3~~Exhibit 3~~. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

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Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Reverse the previous rent accounting entries. • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3~~Exhibit 3~~). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

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Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4~~Exhibit 4~~, to fund the Commission's activities over the six-year regulatory control period.

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Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5~~Exhibit 5~~. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

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Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5~~Exhibit 5~~.

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24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4~~Exhibit 4~~ above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

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78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that

central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5~~Exhibit 5~~, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

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29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit was £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified an accrual of £8,818 relating to an obligation for a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments dating back as far as 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,818. The Commission settled its 2022/23 obligation in October 2023 and are awaiting a response to the voluntary disclosure for prior years.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure. However, it also included the purchase of the £100 gift vouchers for Commission staff, detailed at issue 5 in Exhibit 3~~Exhibit 3~~.

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Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3~~Exhibit 3~~, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return

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Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Management has accepted the findings from the audit and agreed actions to address the weaknesses reported

44. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported, as detailed in Appendix 1.

45. Management advised that it recognises that some of the processes that worked well when they were based in Moray House lapsed when the Commission started to work remotely. They have relied on the new Approvals Max system for review of expenditures and there was insufficient discussion of these expenditures. They acknowledge that this was clearly an oversight on their part. Previously, an approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. They also note that there is an opportunity to use the approvals panel to review potential future expenditures and ensure that they are aligned to the corporate plan and international activities.

46. Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than they could reasonably have foreseen. What they thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management has committed to conducting a lessons learned exercise on what they could and should have done differently. This review will include the personal tax implications of staff working internationally for prolonged periods of time and the will review the financial and legal disclosures required to be in place for staff prior to delivering such contracts. They will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussions with Scottish Government officials to determine how the Commission should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of the Commission in this area. Management is working closely with officials and the

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policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3~~Exhibit 3~~	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Director of Corporate and International Affairs **Agreed date:** December 2023

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Issue/risk	Recommendation	Agreed management action/timing
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3~~Exhibit 3~~.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20,000 which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Chief Executive **Agreed date:** Approvals Panels will be implemented immediately and the minutes shared with the board / Audit and Risk Committee at all subsequent meetings. Training will be provided by the end of January 2024. Three months after the passing of the government's water bill for agreeing and implementing the appropriate arrangements for international activities.

Issue/risk	Recommendation	Agreed management action/timing
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence, and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee and the Board. With immediate effect, management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the Audit and Risk Committee. Management will revise the expense policy to ensure that there is a separate policy relating to hospitality and events so that there is sufficient distinction made between this type of expenditure and regular subsistence expenses. This will help ensure that a retirement dinner, as referenced in section 32, is treated differently to a subsistence allowance.

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Issue/risk	Recommendation	Agreed management action/timing
		Management commits to ensuring that all staff are appropriately trained in this area, including how to tag and describe expenses to ensure that there is clarity between subsistence expenses and expenditure relating to business development or hospitality/events. Management also commits to sharing the minutes of our approvals panel with the Audit and Risk Committee. **Responsible officer:** Director of Strategy and Governance **Agreed date:** Training to be completed by 30 January 2024.
4. Identification of taxable benefits to staff The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will take further advice to establish appropriate rules and procedures. Management will ensure that this advice is implemented in full and ensure adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Chief Executive **Agreed date:** 30 January 2024 for the advice and March 2024 for its implementation.
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities	Management accept that it is likely that Zero Waste Scotland may not contribute

Issue/risk	Recommendation	Agreed management action/timing
any requirement for it to contribute to dilapidations costs at the end of the Commission’s lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	of both parties for Moray House. Paragraphs 37. to 39. ~~39.~~	towards the dilapidation charge. When the contract next comes up for renewal, we will again explore the dilapidations question with Zero Waste Scotland. Management’s focus at the time was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. **Responsible officer:** Chief Executive **Agreed date:** Contract renewal September 2024

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Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: [redacted]
To: [redacted]
Cc: [redacted]
Subject: [EXT] RE: [EXT] RE: Approval sought
Date: 03 November 2023 09:47:05
Attachments: image001.png

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Thanks [redacted] We will note in our AAR that the SG has provided retrospective approval for these payments although my impression from my discussion with Robin was that he wasn't aware of the Chief Operating Officer's attendance at that training course.

Kind regards,

[redacted]

From: [redacted]@wics.scot>
Sent: Friday, November 3, 2023 9:05 AM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@audit-scotland.gov.uk>
Cc: [redacted]@wics.scot>
Subject: FW: [EXT] RE: Approval sought

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Do not click links, open attachments or reply before asking yourself:

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- Are you expecting this email?
- Does it make sense? Would this person really ask this?
- Have you ever had an email like this before?
- Is the email written in good English or in the style you would expect from that person?

Hi [redacted]

Following communication with Alan yesterday, we have received retrospective comment from Jon Rathjen (from SG) on the two items of expenditure you highlighted.

Let me know if you need anything else or require further discussion.

Kind regards

[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: Donna Very [redacted]@wics.scot>
Sent: Friday, November 3, 2023 8:49 AM
To: [redacted]@wics.scot>
Subject: Fwd: [EXT] RE: Approval sought

Hi [redacted]

We got this back from Jon.

D

Begin forwarded message:

> **From:** Jon.Rathjen@gov.scot
> **Date:** 3 November 2023 at 08:02:00 GMT
> **To:** Alan Sutherland [redacted]@wics.scot>
> **Cc:** Donna Very [redacted]@wics.scot>
> **Subject: [EXT] RE: Approval sought**
>
> **CAUTION:** This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.
>
> Alan,
>
> Thank you for bringing these two expenditures to my attention. As you note seeking retrospective approval is not ideal but I am grateful for the opportunity to comment.
>
> On the Christmas gifts I accept this was an oversight and do not think it is proportionate to try and recover the balance but would highlight that any such gift going forward must be contained within then agreed threshold.
>
> On the training costs, I rather agree that this is a unique training offering and can see why single tender was your approach and as such despite board being aware it would have been appropriate to inform the Scottish Government. As I imply had I been informed I would have agreed with the approach as I think this is not something where open tender would have returned better value given the very specific nature of courses in this field. Due diligence had been carried out and the most suitable product selected and as such, given the board was content with the appropriateness of the nature of the spend, I am content to agree retrospectively the procurement approach.

I see that you recognise the importance of seeking permissions for such expenditures in the future and I would also highlight novel or contentious expenditure is also something to raise regardless of cost threshold.

Jon

Jon Rathjen
Deputy Director
Water Policy & DECC Operations
Scottish Government
[redacted]

From: Donna Very <[redacted]@wics.scot> **On Behalf Of** Alan Sutherland
Sent: Thursday, November 2, 2023 6:17 PM
To: Jon Rathjen <Jon.Rathjen@gov.scot>
Cc: Donna Very [redacted]@wics.scot>
Subject: Approval sought

Hi Jon

Audit Scotland has recently concluded the substantive work on the audit of our accounts. As we discussed, they have highlighted to me two areas where we should have obtained approval from Scottish Government. The first of these was an oversight on our part. The second reflects a different interpretation of appropriate rules – but, on reflection, we should have alerted you to the expenditure. These oversights are, of course, not ideal and I apologise for turning to you for this retrospective approval.

The first relates to a £100 gift voucher that we made to all staff last Christmas in recognition for their hard work given the efforts in delivering the consulting activities (well over £500K of revenue). This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. The total cost of these vouchers was £2,500 (25 x £100 Amazon gift vouchers).

As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office. Following a one-to-one with the Chief Operating Officer (COO) in autumn 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The COO researched a number of universities and this course was her preferred option and met the needs identified The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000 (approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for Campus modules.   Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs are comparable to other business schools.   An internal approvals process was completed and the course was approved. The Board were aware of the COO's training.

Our procurement policy requires expenditure over £100k to be approved by the Scottish Government, and over £20k if it is a single supplier purchase. We did not seek approval for this purchase since it was below £100k and it wasn't the type of purchase that could be competitively tendered. Audit Scotland believe we should have sought approval. I now seek this retrospective approval from you.

I am, of course sorry for these oversights and will endeavour to ensure that going forward we ensure all necessary Scottish Government approvals are obtained in advance of the expenditure being incurred.

I am happy to provide further information or discuss if helpful.

Alan

From: [redacted]
To:
Cc:
Subject: RE: [EXT] RE: [EXT] RE: [EXT] Journals sample 13
Date: 25 September 2023 16:46:00
Attachments: Harvard payment.JPG
image001.png
image002.gif
image003.png
Approval Audit Report by ApprovalMax.pdf

Hi [redacted]

I have attached a screenshot o[redacted] showing the payment from US Dollars to GBP so that you can see the conversion rate used.

You'll see from the attached audit report from [redacted] that the original approval was processed and approved in May 2022. My understanding is that approval was based on the fees for the course form the previous year, but by the time the course was booked, the fees had increased. Which is why the invoices is higher than the actual bill.

You will see from the [redacted] payment that the course was paid in October 2022. As there is no prepayment amount at the end of the year for this expenditure, the amount was incurred in the 22-23 financial year.

Kind regards
[redacted]

[redacted]
Head of Finance

M[redacted]
T: 01786 430 200

From: [redacted]@audit-scotland.gov.uk>
Sent: Monday, September 25, 2023 2:41 PM
To: [redacted]@wics.scot>
Cc: [redacted]d@wics.scot>
Subject: [EXT] RE: [EXT] RE: [EXT] Journals sample 13

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Apologies [redacted], I just realised you had sent the invoice on at the end of last week so I must have missed this. However, is there anything you can provide showing the conversion from NZD to GBP?

Thanks

[redacted]

From: [redacted]
Sent: Monday, September 25, 2023 2:10 PM
To: [redacted]@wics.scot>
Cc: [redacted]@wics.scot>
Subject: RE: [EXT] RE: [EXT] Journals sample 13

Hi [redacted]

Thanks for sending this on.

Can you confirm if this has been accounted for as expenditure in 22/23? From a search of the 'other expenditure 22-23 sample testing' listing, it looks as though this was also reversed out of expenditure and therefore hasn't been included as 22/23 expenditure in the accounts.

I was also wondering if there is an invoice for this that you can provide? The approval form you provided is for £68k, but my sample is £76,543.10.

Regards,

[redacted]

From: [redacted]@wics.scot>
Sent: Friday, September 22, 2023 1:11 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@wics.scot>
Subject: RE: [EXT] RE: [EXT] Journals sample 13

Hi [redacted]

I've attached the approval form for the expenditure.
Kind regards

[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

Twitter: @WICScotland **LinkedIn:** WICS
enquiries@wics.scot | wics.scot | scotlandontap.gov.uk

From: [redacted]@audit-scotland.gov.uk>
Sent: 22 September 2023 11:47
To: [redacted]@wics.scot>; [redacted]@wics.scot>
Subject: [EXT] RE: [EXT] Journals sample 13

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Hi [redacted]

Thanks for this. Can you please confirm exactly what this relates to?

Kind regards,
[redacted]

From: [redacted]@wics.scot>
Sent: Thursday, September 21, 2023 6:38 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@wics.scot>
Subject: RE: [EXT] Journals sample 13

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- Is the senders email address right? (click the senders Name to see their email address)
- Are you expecting this email?
- Does it make sense? Would this person really ask this?
- Have you ever had an email like this before?
- Is the email written in good English or in the style you would expect from that person?

H[redacted],

Apologies – I had saved this in the Teams folder, but it has the DLP symbol, which means externals cannot access. Therefore, I have attached the invoice.
Kind regards
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: [redacted]@audit-scotland.gov.uk>
Sent: Thursday, September 21, 2023 3:11 PM
To: [redacted]@wics.scot>; [redacted]@wics.scot>
Subject: [EXT] Journals sample 13

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Hi [redacted]

Is there any additional back up you can provide in relation to sample 13 of our journals sample? It is the payment in relation to Harvard Business School. Is there an invoice you can provide?

Thanks,

[redacted]

[redacted]
Senior Auditor

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
[redacted]
www.audit-scotland.gov.uk

HARVARD | BUSINESS | SCHOOL

Executive Education Invoice

Bill To:

Ashford, Michelle
Water Industry Commission for Scotland
Moray House Forthside
Stirling FK81QZ
United Kingdom

Invoice Number:	SIN076646
PO Number:	
Invoice Date:	20 October, 2022
Total Charges:	$ 86,000.00
Total Payments/Credits:	$ 0.00
Balance Due:	**$ 86,000.00**
Due Date:	19 November, 2022

Participant Name:	Michelle Ashford
Program Name:	Advanced Management Program
Program Acronym:	AMP204
Program Dates:	January 04, 2023 - May 05, 2023

Invoice Item	Item Description	Amount
REG-FEE	Program Fee (Michelle Ashford AMP204).	86,000.00
	Balance Due:	**$ 86,000.00**

Payment Options

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]

[redacted]

[redacted]

From: Alan Sutherland
To: [redacted]
Cc: Directors
Date: 12 December 2023 12:39:43
Attachments: WICS_s22_DRAFT for clearance_WICS_comments.docx

H [redacted]

Sorry for the delay. We have now gathered and added draft comments. It would be good to have an opportunity to discuss these with you, prior to formally submitting.

I will send a teams invite for 1530. Please feel free to change the time if this does not work for you.

All best

A

The 2022/23 audit of the Water Industry Commission for Scotland

DRAFT – IN CONFIDENCE

AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2023

The 2022/23 audit of the Water Industry Commission for Scotland

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2022/23. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on the Commission's financial statements for 2022/23. I have prepared this report to draw the Scottish Parliament's attention to significant weaknesses in the governance and financial management arrangements identified by the auditor. I am concerned that the current culture within the Commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds.

Key messages

- The Commission incurred expenditure during 2022/23 that required Scottish Government approval. This was only received from the sponsor team retrospectively following audit intervention.
- The retrospective approval included for expenditure on the Chief Operating Officer's attendance at a training course at Harvard Business School in Boston at a total cost of £77,350.
- The auditor identified widespread issues with the expenses reimbursement process; including claims not supported by itemised receipts, exceeding the approved subsistence rates, and, on occasion, the reimbursement of the purchase of alcohol.

- The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.

Background

3. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. It also works to ensure that the industry is internationally recognised and sustainable.

4. The Commission employs 26 staff and incurred expenditure of £4.036 million during 2022/23 (with 67 per cent relating to staff costs). It received income of £5.288 million during the year, including levy income of £2.279 million from Scottish Water and £1.718 million from licensed providers, and £1.185 million from international work related to the Scottish Government's Hydro Nation strategy. This resulted in the Commission reporting an operating surplus of £1.251 million for the year ended 31 March 2023.

5. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

The Commission demonstrated poor governance over the approval of expenditure, including insufficient engagement with its Scottish Government sponsor division

6. In 2022/23 the Chief Operating Officer attended a training course at Harvard Business School in Boston at a total cost, including flights, of £77,350. Scottish Government approval is required for any service above £20,000 that has not been awarded via a competitive tender exercise.

7. Further, the Commission purchased a £100 gift voucher for each member of staff as a Christmas gift at a total cost of £2,600 (a similar arrangement was in place in 2021/22 when the total cost was £2,900). This exceeded the Commission's delegated limit of £75 for gifts and should have been approved by the Scottish Government. Due to the nature of this payment to each member of staff, it also represented a non-salary reward and should have been treated as a taxable benefit. This was not the case and the associated £1,133 of tax and national insurance payments were paid by the Commission to His Majesty's Revenue and Customs (HMRC).

8. No approval was sought from the Scottish Government, or the Board, prior to the above payments being made. It was only once the issues were identified and reported by the auditor that retrospective approval was sought and received from the sponsor team within the Scottish Government, and the Board were advised that retrospective approval had been given.

9. I am concerned that this amount of public money was spent without due process being followed or a clear assessment being undertaken to demonstrate that this expenditure represented value for money. All expenditure should be incurred in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual. If there is any dubiety as to whether planned expenditure is permissible, approval should be sought from the sponsor division prior to the expenditure being incurred.

There were weaknesses in the financial control arrangements for the approval of expense claims

10. The Commission's Finance Policies and Guidelines outline the expectations and approved rates for expense claims. The auditor identified widespread issues with expense claims being submitted and approved without supporting itemised receipts, including items submitted by the Chief Executive, and exceeding the approved rates.

11. In their annual audit report, the auditor highlights a specific example where the cost per head claimed for a dinner, attended by the Chief Executive, exceeded £200 per person despite the approved non-city limit being £25. This, and other claims, also included the purchase of alcohol. Unusually for a public body, the Commission's existing policies do not explicitly prohibit the purchase of alcohol as a business expense. The Commission should introduce clear guidance on what is deemed to be acceptable in this regard.

12. Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. The use of approved rates ensures that value for money has been considered when incurring such expenditure.

13. The governance statement in the Commission's 2022/23 annual report and accounts includes the following disclosure '*There have been no governance issues identified during the year that are significant in relation to WICS' overall governance framework. However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy. Following a revision of the policy in January 2023, the Accountable Officer is committed to building on the changes made to the policy and strengthening further our expenditure in this area. There were two items of expenditure identified that required retrospective approval by the Scottish Government. Again the Accountable Officer is taking action to address the weaknesses that led to the oversight of appropriate approval.*'

Lack of adequate arrangements resulted in public funds being used to settle personal tax costs

14. A PAYE settlement agreement (PSA) with HMRC allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits for its employees.

15. Following a review by management, payments dating back to 2018/19 were identified that should have been treated as taxable benefits to staff. The Commission made a payment of £3,384 in October 2023 to settle its 2022/23 obligation (this included the £1,133 detailed at paragraph 7 above). The Commission has submitted a voluntary disclosure for the period 2018/19 to 2021/22 but has estimated that a further payment of £5,435 will be required for those years.

16. The Commission needs to ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

Conclusions

17. The auditor concluded that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. Value for money should be a key consideration for all expenditure incurred by public bodies and the findings of the auditor highlight unacceptable behaviour, by senior officials within the Commission, in the use of public funds.

18. I recognise that management has accepted the findings and recommendations from the auditor and has committed to specific actions to address them as a matter of urgency.

19. I will continue to monitor progress on these matters and report further in public as necessary.

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AS.4.0

From:	Alan Sutherland
To:	David Satti
Cc:	Colin McNaughton; Donna Very; [redacted]; Andrea Mancini
Subject:	Re: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report
Date:	13 November 2023 21:24:30
Attachments:	image001.png image001.png WICS_2022-23_AAR_Proposed_final_comments.docx

---

Looks good to me. I think the HN commitment discussed earlier is covered by the commitment to work with officials/ bill team.

A

> On 13 Nov 2023, at 17:11, David Satti [redacted]@wics.scot> wrote:
>
> Evening all
>
> I've taken [redacted]s most recent report and added in the change discussed earlier including the commitment to a hospitality/event policy.
>
> If we don't have any further edits then we could get this to [redacted] either later tonight or first thing tomorrow to give him more time to turn around the document before we sent out ARC papers.
>
> Regards
> David
>
> ---
>
> **From:** [redacted]@audit-scotland.gov.uk>
> **Sent:** Monday, November 13, 2023 3:34 PM
> **To:** Alan Sutherland [redacted]@wics.scot>
> **Cc:** [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@audit-scotland.gov.uk>
> **Subject:** [EXT] RE: External audit - Draft 2022/23 Annual Audit Report
>
> **CAUTION:** This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.
>
> Afternoon Alan,
>
> Further to our meeting this morning, please find attached a revised version of our 2022/23 Annual Audit Report which has been updated as detailed below:
>
> - Final key message revised to include a sentence stating: 'Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.'

- Paragraphs 44-46 included to capture the narrative provided by management in response to our draft AAR.

- The agreed actions for the 5 recommendations have been included in the action plan at Appendix 1.

- Other revisions made after our consideration of the comments and clarifications provided by [redacted] last week. The only significant change was at paragraphs 34-36 where we have revised the wording to reflect the most up-to-date information on the PSA payment and prior year submission.

I would be grateful if you could provide any further comments by 12pm tomorrow (Tuesday) to enable us to finalise the report for issue and inclusion in the ARC papers by close of business.

Kind regards,

[redacted]

From: Donna Very [redacted]@wics.scot>
Sent: Friday, November 10, 2023 3:01 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]audit-scotland.gov.uk>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Alan Sutherland [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>
Subject: External audit - Draft 2022/23 Annual Audit Report

[redacted]

Please find attached a copy of the WICS response on the Draft 2022/23 Annual Audit Report. We look forward to discussing this with you on Monday.

Kind regards

[redacted]

WICS, First Floor, Moray House, Forthside Way, Stirling FK8 1QZ
M: [redacted] | wics.scot | scotlandontap.gov.uk

Twitter: @WICScotland **LinkedIn:** WICS

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland
7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3~~Exhibit 3~~. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

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timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1~~Exhibit 1~~.

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Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2~~Exhibit 2~~ sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

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Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3~~Exhibit 3~~ for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3~~Exhibit 3~~ for details.

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Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3~~Exhibit 3~~ for details.

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We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3~~Exhibit 3~~. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

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Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Reverse the previous rent accounting entries. • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary’s asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission’s pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission’s unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission’s extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission’s assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at ‘Note 3.5.12’ in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3~~Exhibit 3~~). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

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Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4~~Exhibit 4~~, to fund the Commission's activities over the six-year regulatory control period.

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Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5~~Exhibit 5~~. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

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Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5~~Exhibit 5~~.

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24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4~~Exhibit 4~~ above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

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78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that

central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5~~Exhibit 5~~, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

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29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit was £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified an accrual of £8,818 relating to an obligation for a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments dating back as far as 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,818. The Commission settled its 2022/23 obligation in October 2023 and are awaiting a response to the voluntary disclosure for prior years.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure. However, it also included the purchase of the £100 gift vouchers for Commission staff, detailed at issue 5 in Exhibit 3~~Exhibit 3~~.

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Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3~~Exhibit 3~~, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return

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Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Management has accepted the findings from the audit and agreed actions to address the weaknesses reported

44. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported, as detailed in Appendix 1.

45. Management advised that it recognises that some of the processes that worked well when they were based in Moray House lapsed when the Commission started to work remotely. They have relied on the new Approvals Max system for review of expenditures and there was insufficient discussion of these expenditures. They acknowledge that this was clearly an oversight on their part. Previously, an approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. They also note that there is an opportunity to use the approvals panel to review potential future expenditures and ensure that they are aligned to the corporate plan and international activities.

46. Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than they could reasonably have foreseen. What they thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management has committed to conducting a lessons learned exercise on what they could and should have done differently. This review will include the personal tax implications of staff working internationally for prolonged periods of time and the appropriate financial and legal disclosures required to be in place for staff prior to delivering such contracts. They will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussions with Scottish Government officials to determine how the Commission should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of the Commission in this area. Management is working closely with officials and the

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policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3~~Exhibit 3~~	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Director of Corporate and International Affairs **Agreed date:** December 2023

Formatted: AS-C09-Exhibit reference

Issue/risk	Recommendation	Agreed management action/timing
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3~~Exhibit 3~~.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20,000 which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Chief Executive **Agreed date:** Approvals Panels will be implemented immediately and the minutes shared with the board / Audit and Risk Committee at all subsequent meetings. Training will be provided by the end of January 2024. Three months after the passing of the government's water bill for agreeing and implementing the appropriate arrangements for international activities.

Formatted: AS-C09-Exhibit reference

Issue/risk	Recommendation	Agreed management action/timing
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence, and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee and the Board. With immediate effect, management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the Audit and Risk Committee. Management will revise the expense policy to ensure that there is a separate policy relating to hospitality and events so that there is sufficient distinction made between this type of expenditure and regular subsistence expenses. This will help ensure that a retirement dinner as referenced in section 32 is treaded differently to a subsistence allowance.

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Issue/risk	Recommendation	Agreed management action/timing
		Management commits to ensuring that all staff are appropriately trained in this area, including how to tag and describe expenses to ensure that there is clarity between subsistence expenses and expenditure relating to business development or hospitality/events. Management also commits to sharing the minutes of our approvals panel with the Audit and Risk Committee. **Responsible officer:** Director of Strategy and Governance **Agreed date:** Training to be completed by 30 January 2024.
4. Identification of taxable benefits to staff The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will take further advice to establish appropriate rules and procedures. Management will ensure that this advice is implemented in full and ensure adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Chief Executive **Agreed date:** 30 January 2024 for the advice and March 2024 for its implementation.
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities	Management accept that it is likely that Zero Waste Scotland may not contribute

Issue/risk	Recommendation	Agreed management action/timing
any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	of both parties for Moray House. Paragraphs 37. to 39. ~~39.~~	towards the dilapidation charge. When the contract next comes up for renewal, we will again explore the dilapidations question with Zero Waste Scotland. Management's focus at the time was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. **Responsible officer:** Chief Executive **Agreed date:** Contract renewal September 2024

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Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: Alan Sutherland
To: David Satti
Cc: Donna Very; Directors
Subject: Re: [EXT] RE: Management response to auditor findings
Date: 09 November 2023 12:42:26
Attachments: WICS_2022-23_AAR_WICS_draft_response.docx

Happy, if others are too

Thanks all

A

On 9 Nov 2023, at 12:33, David Satti [redacted]@wics.scot> wrote:

Agreed, Alan. Hopefully he will recognise that and see sense. The point has been made, and we are responding.

Attached is a clean version, which is ready to go to [redacted].

Regards
David

From: Alan Sutherland [redacted]@wics.scot>
Sent: Thursday, November 9, 2023 11:59 AM
To: David Satti [redacted]@wics.scot>
Cc: Donna Very [redacted]@wics.scot>; Directors [redacted]@wics.scot>
Subject: Re: [EXT] RE: Management response to auditor findings

Embedded

On 9 Nov 2023, at 11:50, David Satti [redacted]@wics.scot> wrote:

Thanks Donna

We didn't get any edits or suggestions from Robin – he thought the responses were good. His focus is more on what the ARC changes as a result.

Donald has two points.

The first relates to our response around the expenses, which he thinks could be strengthened given the auditor's recommendation – mainly the "management will endeavour to ensure that, wherever possible". I've suggested some words below.

Happy with these words - provided that there is a recognition that sometimes an item used receipt is not available.

The second point relates to the reference to the £200 vs the non-city allowance of £25. He thinks there is a conversation to be had with [redacted] on events vs regular subsistence in the hope that the £200 will be removed. If there is an unwillingness to remove this then qualifying it as a retirement event would help ensure that a perception isn't created that we are spending £200 per head for regular subsistence in the knowledge that our policy at the time has a limit of £25.

I think it is important that there is a recognition that this was an 'exceptional' circumstance, ie a retirement of an employee of 20 yrs service.

I also wonder, given the conversations today @Alan Sutherland, whether we offer up a review of the delegated authorities on the Scottish Government approval of expenditure response? I've suggested: "Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures."

@ Donna Very, Alan asked if you could reach out to [redacted] and arrange a call for tomorrow? We could send him our draft responses alongside the request when we are all happy with them. I've attached a V2 in track changes.

Regards
David

Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified.

The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee (ARC) and the Board.

Going forward, Management will ~~endeavour to ensure that, wherever possible, all expense claims will be supported by itemised receipts~~. ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the ARC.

Management commits to ensuring that all staff are appropriately trained in this area. Management also commits to sharing the minutes of our approvals panels with the ARC.

From: Donna Very [redacted]@wics.scot>
Sent: Thursday, November 9, 2023 10:14 AM
To: Directors [redacted]@wics.scot>
Subject: FW: [EXT] RE: Management response to auditor findings

David

For adding to the audit report.

D

From: Jon.Rathjen@gov.scot <Jon.Rathjen@gov.scot>
Sent: Thursday, November 9, 2023 10:02 AM
To: Donna Very [redacted]@wics.scot>
Cc: Alan Sutherland [redacted]@wics.scot>
Subject: [EXT] RE: Management response to auditor findings

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

I might add 'and legal structures' after the systems and processes part. WICs is committed to maintaining the standards of behaviour and transparency required by public bodies in Scotland.

Jon

From: Donna Very [redacted]@wics.scot>
Sent: Wednesday, November 8, 2023 6:17 PM
To: Jon Rathjen <Jon.Rathjen@gov.scot>
Cc: Alan Sutherland [redacted]@wics.scot>
Subject: Management response to auditor findings

Hi Jon

I know you had a chat today with Alan so just wanted to follow up with our response to the auditor's findings. If you have anything you wish to add or delete please let me know.

Donna

Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than we could reasonably have foreseen. Surprisingly, what we thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems and processes would have been proactively tailored to deal with this growth. Management commits to conducting a lessons learned exercise on what we could and should have done differently. We will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussion with Scottish Government officials to determine how WICS should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of WICS in this area. Management is working closely with officials and the policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

AUDIT SCOTLAND

Prepared for the Water Industry Commission for Scotland and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission’s lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000

Materiality level	Amount
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	actuary by the Commission.	
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
calculation is required to be undertaken by the actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report.

Issue	Resolution
Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission’s cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission’s 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission’s work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.

- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Management recognises that some of the processes that worked well when we were based in Moray House lapsed when we started to work remotely. We relied on the new Approvals Max system for our review of expenditures and there was insufficient discussion of these expenditures. This was clearly an oversight on our part. Previously, our approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. There is also the opportunity to use that approvals panel to review potential future expenditures and ensure that they are aligned to our corporate plan and our international activities.

Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than we could reasonably have foreseen. Surprisingly, what we thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management commits to conducting a lessons learned exercise on what we could and should have done differently. We will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussion with Scottish Government officials to determine how WICS should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of WICS in this area. Management is working closely with officials and the policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

44.

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not

Issue/risk	Recommendation	Agreed management action/timing
Risk: The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	House at the end of the lease in March 2026. Issue 2 in Exhibit 3	be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Donna Very **Agreed date: March 2024**
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20k which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Alan Sutherland

Issue/risk	Recommendation	Agreed management action/timing
		Agreed date: End March 2024 and three months after the Scottish Government's prospective water bill passes Parliament
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee (ARC) and the Board. Going forward, Management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the ARC. Management commits to ensuring that all staff are appropriately trained in this area. Management also commits to sharing the minutes of our approvals panels with the ARC.

Issue/risk	Recommendation	Agreed management action/timing
		Responsible officer: David Satti **Agreed date:** June 2024
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Alan Sutherland **Agreed date:** March 2024
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Management recognise that Zero Waste Scotland may not contribute towards the dilapidation charge. However, the focus of Management was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. WICS considers that it has benefited from this arrangement. **Responsible officer:** Alan Sutherland **Agreed date: NA**

Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

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From:	Alan Sutherland
To:	[redacted]
Cc:	Directors
Subject:	Re: [EXT] RE: [EXT] External audit - Payment requiring SG approval
Date:	02 November 2023 17:34:42
Attachments:	image001.png image002.png image003.png image001.png image002.png image003.png Approval form 2 NCA - Michelle Ashford (Exec Education Course).docx Executive Education courses - option appraisal.xlsx

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[redacted]

Will go back to him. We have prepared a note to Jon R. It would have been helpful if he had copied me in his response to you.

All best

A

On 2 Nov 2023, at 17:30, [redacted] [redacted]@wics.scot> wrote:

Hi Alan,

I had a catch up with the auditors this afternoon and [redacted] asked if I had heard from you on his query below. Can you get back to him to confirm whether you are planning to seek retrospective approval for this expenditure?

Thanks

[redacted]

[redacted]

Head of Finance

M: [redacted]

T: 01786 430 200

From: [redacted]@audit-scotland.gov.uk>
Sent: Sunday, October 29, 2023 9:36 PM
To: [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: [EXT] RE: [EXT] External audit - Payment requiring SG approval

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Hi [redacted]

Thanks for coming back to us on this. The heading on the attached form seemed to suggest it required SG approval if it was greater than £20k but are you saying that doesn't apply to this type of expenditure? If so, can you just point us in the direction of the relevant policy, or section of your framework document that covers this.

We will wait and see what Alan responds with but on our VFM point then we don't think the process followed represents a robust VFM assessment. The attached option appraisal doesn't show the relative costs of each of the options but our bigger issue is that it is not clear what assessment was done as to whether this course was essential to the business of WICS or the individual undertaking their role. For this level of expenditure we would have expected either a clear case that the individual could not do their job without this training or that the cost of the course would have been recouped through business benefits to the organisation resulting from the training. We are happy to discuss this though if there is something we are missing around this.

Hope you are doing OK and we can catch-up at our meeting on Thursday afternoon on what we can to support you through the audit reporting process and the implementation of our recommendations.

Take care,

[redacted]

From: [redacted]@wics.scot>
Sent: Sunday, October 29, 2023 3:40 PM
To: [redacted]@audit-scotland.gov.uk>; Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: RE: [EXT] External audit - Payment requiring SG approval

H [redacted]

Our procurement policy requires expenditure over £100k to be approved by the Scottish Government, and over £20k if it is a single supplier purchase. If I remember correctly, the reason this did not go to SG for approval at the time was that the total value was less than £100k and it was not the type of purchase that could be competitively tendered. There was a review of potential options attached to the purchase order (see attached) and the choice of course would have been discussed between Alan and Michelle as part of Michelle's personal development.

Please let me know if you require any further information from me, and I will let Alan review and get back to you with this thoughts on this matter.
Kind regards
[redacted]
Head of Finance

[redacted]
T: 01786 430 200

<image001.png>

Twitter: @WICScotland **LinkedIn:** WICS
enquiries@wics.scot | wics.scot | scotlandontap.gov.uk

From: [redacted]@audit-scotland.gov.uk>
Sent: 27 October 2023 11:08
To: Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>; [redacted]@wics.scot>
Subject: [EXT] External audit - Payment requiring SG approval

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Morning Alan,

Following our clearance meeting on Tuesday morning, the completion of our expenditure testing has identified a further payment made during 2022/23 that required Scottish Government approval. This relates to the cost of a training course attended by the Chief Operating Officer as detailed in the attached form. As the value of this exceeded £20k it required to be approved by the Scottish Government but we are not aware whether this approval was obtained at the time. Given the value of this payment we need to see the SG approval to be able to provide a clean regularity opinion on the 2022/23 annual accounts. Would you therefore be able to either:

- Provide a copy of the SG approval obtained at the time demonstrating that they signed off on this expenditure, or
- Contact your sponsor division to request retrospective approval for this payment.

In connection to this payment, we also don't believe that the benefit analysis section of the attached Expenditure appraisal form provides adequate evidence that a value for money of the proposal was completed prior to it being approved. We will therefore be including a recommendation in our Annual Audit Report in relation to this to ensure this is more clearly documented in the future.

If you do require to obtain retrospective approval for this payment (i.e. SG approval was not obtained at the time) then we would also ask if you could similarly request SG approval for the £2,500 expenditure incurred on the purchase of the 25 x £100 Amazon gift vouchers as this also should have been signed off by the SG as it exceeded the £75 gift threshold that WICS can authorise, as discussed at our meeting on Monday.

Regards,

[redacted]

[redacted]

Senior Audit Manager

[redacted]

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Please note that my current working pattern is 8:45am-5pm Monday to Friday

Preference	Business School	Programme
1	Harvard	Advanced Management Program: Prepare for the Highest Level of Leadership...
5	Harvard	Program for Leadership Development: Accelerating the Careers of Hig…
4	Harvard	General Management Program: Shaping the Future of Outstanding Leaders
2	Stanford	Stanford Executive Program : Be a leader who matters
3	Yale	Yale Global Executive Leadership Program

Summary	Format
Explore global leadership in customer and product markets, changing geopolitical influences, and current capital markets.	Blended modular
Personalized to your leadership goals, the integrated four-module format provides an end-to-end view of business and the global marketplace.	Blended
The highly integrated on-campus and distance-learning modules will improve your ability to run an end-to-end business and play a greater role in corporate success.	Blended
A one-of-a-kind approach to leadership development and personal growth, the Stanford Executive Program builds off the passion and perspective of our faculty, participants, and environment to help you evolve on a personal level, drive change on an organizational level, and make a difference in the world at large. Explore fresh ways of thinking. Discover exciting new directions. Build a global network that will last a lifetime.	FT (6 weeks) or Flex (4 months with two 2 week on campus)
The Yale Global Executive Leadership Program (YGELP) will prepare you for the highest levels of global leadership. You will leave the program equipped with strategic insights, leadership skills, and a deep understanding of global business context needed to drive growth and profitability in a high-performing organization. Your five weeks at Yale will include participation in the world-renowned Yale Chief Executive Leadership Institute and will culminate with a certificate of participation from the Yale School of Management.	10 months with 5 weeks on campus

Link
https://www.exed.hbs.edu/advanced-management-program/
https://grow.stanford.edu/browse/stanford-executive-program/?program_type=management&ab=browse&campaignid=71700000088514177&adgroupid=58700007495872353&adgroup=MGT-NT+-+Management+-+Competitors+Executive&kwid=43700067446926840&utm_medium=cpc&utm_source=GOOGLE&utm_term=yale+executive+education&matchtype=e&extensionid=&targetid=kwd-308744037300&utm_campaign=MGT-NT+-+Management+%28INTL%29&utm_content=560782687103&loc_physical_ms=1007397&loc_interest_ms=&network=g&adposition=&device=c&feeditemid=&gclid=EAIaIQobChMIw6ab8OGa9gIVYoFQBh0mAQd9EAAYBCAAEgIdYPD_BwE&gclsrc=aw.ds&format=inperson
https://som.yale.edu/programs/executive-education/for-individuals/yale-global-executive-leadership-program

Dates	Cost
04.01.23-12.05.23 (blended modular) 04 JAN–11 FEB 2023 — Module 1 (Virtual, Self-Paced) 12 FEB–03 MAR 2023 — Module 2 (HBS Campus) 04 MAR–22 APR 2023 — Module 3 (Virtual, Self-Paced) 23 APR–12 MAY 2023 — Module 4 (HBS Campus)	$84000 / £62000
05.07.22-23.01.23	$52000 / £38000
09.01.23-28.04.22	$75000 / £55000
FULL-TIME PROGRAM DATES June 17 – July 29, 2023 FLEX PROGRAM DATES October 29, 2022 – February 17, 2023 Module 1 : 2 weeks on campus Oct. 29 – Nov. 11, 2022 Module 2 : Live online learning Nov. 14, 2022 – Feb. 3, 2023 Module 3 : 2 weeks on campus Feb. 6 – Feb. 17, 2023	$78000 / £56000
	$60000 / £44000

Benefits	Application Date
Gain new strategic insights, global perspectives, and leadership skills that enable you to lead change, drive innovation, and sustain a competitive advantage.	
Gain a holistic view of business operations that enables you to build high-performing global teams, lead cross-functional initiatives, and drive innovation and profitable growth.	
Assess your strengths and weaknesses as a leader; expand your grasp of the whole range of company operations—from strategy and finance to marketing and leadership.	
The Stanford Executive Program is a different kind of leadership program. Placing health and wellbeing on the same level as leadership learning, the SEP experience allows you to rediscover a level of deep authenticity and reconnect with a true sense of rejuvenation that will permeate life well beyond your time in the program. It's why you'll hear SEP Alumni use the adjective "life-changing" without a trace of hyperbole	FULL-TIME Round Deadline Decision By 1 - Dec 2 2022 2 - Mar.17, 2023 FLEX Round Deadline Decision By 1 Apr. 29, 2022 May 27, 2022 2 Aug. 19, 2022 Sep. 12, 2022
As a leader, the world expects you to compete strategically and win globally, no matter the odds. The Yale Global Executive Leadership Program prepares you for these challenges, to rise to the highest levels of global leadership. You will leave the program equipped with strategic insights, leadership skills, and the deep understanding of global business context needed to drive growth and profitability in a high-performing organization. The	Rolling

Expenditure appraisal form

For purchases where a non-competitive action is proposed

This expenditure should be approved by the budget holder, the approval panel, Board (if over £100k) and Scottish Government (if over £20k)

General information

Title	Advanced Management Programme
Supplier	Harvard Business School
Estimated timing	January – May 2023 (subject to admissions process)
Lead purchaser	Alan Sutherland
Value*	£68,000

*including VAT

DESCRIPTION OF PURCHASE

This request seeks approval for the Chief Operating Officer to attend the Harvard Business School Advanced Management Programme in Boston.

The programme comprises a blended modular approach from 4 January 2023 to 12 May 2023, with Modules 1 and 3 being virtual and self-paced and modules 2 and 4 in person on the HBS campus.

The programme builds on leadership skills and business competencies which will assist the COO in the development of her skillset. There is a strong focus on team building and collaboration.

KEY DELIVERABLES

Blended modular programme comprising four modules:

04 JAN–11 FEB 2023 — Module 1 (Virtual, Self-Paced)

12 FEB–03 MAR 2023 — Module 2 (HBS Campus)

04 MAR–22 APR 2023 — Module 3 (Virtual, Self-Paced)

23 APR–12 MAY 2023 — Module 4 (HBS Campus)

BENEFIT ANALYSIS

The office is committed to the development of its staff and this programme will build on current skills, broaden perspective, and enhance business vision, to assist in future-proofing the organisation.

Collaborative projects and assignments constitute a significant part of the programme and serve as great team building and communication exercises, through interaction with other professionals with diverse corporate experiences.

COST INFORMATION

Advanced Management Programme – Harvard Business School $84,000 (approx. £63,000). The programme fee includes tuition, books, case materials, accommodation and most meals for the HBS Campus modules.
Travel – flights from Scotland to Boston for HBS Campus modules x 2 - £5,000.

RISK ASSESSMENT

Non-U.S. citizens or residents require a non-immigrant visa to attend the programme in the United States. The visa required is the 90-day B-1/B-2 Visa as program participants are not considered full-time enrolled students at Harvard University, and none of the programs require stays longer than 90 days. On successful admission to the programme, the admission letter should be sufficient to obtain a visa for entry into the United States.

JUSTIFICATION FOR USE OF NON-COMPETITIVE ACTION

This programme is required for the development of a key employee. Not progressing with the approval of this procurement would impede the Commission's aim to commit to the development of staff.
Several similar business schools were considered but the programme at Harvard meets the needs of the staff member. The programme is in a similar price range to other comparable courses.

SUSTAINABILITY ASSESSMENT

Not applicable.

CONTRACT MANAGEMENT

Not applicable

From: [redacted]
To: Alan Sutherland
Cc: [redacted]; Directors
Subject: [EXT] Re: [EXT] External audit - Payment requiring SG approval
Date: 02 November 2023 17:41:54

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Thanks for confirming Alan. We are currently drafting our Annual Audit Report and will issue it for comment by close of business on Monday next week.

Kind regards,

[redacted]

From: Alan Sutherland [redacted]@wics.scot>
Sent: Thursday, November 2, 2023 5:39:18 PM
To: [redacted]@audit-scotland.gov.uk>
Cc: [redacted]@audit-scotland.gov.uk>; [redacted]@wics.scot>; Directors [redacted]@wics.scot>
Subject: Re: [EXT] External audit - Payment requiring SG approval

EXTERNAL: THIS EMAIL ORIGINATED OUTWITH AUDIT SCOTLAND

Do not click links, open attachments or reply before asking yourself:

- Is the senders email address right? (click the senders Name to see their email address)
- Are you expecting this email?
- Does it make sense? Would this person really ask this?
- Have you ever had an email like this before?
- Is the email written in good English or in the style you would expect from that person?

Hi [redacted]

We have written to Jon requesting these retrospective approvals.

Alan

> On 27 Oct 2023, at 11:09, [redacted]@audit-scotland.gov.uk> wrote:
>
> **CAUTION:** This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.
>
> Morning Alan,
>
> Following our clearance meeting on Tuesday morning, the completion of our expenditure testing has identified a further payment made during

2022/23 that required Scottish Government approval. This relates to the cost of a training course attended by the Chief Operating Officer as detailed in the attached form. As the value of this exceeded £20k it required to be approved by the Scottish Government but we are not aware whether this approval was obtained at the time. Given the value of this payment we need to see the SG approval to be able to provide a clean regularity opinion on the 2022/23 annual accounts. Would you therefore be able to either:

- Provide a copy of the SG approval obtained at the time demonstrating that they signed off on this expenditure, or
- Contact your sponsor division to request retrospective approval for this payment.

In connection to this payment, we also don't believe that the benefit analysis section of the attached Expenditure appraisal form provides adequate evidence that a value for money of the proposal was completed prior to it being approved. We will therefore be including a recommendation in our Annual Audit Report in relation to this to ensure this is more clearly documented in the future.

If you do require to obtain retrospective approval for this payment (i.e. SG approval was not obtained at the time) then we would also ask if you could similarly request SG approval for the £2,500 expenditure incurred on the purchase of the 25 x £100 Amazon gift vouchers as this also should have been signed off by the SG as it exceeded the £75 gift threshold that WICS can authorise, as discussed at our meeting on Monday.

Regards,

[redacted]

[redacted]
Senior Audit Manager

[redacted]

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
8 Nelson Mandela Place, Glasgow, G2 1BT
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

From: [redacted]
To: [redacted]
Cc: [redacted]
Subject: [EXT] External audit - Draft 2022/23 Annual Audit Report
Date: 06 November 2023 14:27:14
Attachments: image001.png
image002.png
WICS_2022-23_AAR_Draft.docx

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

[redacted],

Apologies for the delay in sending this through but we were just updating the report for the figures in the latest version of the annual accounts. If there are any further changes then we can reflect these in the final issued version of the report.

As discussed on Thursday last week I would be grateful if you could get back with any comments by the end of today to enable us to issue the draft report to Alan.

Give me or [redacted] a shout if there is anything that it is easy to discuss over a Teams call.

[redacted]

[redacted]
Senior Audit Manager

[redacted]

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
8 Nelson Mandela Place, Glasgow, G2 1BT
[redacted] **E:** [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23. We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission’s lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23. We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total

overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not have any immediate concerns about the financial sustainability of the Commission, but management should consider contingency plans to respond to any unexpected decrease in Hydro Nation income in future years

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not have any immediate concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.174 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income. However, management should ensure that there are contingency plans to respond to any unexpected decrease in Hydro Nation income and prevent unnecessary expenditure for the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Issue/risk	Recommendation	Agreed management action/timing
and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Paragraphs 31. to 33.	
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Water Industry Commission for Scotland

2022/23 Annual Audit Report

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www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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T: 0131 625 1500 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: [redacted]
To: [redacted]
Cc: [redacted]
Subject: [EXT] RE: [EXT] External audit - Payment requiring SG approval
Date: 30 October 2023 09:18:11
Attachments: image001.png
image002.png
image003.png
Executive Education courses - option appraisal.xlsx

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Apologies [redacted] has just pointed to me that column H did include the costs of each option but my other comments on the robustness of the VFM assessment still apply and as I say we will wait and see what Alan says in relation to this.

[redacted]

From: [redacted]
Sent: Sunday, October 29, 2023 9:36 PM
To: [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: RE: [EXT] External audit - Payment requiring SG approval

Hi [redacted]

Thanks for coming back to us on this. The heading on the attached form seemed to suggest it required SG approval if it was greater than £20k but are you saying that doesn't apply to this type of expenditure? If so, can you just point us in the direction of the relevant policy, or section of your framework document that covers this.

We will wait and see what Alan responds with but on our VFM point then we don't think the process followed represents a robust VFM assessment. The attached option appraisal doesn't show the relative costs of each of the options but our bigger issue is that it is not clear what assessment was done as to whether this course was essential to the business of WICS or the individual undertaking their role. For this level of expenditure we would have expected either a clear case that the individual could not do their job without this training or that the cost of the course would have been recouped through business benefits to the organisation resulting from the training. We are happy to discuss this though if there is something we are missing around this.

Hope you are doing OK and we can catch-up at our meeting on Thursday afternoon on what we can to support you through the audit reporting process and the implementation of our recommendations.

Take care,

[redacted]

From: [redacted]@wics.scot>
Sent: Sunday, October 29, 2023 3:40 PM
To: [redacted]@audit-scotland.gov.uk>; Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>

Subject: RE: [EXT] External audit - Payment requiring SG approval

Hi [redacted]

Our procurement policy requires expenditure over £100k to be approved by the Scottish Government, and over £20k if it is a single supplier purchase. If I remember correctly, the reason this did not go to SG for approval at the time was that the total value was less than £100k and it was not the type of purchase that could be competitively tendered. There was a review of potential options attached to the purchase order (see attached) and the choice of course would have been discussed between Alan and Michelle as part of Michelle's personal development.

Please let me know if you require any further information from me, and I will let Alan review and get back to you with this thoughts on this matter.
Kind regards

[redacted]

Head of Finance

M: [redacted]
T: 01786 430 200

Twitter: @WICScotland **LinkedIn:** WICS
enquiries@wics.scot | wics.scot | scotlandontap.gov.uk

From: [redacted]@audit-scotland.gov.uk>
Sent: 27 October 2023 11:08
To: Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>; [redacted]@wics.scot>
Subject: [EXT] External audit - Payment requiring SG approval

> **CAUTION:** This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Morning Alan,

Following our clearance meeting on Tuesday morning, the completion of our expenditure testing has identified a further payment made during 2022/23 that required Scottish Government approval. This relates to the cost of a training course attended by the Chief Operating Officer as detailed in the attached form. As the value of this exceeded £20k it required to be approved by the Scottish Government but we are not aware whether this approval was obtained at the time. Given the value of this payment we need to see the SG approval to be able to provide a clean regularity opinion on the 2022/23 annual accounts. Would you therefore be able to either:

- Provide a copy of the SG approval obtained at the time demonstrating that they signed off on this expenditure, or
- Contact your sponsor division to request retrospective approval for this payment.

In connection to this payment, we also don't believe that the benefit analysis section of the attached Expenditure appraisal form provides adequate evidence that a value for money of the proposal was completed prior to it being approved. We will therefore be including a recommendation in our Annual Audit Report in relation to this to ensure this is more clearly documented in the future.

If you do require to obtain retrospective approval for this payment (i.e. SG approval was not obtained at the time) then we would also ask if you could similarly request SG approval for the £2,500 expenditure incurred on the purchase of the 25 x £100 Amazon gift vouchers as this also should have been signed off by the SG as it exceeded the £75 gift threshold that WICS can authorise, as discussed at our meeting on Monday.

Regards,

[redacted]

[redacted]
Senior Audit Manager

[redacted]

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
8 Nelson Mandela Place, Glasgow, G2 1BT
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

Preference	Business School	Programme
1	Harvard	Advanced Management Program: Prepare for the Highest Level of Leadership...
5	Harvard	Program for Leadership Development: Accelerating the Careers of Hig…
4	Harvard	General Management Program: Shaping the Future of Outstanding Leaders
2	Stanford	Stanford Executive Program : Be a leader who matters
3	Yale	Yale Global Executive Leadership Program

Summary	Format
Explore global leadership in customer and product markets, changing geopolitical influences, and current capital markets.	Blended modular
Personalized to your leadership goals, the integrated four-module format provides an end-to-end view of business and the global marketplace.	Blended
The highly integrated on-campus and distance-learning modules will improve your ability to run an end-to-end business and play a greater role in corporate success.	Blended
A one-of-a-kind approach to leadership development and personal growth, the Stanford Executive Program builds off the passion and perspective of our faculty, participants, and environment to help you evolve on a personal level, drive change on an organizational level, and make a difference in the world at large. Explore fresh ways of thinking. Discover exciting new directions. Build a global network that will last a lifetime.	FT (6 weeks) or Flex (4 months with two 2 week on campus)
The Yale Global Executive Leadership Program (YGELP) will prepare you for the highest levels of global leadership. You will leave the program equipped with strategic insights, leadership skills, and a deep understanding of global business context needed to drive growth and profitability in a high-performing organization. Your five weeks at Yale will include participation in the world-renowned Yale Chief Executive Leadership Institute and will culminate with a certificate of participation from the Yale School of Management.	10 months with 5 weeks on campus

Link
https://www.exed.hbs.edu/advanced-management-program/
https://grow.stanford.edu/browse/stanford-executive-program/?program_type=management&ab=browse&campaignid=71700000088514177&adgroupid=58700007495872353&adgroup=MGT-NT+-+Management+-+Competitors+Executive&kwid=43700067446926840&utm_medium=cpc&utm_source=GOOGLE&utm_term=yale+executive+education&matchtype=e&extensionid=&targetid=kwd-308744037300&utm_campaign=MGT-NT+-+Management+%28INTL%29&utm_content=560782687103&loc_physical_ms=1007397&loc_interest_ms=&network=g&adposition=&device=c&feeditemid=&gclid=EAIaIQobChMIw6ab8OGa9gIVYoFQBh0mAQd9EAAYBCAAEgIdYPD_BwE&gclsrc=aw.ds&format=inperson
https://som.yale.edu/programs/executive-education/for-individuals/yale-global-executive-leadership-program

Dates	Cost
04.01.23-12.05.23 (blended modular) 04 JAN–11 FEB 2023 — Module 1 (Virtual, Self-Paced) 12 FEB–03 MAR 2023 — Module 2 (HBS Campus) 04 MAR–22 APR 2023 — Module 3 (Virtual, Self-Paced) 23 APR–12 MAY 2023 — Module 4 (HBS Campus)	$84000 / £62000
05.07.22-23.01.23	$52000 / £38000
09.01.23-28.04.22	$75000 / £55000
FULL-TIME PROGRAM DATES June 17 – July 29, 2023 FLEX PROGRAM DATES October 29, 2022 – February 17, 2023 Module 1 : 2 weeks on campus Oct. 29 – Nov. 11, 2022 Module 2 : Live online learning Nov. 14, 2022 – Feb. 3, 2023 Module 3 : 2 weeks on campus Feb. 6 – Feb. 17, 2023	$78000 / £56000
	$60000 / £44000

Benefits	Application Date
Gain new strategic insights, global perspectives, and leadership skills that enable you to lead change, drive innovation, and sustain a competitive advantage.	
Gain a holistic view of business operations that enables you to build high-performing global teams, lead cross-functional initiatives, and drive innovation and profitable growth.	
Assess your strengths and weaknesses as a leader; expand your grasp of the whole range of company operations—from strategy and finance to marketing and leadership.	
The Stanford Executive Program is a different kind of leadership program. Placing health and wellbeing on the same level as leadership learning, the SEP experience allows you to rediscover a level of deep authenticity and reconnect with a true sense of rejuvenation that will permeate life well beyond your time in the program. It’s why you’ll hear SEP Alumni use the adjective “life-changing” without a trace of hyperbole	FULL-TIME Round Deadline Decision By 1 - Dec 2 2022 2 - Mar.17, 2023 FLEX Round Deadline Decision By 1 Apr. 29, 2022 May 27, 2022 2 Aug. 19, 2022 Sep. 12, 2022
As a leader, the world expects you to compete strategically and win globally, no matter the odds. The Yale Global Executive Leadership Program prepares you for these challenges, to rise to the highest levels of global leadership. You will leave the program equipped with strategic insights, leadership skills, and the deep understanding of global business context needed to drive growth and profitability in a high-performing organization. The	Rolling

From: [redacted]
To: Alan Sutherland
Subject: RE: [EXT] External audit - Draft 2022/23 Annual Audit Report
Date: 06 November 2023 18:20:00
Attachments: WICS_2022-23_AAR_Draft_[redacted]_comments.docx
image001.png

Hi Alan,

I've attached a copy with my comments – [redacted]

Unfortunately I don't entirely understand your points about categories of expenditure. All our expenditure needs to adhere to the SPFM and our framework agreement, regardless of what the expenditure is, which is where I think Audit Scotland are coming from.

WICS will need to provide responses to the recommendations. If you'd like to chat to [redacted] before we provide a response, let me know and I can arrange it.

Kind regards
[redacted]

[redacted]
Head of Finance

M: [redacted]
T: 01786 430 200

From: Alan Sutherland [redacted]@wics.scot>
Sent: Monday, November 6, 2023 6:06 PM
To: [redacted]@wics.scot>
Subject: Fwd: [EXT] External audit - Draft 2022/23 Annual Audit Report

Hi [redacted]

I have read the audit letter.

I think it conflates a number of issues:

- there are the expenditures related to our HN activity, which are paid for directly or through amortisation,
- there are expenditures on subsistence; and
- there are expenditures around marking retirements.

It would seem to me more accurate to tease out these differences in a short introductory paragraph.

To apply the same lense to expenditures across these three areas seems a tad strange to me.[redacted].

To be threatening further fee increases after the uplift demanded last year is quite concerning.

Doubtless you will have some comments on what he has sent through. It would be good to discuss your thoughts.

All best

A

Begin forwarded message:

From: [redacted]@audit-scotland.gov.uk>
Date: 6 November 2023 at 15:40:44 GMT
To: Alan Sutherland [redacted]@wics.scot>, [redacted]@wics.scot>
Cc: [redacted]@audit-scotland.gov.uk>
Subject: [EXT] External audit - Draft 2022/23 Annual Audit Report

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Alan / [redacted]

Please find attached our draft 2022/23 Annual Audit Report. I would be grateful if you could review this document to confirm the factual accuracy of the contents and provide actions and timescales for each of the recommendations set out in Appendix 1.

Our report is due to be considered along with the audited 2022/23 Annual Report and Accounts at the next ARC meeting on Tuesday 21st November so I would appreciate if you could provide your response by close of business on Friday (10th November) to enable us to finalise the document in time for the ARC papers being issued next week.

Kind regards,

[redacted]

[redacted]
Senior Audit Manager

[redacted]

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building
8 Nelson Mandela Place, Glasgow, G2 1BT
T: [redacted]@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Please note that my current working pattern is 8:45am-5pm Monday to Friday

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

<table>
<tr><th>Nature of risk</th><th>Audit response</th><th>Conclusion</th></tr>
<tr><td colspan="3">Other non-significant risks of material misstatement</td></tr>
<tr><td>2. Introduction of IFRS 16
International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022.
Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value.
The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.</td><td>• Reviewed list of leases to assess for completeness.
• Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.</td><td>We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.</td></tr>
<tr><td>3. Estimation in the valuation of pension assets and liabilities
As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million.
Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates).
Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations.
There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.</td><td>• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions.
• Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole.
• Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.</td><td>The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.</td></tr>
</table>

Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission’s unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288

million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Issue/risk	Recommendation	Agreed management action/timing
and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Paragraphs 31. to 33.	
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Narrative on agreed action **Responsible officer:** XXX **Agreed date:** XXX

Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

AUDIT SCOTLAND

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: Donna Very
To: David Satti
Subject: Re: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report
Date: 13 November 2023 17:34:28
Attachments: image001.png
image001.png
WICS_2022-23_AAR_Proposed_final_comments.docx

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expense policy to ensure that there is a separate policy relating to hospitality and events so that there is sufficient distinction made between this type of expenditure and regular subsistence expenses. This will help ensure that a retirement dinner as referenced in section 32 is treaded differently to a subsistence allowance.

Can we change treaded to treated and I'm
Happy
Sent from my iPhone

On 13 Nov 2023, at 17:11, David Satti [redacted]@wics.scot> wrote:

Evening all

I've taken [redacted] most recent report and added in the change discussed earlier including the commitment to a hospitality/event policy.

If we don't have any further edits then we could get this to [redacted] either later tonight or first thing tomorrow to give him more time to turn around the document before we sent out ARC papers.

Regards
[redacted]

From: [redacted]@audit-scotland.gov.uk>
Sent: Monday, November 13, 2023 3:34 PM
To: Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@audit-scotland.gov.uk>
Subject: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Afternoon Alan,

Further to our meeting this morning, please find attached a revised version of our 2022/23 Annual Audit Report which has been updated as detailed below:

- Final key message revised to include a sentence stating:

'Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.'

- Paragraphs 44-46 included to capture the narrative provided by management in response to our draft AAR.

- The agreed actions for the 5 recommendations have been included in the action plan at Appendix 1.

- Other revisions made after our consideration of the comments and clarifications provided by [redacted] last week. The only significant change was at paragraphs 34-36 where we have revised the wording to reflect the most up-to-date information on the PSA payment and prior year submission.

I would be grateful if you could provide any further comments by 12pm tomorrow (Tuesday) to enable us to finalise the report for issue and inclusion in the ARC papers by close of business.

Kind regards,

[redacted]

From: Donna Very [redacted]@wics.scot>
Sent: Friday, November 10, 2023 3:01 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@audit-scotland.gov.uk>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Alan Sutherland [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>
Subject: External audit - Draft 2022/23 Annual Audit Report

[redacted]

Please find attached a copy of the WICS response on the Draft 2022/23 Annual Audit Report. We look forward to discussing this with you on Monday.

Kind regards

[redacted]

WICS, First Floor, Moray House, Forthside Way, Stirling FK8 1QZ
M: [redacted] | wics.scot | scotlandontap.gov.uk

Twitter: @WICScotland **LinkedIn:** WICS

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

DRAFT

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission’s lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000

Materiality level	Amount
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2 sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3 for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3 for details.

Nature of risk	Audit response	Conclusion
members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	actuary by the Commission.	
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3 for details.

We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
calculation is required to be undertaken by the actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report.

<table>
<tr><th>Issue</th><th>Resolution</th></tr>
<tr><td>Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.</td><td>We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.</td></tr>
<tr><td>5. Scottish Government approval of expenditure

Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were:
The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government.
The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission’s delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.</td><td>On 3 November 2023, the Deputy Director of the Scottish Government’s Water Policy Division (the Commission’s sponsor division) provided retrospective approval for both items of expenditure.

As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts.

Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission’s Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred.

Recommendation 2
(Appendix 1, action plan)</td></tr>
</table>

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4, to fund the Commission's activities over the six-year regulatory control period.

Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5.

24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4 above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit is £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified a payment of £8,211 relating to a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments totalling £20,029 dating back to 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,211. Grant Thornton are preparing a voluntary disclosure for these amounts for the Commission to submit in their 2022/23 PSA return.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure, including the purchase of the £100 gift vouchers for Commission staff detailed at issue 5 in Exhibit 3, that it would not be practical to recharge to staff now. However, it also included a payment for a flight for a relative of a current Commission employee that we would have expected to be recharged to the individual and treated as a taxable benefit.

Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.

- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Management recognises that some of the processes that worked well when we were based in Moray House lapsed when we started to work remotely. We relied on the new Approvals Max system for our review of expenditures and there was insufficient discussion of these expenditures. This was clearly an oversight on our part. Previously, our approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. There is also the opportunity to use that approvals panel to review potential future expenditures and ensure that they are aligned to our corporate plan and our international activities.

Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than we could reasonably have foreseen. Surprisingly, what we thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management commits to conducting a lessons learned exercise on what we could and should have done differently. We will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussion with Scottish Government officials to determine how WICS should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of WICS in this area. Management is working closely with officials and the policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

44.

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not

Issue/risk	Recommendation	Agreed management action/timing
Risk: The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	House at the end of the lease in March 2026. Issue 2 in Exhibit 3	be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Donna Very **Agreed date: December 2023**
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20k which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Alan Sutherland

Issue/risk	Recommendation	Agreed management action/timing
		Agreed date: Approvals Panels will be implemented immediately and the minutes shared with the board/ARC at all subsequent meetings. Training will be provided by end January 2024. Three months after the passing of the government's water bill for agreeing and implementing the appropriate arrangements.
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee (ARC) and the Board. With immediate effect, Management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its

Issue/risk	Recommendation	Agreed management action/timing
		monitoring and reporting in this area to the ARC. Management commits to ensuring that all staff are appropriately trained in this area. Management also commits to sharing the minutes of our approvals panels with the ARC. **Responsible officer: David Satti** **Agreed date:** Training to be completed by 30 January 2024.
4. Identification of taxable benefits to staff The Commission paid £8,211 during 2022/23 in respect of the UK tax and national insurance contributions due on previous payments that should have been treated as taxable benefits. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will take further advice to establish appropriate rules and procedures. Management will ensure that this advice is implemented in full and ensure adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Alan Sutherland **Agreed date:** 30 January 2024 for the advice and March 2024 for its implementation.
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House. Paragraphs 37. to 39.	Management accept that it is likely that Zero Waste Scotland may not contribute towards the dilapidation charge. When the contract next comes up for renewal, we will again explore the

Issue/risk	Recommendation	Agreed management action/timing
Risk: The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.		dilapidations question with Zero Waste Scotland. Management's focus at the time was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. **Responsible officer:** Alan Sutherland **Agreed date:** Contract renewal September 2024

Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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www.audit-scotland.gov.uk

From: Alan Sutherland
To: Donna Very
Subject: Re:
Date: 27 October 2023 17:10:22

It's a good draft. The timing of discussions on this went back much further, I think.

Worth circulating?

A

> On 27 Oct 2023, at 17:02, Donna Very [redacted]@wics.scot> wrote:
>
> Alan
>
> Not sure about this and I am feeling a bit miserable about it so will look again on Monday
>
> Hi Jon
>
> Hope you are well.
>
> Audit Scotland has been conducting an audit of our accounts and have highlighted two areas where we should have obtained approval from Scottish Government. This, of course, is not ideal and we apologise for these oversights.
>
> As you know, WICS puts a lot of investment into the training and development of our staff and as an organisation, we want to ensure that our office has the right skillsets and people to carry out their functions to a high standard. We want staff to feel valued and need to future-proof the office. Following a one-to-one with the Chief Operating Officer (COO) at the end of 2022, our COO sought approval to attend a Harvard Business School Advanced Management Programme. The programme builds on leadership skills and business competencies with a strong focus on team building and collaboration. The total cost of this course $84,000 (approx. £63,000). The programme fee included tuition, books, case materials, accommodation and most meals for the Campus modules. Travel – flights from Scotland to Boston for Harvard x 2 - £5,000. The total costs was comparable to other business schools. An internal approvals process was completed and the course was approved. The Board were aware of the COO's training (AS – I cannot find anything just yet but finance reports must show or comment on it)
>
> As this course was over £20,000, WICS should have sought approval. We apologise for this oversight and seek retrospective approval from you.
>
> The other area where we should have sought approval was for £2,500

expenditure incurred for the purchase of 25 x £100 Amazon gift vouchers. This should have had SG approval as it exceeded the £75 gift threshold that we can authorise. This was an oversight on our part and we seek retrospective approval for this.

We are of course sorry for these oversights and will endeavour to ensure that going forward we do not miss SG approval for such things.

I look forward to hearing from you.

Donna

From: Alan Sutherland
To: David Satti
Cc: Colin McNaughton; Donna Very; [redacted]; Andrea Mancini
Subject: Re: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report
Date: 13 November 2023 21:24:30
Attachments: image001.png
image001.png
WICS_2022-23_AAR_Proposed_final_comments.docx

Looks good to me. I think the HN commitment discussed earlier is covered by the commitment to work with officials/ bill team.

A

On 13 Nov 2023, at 17:11, David Satti [redacted]@wics.scot> wrote:

Evening all

I've taken [redacted]s most recent report and added in the change discussed earlier including the commitment to a hospitality/event policy.

If we don't have any further edits then we could get this to [redacted] either later tonight or first thing tomorrow to give him more time to turn around the document before we sent out ARC papers.

Regards
David

From: [redacted]@audit-scotland.gov.uk>
Sent: Monday, November 13, 2023 3:34 PM
To: Alan Sutherland [redacted]@wics.scot>
Cc: [redacted]wics.scot>; David Satti [redacted]@wics.scot>; Colin McNaughton [redacted]@wics.scot>; Andrea Mancini [redacted]i@wics.scot>; Donna Very [redacted]@wics.scot>; [redacted]@audit-scotland.gov.uk>
Subject: [EXT] RE: External audit - Draft 2022/23 Annual Audit Report

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Afternoon Alan,

Further to our meeting this morning, please find attached a revised version of our 2022/23 Annual Audit Report which has been updated as detailed below:

- Final key message revised to include a sentence stating: 'Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.'

- Paragraphs 44-46 included to capture the narrative provided by management in response to our draft AAR.

- The agreed actions for the 5 recommendations have been included in the action plan at Appendix 1.

- Other revisions made after our consideration of the comments and clarifications provided by [redacted] last week. The only significant change was at paragraphs 34-36 where we have revised the wording to reflect the most up-to-date information on the PSA payment and prior year submission.

I would be grateful if you could provide any further comments by 12pm tomorrow (Tuesday) to enable us to finalise the report for issue and inclusion in the ARC papers by close of business.

Kind regards,

[redacted]

From: Donna Very [redacted]@wics.scot>
Sent: Friday, November 10, 2023 3:01 PM
To: [redacted]@audit-scotland.gov.uk>; [redacted]@audit-scotland.gov.uk>
Cc: [redacted]@wics.scot>; David Satti [redacted]@wics.scot>; Alan Sutherland [redacted]@wics.scot>; Colin McNaughton <[redacted]@wics.scot>; Andrea Mancini [redacted]@wics.scot>
Subject: External audit - Draft 2022/23 Annual Audit Report

[redacted]

[redacted] attached a copy of the WICS response on the Draft 2022/23 Annual Audit Report. We look forward to discussing this with you on Monday.

Kind regards

[redacted]

WICS, First Floor, Moray House, Forthside Way, Stirling FK8 1QZ
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Twitter: @WICScotland **LinkedIn:** WICS

statements made which are clearly the senders own and not made on behalf of the Water Industry Commission For Scotland.

Water Industry Commission for Scotland

Proposed 2022/23 Annual Audit Report

Prepared for the Water Industry Commission for Scotland
and the Auditor General for Scotland

7 December 2023

Contents

Key messages

2022/23 annual report and accounts

1 Audit opinions on the annual report and accounts are unmodified.

2 Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

3 We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Wider scope audit work

4 The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

5 We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

6 The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission’s lease with Stirling Council.

7 The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Water Industry Commission for Scotland (the Commission) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

2. The scope of the audit was set out in our annual audit plan presented to the May meeting of the Audit and Risk Committee. This Annual Audit Report comprises significant matters arising from the audit of the Water Industry Commission for Scotland's annual report and accounts and conclusions on wider scope areas, as set out in the *Code of Audit Practice 2021*, which for less complex bodies includes conclusions on financial sustainability and Best Value.

3. We would like to thank Commission members and officers, particularly those in finance, for their cooperation and assistance during the audit and we look forward to continuing to work together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. The Commission has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts in accordance with the accounts direction from Scottish Ministers. The Commission is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

5. The responsibilities of the independent appointed auditor are established by the Public Finance and Accountability (Scotland) Act 2000; the Code of Audit Practice 2021 and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of its responsibility to address the issues we raise and from maintaining adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard and that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity or our independence.

Part 1. 2022/23 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Audit opinions on the annual report and accounts are unmodified.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year.

Audit opinions on the annual report and accounts are unmodified

8. The Board approved the annual report and accounts for the Water Industry Commission for Scotland for the year ended 31 March 2023 on 7 December 2023. The independent auditor's report included the following audit opinions on the annual report and accounts:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Despite issues with the quality of the accounts presented for audit, the 2022/23 annual report and accounts were certified in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 25 July 2023. A number of issues were identified with the accounts presented for audit, particularly in relation to first time adoption of *International Financial Reporting Standard 16 – Leases* accounting, as detailed in Exhibit 3~~Exhibit 3~~. These issues impacted upon the audit resources required to deliver the 2022/23 audit although finance staff did provide good support to the team during the audit process. This allowed us to still complete the final accounts audit in line with the agreed audit

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timetable, and the 2022/23 annual report and accounts were certified on 7 December 2023.

We will review the fee level for the 2023/24 audit to reflect the extent of the issues encountered this year but expect management to take corrective action to ensure similar issues are not encountered next year

10. As detailed in our annual audit plan, in determining the fee for the 2022/23 audit we took account of the risk exposure of the Commission and the planned management assurances in place. Our fee was also set based on an assumption that the Commission had effective governance arrangements, would prepare comprehensive and accurate accounts for audit, and there would be no major change in respect of the scope of the audit during the year.

11. Due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We will take account of this when setting the fee for the 2023/24 audit although we expect management to take corrective action to ensure similar issues are not encountered next year.

Our audit approach and testing was informed by the overall materiality level of £83,000

12. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact the opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature and it is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the financial results reported in the audited 2021/22 annual report and accounts. These materiality levels were reported in our annual audit plan to the May meeting of the Audit and Risk Committee.

14. On receipt of the unaudited 2022/23 annual report and accounts we revised our materiality levels to reflect the financial results for the year ended 31 March 2023. These are detailed in Exhibit 1~~Exhibit 1~~.

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Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£83,000
Performance materiality	£62,000
Reporting threshold	£4,000

Source: Audit Scotland

15. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 75 per cent of overall materiality, reflecting the scale of previous year's adjustments, the extent of estimation in the accounts and the planned testing in proportion to the scale of the organisation.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

16. Exhibit 2~~Exhibit 2~~ sets out the significant and non-significant risks of material misstatement to the financial statements. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

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Exhibit 2
Significant and other risks of material misstatement

Nature of risk	Audit response	Conclusion
Significant risks of material misstatement		
1. Risk of material misstatement due to fraud caused by management override of controls As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluated significant transactions outside the normal course of business.	We are satisfied that there is no material misstatement arising from this risk.

Nature of risk	Audit response	Conclusion
Other non-significant risks of material misstatement		
2. Introduction of IFRS 16 *International Financial Reporting Standard 16 – Leases* is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.	• Reviewed list of leases to assess for completeness. • Tested lease agreements to ensure they had been correctly assessed and accounted for in the 2022/23 financial statements.	We reviewed the accounting treatment adopted for the Moray House lease agreement between Stirling Council and the Commission, and the sub-lease agreement between the Commission and Zero Waste Scotland. This identified that neither lease agreement had been correctly accounted for in accordance with the requirements of IFRS16 – see issue 1 in Exhibit 3~~Exhibit 3~~ for details.
3. Estimation in the valuation of pension assets and liabilities As at 31 March 2022, the Commission recognised a net pension liability of £2.201 million. Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates). Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations. There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual report and accounts.	• Assessed the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Reviewed the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Reviewed officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Commission.	The IAS19 valuation was correctly reflected in the unaudited accounts but a minor adjustment was required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 – see issue 3 in Exhibit 3~~Exhibit 3~~ for details.

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Nature of risk	Audit response	Conclusion
4. Potential tax implications of international work The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.	Reviewed the tax position of this project to establish whether a contingent liability or provision requires to be recognised under *IAS37 – Provisions, Contingent Liabilities and Contingent Assets*.	We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work – see issue 4 in Exhibit 3~~Exhibit 3~~ for details.

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We reported the significant findings from the audit to those charged with governance prior to the annual report and accounts being approved and certified

17. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the board's accounting practices.

18. The significant findings are summarised in Exhibit 3~~Exhibit 3~~. Our audit also identified a number of other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts and were not considered significant enough to be separately reported under ISA260.

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Exhibit 3
Significant findings and key matters from the audit of the annual report and accounts

Issue	Resolution
1. IFRS 16 lease accounting requirements International Financial Reporting Standard 16 – Leases is effective for accounting periods starting from 1 April 2022. Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value. The 2022/23 annual report and accounts presented for audit did not adequately reflect the accounting requirements of IFRS16 in terms of the recognition of the right of use asset and lease liability for the Commission's agreement to lease Moray House from Stirling Council until March 2026, the lease asset and transfer of the right of use asset for the sub-lease agreement with Zero Waste Scotland to September 2024, and the related accounting policies and disclosure notes required by the 2022/23 FReM.	During the audit we reviewed the lease and sub-lease agreements, and worked with finance staff, to ensure the audited financial statements correctly reflected the accounting requirements of IFRS16 and the 2022/23 FReM. This resulted in a number of revisions being made to: • Reverse the previous rent accounting entries. • Initially recognise a right of use property lease asset, and corresponding lease liability, of £0.409 million in the Statement of Financial Position, in respect of the lease agreement with Stirling Council. • Write down the right of use property asset by £0.250 million to £0.159 million, and creating a corresponding lease debtor, to reflect the impact of the sub-lease agreement with Zero Waste Scotland. • Create a separate 'Note 3.5.7 Leases' to disclose the cost, in-year movement and carrying value of the right of use property asset, and the split of future lease payments due to Stirling Council and from Zero Waste Scotland. • Revise the accounting policies to explain the accounting requirements of IFRS16 and how these have been interpreted and applied to the Commission's current lessee and lessor agreements. We are content that the 2022/23 audited annual report and accounts accurately reflect the IFRS 16 accounting requirements for the Commission's current lessee and lessor agreements.

Issue	Resolution
2. Dilapidation provision for Moray House The unaudited annual report and accounts included a provision of £0.115 million (£0.074 million at 31 March 2022) for the costs that will be incurred to return Moray House to its pre-lease condition when the lease agreement ends in March 2026. As the value of the provision at 31 March 2023 was a material balance, and had increased by £0.041 million (55 per cent) from the prior year, we reviewed the methodology used to calculate it to ensure it satisfied the requirements of IAS37 - Provisions, Contingent Liabilities and Contingent Assets. Our review established that the provision calculation is based on the cost per square feet per year of the dilapidation costs that the Commission had to pay when it vacated a former office at Ochil House in April 2011, and applying this to the size of Moray House and the length of the lease agreement with Stirling Council. Adjustment had also been made to reflect the projected impact of inflation up to March 2026. Based on our discussions with management about the modifications made to Moray House during the current lease, and the dilapidation costs incurred for Ochil House, we do not believe the current methodology represents a reliable and robust approach to calculate the dilapidation charge that the Commission is likely to incur at the end of the current lease agreement.	Our review of the nature of the provision confirmed that it satisfies the conditions for a provision to be created under IAS 37 (i.e. represents a present obligation based on a past event) as there is an obligation for the Commission to meet these costs when the current lease ends. We have also concluded that the value of the provision is not materially misstated and have accepted this for the 2022/23 annual report and accounts. However, the current calculation methodology is unlikely to have produced an accurate estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement. Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. **Recommendation 1** (Appendix 1, action plan)
3. Unfunded pension liabilities The Commission is a member of Falkirk Pension Fund. Pension assets and liabilities are valued annually for each individual member body, by the actuary Hymans Robertson LLP, for inclusion in the annual report and accounts. Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates. The Commission's 2022/23 IAS19 valuation showed a pension asset at 31 March 2023 of £2.802 million (pension liability of £2.201 million at 31 March 2022). However, where a pension asset is identified under IAS19, an IFRIC14 asset ceiling calculation is required to be undertaken by the	The required adjustment was made in the audited financial statements to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million.

Issue	Resolution
actuary to assess whether the net present value of estimated future service costs exceed the net present value of future contributions. If this is the case then no pension asset should be recognised and an asset ceiling adjustment should be applied to reduce the pension asset to zero. The actuary's asset ceiling calculation identified that an asset ceiling adjustment of £2.802 million was required to reduce the Commission's pension asset at 31 March 2023 to zero. The asset ceiling adjustment was correctly reflected in the unaudited accounts resulting in a pension asset of zero at 31 March 2023 in the Statement of Financial Position. However, a further minor adjustment was also required to recognise the present value of the Commission's unfunded pension liabilities at 31 March 2023 of £0.034 million (£0.040 million at 31 March 2022) which relates to the element of retirement benefits of former staff which require to be paid directly from employer contributions rather than from the fund assets.	
4. Tax implications of international work The Commission entered a contract with the Department of Internal Affairs (DIA) in New Zealand to provide services relating to the Three Waters Reform Programme. The contract activity was performed both physically in New Zealand and remotely from the United Kingdom. As a result of the Commission's extended presence in New Zealand, it decided to make a voluntary disclosure to the Inland Revenue Department (IRD) to ensure all taxation obligations arising from the project were met. As a statutory body, the Commission does not undertake projects with an intention to make profit and instead budgets project activity to break-even. From the 1 June 2023, WICS has been registered as an employer in New Zealand. On the basis that there was no intention to make a profit on the activities in New Zealand, the IRD provided the Commission with a special tax rate certificate confirming that no corporation tax would be due. The services provided to the DIA by the Commission would likely be liable to Goods and Services Tax (the New Zealand equivalent of VAT) at a rate of 15 per cent. As the DIA is able to reclaim GST paid, there would be no financial gain	As part of our audit we considered the Commission's assessment of the potential tax implications of the international work, including consideration of the latest exchanges with Grant Thornton who the Commission has engaged to provide advice on New Zealand tax arrangements. We have accepted that there does not appear to be any tax liability to the Commission at 31 March 2023 in relation to its international work. However, we asked management to include a contingent liability disclosure to reflect the residual risk that the Commission may still face a tax liability in relation to this work. This disclosure has been included at 'Note 3.5.12' in the audited financial statements and also included in the Parliamentary Accountability Report section of the Annual Report. We noted that there are likely to be personal tax implications for any individuals who work in New Zealand for longer than six months in any financial

Issue	Resolution
for any parties in charging GST on invoices from the Commission to the DIA. Therefore, the Commission submitted a voluntary disclosure to the IRD on the basis that GST is technically required to be charged, but that there would be no benefit to filing returns. This approach has been accepted by the IRD and all income from the DIA included in the annual report and accounts excludes GST.	year. Management should ensure that relevant staff are aware of this so they can make appropriate arrangements to pay the required income tax due in the UK and other jurisdictions.
5. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government approval which had not been obtained. These were: • The cost of a training course attended by the Chief Operating Officer at Harvard Business School in Boston at a total cost, including flights, of £77,350. As the value of this service exceeded £20,000 and had not been awarded via a competitive tender exercise, it required to be approved by the Scottish Government. • The purchase of £100 gift vouchers for a retail outlet for all Commission staff (at a total cost of £2,600) as a Christmas gift in December 2023. As this exceeded the Commission's delegated limit of £75 for gifts, it required to be approved by the Scottish Government. Due to the nature of this payment it also represents a non-salary reward to the recipients and should have been treated as a taxable benefit but management has confirmed it was not and the £1,133 of tax and national insurance payments due on these payments has been paid by the organisation.	On 3 November 2023, the Deputy Director of the Scottish Government's Water Policy Division (the Commission's sponsor division) provided retrospective approval for both items of expenditure. As the purchase of the gift vouchers represented both a gift paid by the organisation and a non-salary reward received by staff during 2022/23, we asked management to include relevant disclosures in the remuneration and staff report and the parliamentary accountability report. These have both been included in the audited annual report and accounts. Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. **Recommendation 2** (Appendix 1, action plan)

Source: Audit Scotland

All misstatements identified during the 2022/23 audit were corrected in the audited annual report and accounts

19. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

20. Two misstatements were identified during the audit which exceeded our reporting threshold (issues 1 and 3 in Exhibit 3~~Exhibit 3~~). These were both corrected in the audited accounts. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which related to the new IFRS 16 lease accounting requirements and recognition of the Commission's unfunded pension liabilities at 31 March 2023. We concluded that these were isolated errors that had been identified in their entirety and did not indicate further systemic error.

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Part 2. Wider scope audit work

For less complex bodies wider-scope audit work considers the financial sustainability of the body and the services that it delivers over the medium to longer term, and the arrangements for securing Best Value.

The Commission reported an operating surplus of £1.3 million for 2022/23 and we do not currently have any concerns about the financial sustainability of the organisation.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts. The Commission also identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported.

The Commission reported an operating surplus of £1.3 million for 2022/23

21. The Commission is funded by a levy paid by Scottish Water and the licensed providers that participate in the non-household retail market. For 2021-2027 the Scottish Government approved levies totalling £24.68 million, Exhibit 4~~Exhibit 4~~, to fund the Commission's activities over the six-year regulatory control period.

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Exhibit 4
Levy income for 2021-2027 regulatory control period

	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	26/27 £m	Total £m
Scottish Water levy	2.36	2.28	2.30	2.32	2.35	2.37	**13.88**
Licensed Provider's levy	1.67	1.72	1.77	1.82	1.88	1.93	**10.79**
Total levy income	**3.92**	**4.00**	**4.07**	**4.15**	**4.23**	**4.31**	**24.68**

Source: Water Industry Commission for Scotland Corporate Plan 2021-2027

22. For 2022/23 the Commission reported an operating surplus of £1.251 million (£0.610 million in 2021/22), Exhibit 5~~Exhibit 5~~. This reflected annual income of £5.288 million (including levy income of £3.997 million) and expenditure of £4.036 million (with 67 per cent relating to staff costs). The increased surplus reported for the year was largely attributable to an increase of £0.706 million (247 per cent) in Hydro Nation income from £0.479 million in 2021/22 to £1.185 million in 2022/23.

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Exhibit 5
Financial outturn

	2021/22 £m	2022/23 £m	Cumulative position for 2021-2027 control period £m
Income	4.481	5.288	9.769
Expenditure	(3.871)	(4.036)	(7.907)
Operating surplus / (deficit)	**0.610**	**1.251**	**1.861**

Source: Water Industry Commission for Scotland 2022/23 Annual Report and Accounts

The Commission's cash reserves increased to £3.5 million at 31 March 2023, any excess funds at the end of the regulatory period will be returned to Scottish Water and Licensed Providers

23. At the end of the previous six-year regulatory period the Commission held a cash and cash equivalents balance of £2.452 million. This has increased to £3.457 million at 31 March 2023 as a result of the operating surpluses achieved in the first two years of the new 2021-2027 regulatory period, Exhibit 5~~Exhibit 5~~.

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24. The level of the cash reserves held at 31 March 2023 represented 83 per cent of the Commission's 2022/23 expenditure, and current liabilities at the year-end totalled only £0.523 million.

25. Management advised that due to the nature of the Commission's work, the annual expenditure during a regulatory period can vary significantly. To allow Scottish Water and Licensed Providers a predictable payment schedule, the income is agreed at a set rate for each year at the outset of the regulatory period, as shown in Exhibit 4~~Exhibit 4~~ above. The impact of this is that the Commission can have unusually high cash balances at certain points in the regulatory cycle. At the end of a regulatory period, if there are excess funds, they are returned to Scottish Water and the Licensed Providers, as appropriate.

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78 per cent of central support costs were allocated to network regulation and retail activity in 2022/23, with the remaining 22 per cent allocated to international work

26. As part of our audit we reviewed the methodology for the allocating central support costs to operating segments to ensure this provided an accurate basis for attributing these costs to the activities they related to. This identified that

central support costs are currently allocated based on head count with the total overheads of £1.779 million being allocated £0.697 million (39 per cent) to network regulation, £0.697 million (39 per cent) to retail, and £0.385 million (22 per cent) to international work.

27. We have accepted that this as a reasonable basis for allocating central overheads to operating segments during the year, but we noted that finance are looking at whether improvements could be made to provide a better basis for allocating costs based on activity.

We do not currently have any concerns about the financial sustainability of the Commission

28. As shown in Exhibit 5~~Exhibit 5~~, the Commission has reported an operating surplus in each of the first two years of the current regulatory control period and has achieved a cumulative surplus of £1.861 million over that period.

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29. In 2022/23, the Commission's expenditure totalled £4.036 million which was £0.039 million more than the levy income of £3.997 million received during the year. The additional expenditure was funded through Hydro Nation income.

30. We do not currently have any concerns about the financial sustainability of the Commission as the in-year costs of the Hydro Nation work significantly exceeded £0.039 million, and therefore even if this activity ceased entirely, we would expect there to be sufficient cost savings (i.e. through reduced travel and subsistence costs) to enable the organisation to operate within the levy income.

We identified widespread issues with staff submitting expense claims that significantly exceeded the approved subsistence rates and were not supported by itemised receipts

31. Our testing for the 2022/23 audit identified an expense claim submitted by the Chief Executive in March 2023 that included two items that were not supported by itemised receipts as required by the Commission's Finance Policies and Guidelines. We therefore conducted a wider review of expense claims submitted during 2022/23.

32. Our review of expense claims identified widespread issues with staff submitting claims that were not supported by itemised receipts. We also noted multiple instances where the amounts claimed significantly exceeded the approved rates set out at Appendix A of the Commission's Finance Policies and Guidelines. This included one instance where the cost per head for a dinner claimed exceeded £200 per person, the approved non-city limit was £25, and included the purchase of alcohol.

33. The description of many of these claims suggest it related to business entertaining costs. However, the Commission does not have a separate budget for this type of expenditure, and the Finance Policies and Guidelines have no dispensation for staff to exceed the approved subsistence rates when engaged in this type of activity.

Recommendation 3

Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines.

The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff

34. During the 2022/23 audit we identified an accrual of £8,818 relating to an obligation for a PAYE settlement agreement (PSA) for UK tax and national insurance due on taxable benefits that had been paid to employees. A PSA allows an organisation to make one annual payment to cover all the tax and national insurance due on minor, irregular or impracticable expenses or benefits to its employees.

35. Management advised that a review had been undertaken during the year to identify previous payments made by the Commission that should have been treated as taxable benefits to staff and that would have incurred national insurance contributions and been liable for income tax. This identified payments dating back as far as 2018/19 that should have been treated as taxable benefits and would have incurred national insurance contributions and income tax payments of £8,818. The Commission settled its 2022/23 obligation in October 2023 and are awaiting a response to the voluntary disclosure for prior years.

36. Our review of the items identified found that the majority related to leaving lunches, birthday gifts and other minor items of expenditure. However, it also included the purchase of the £100 gift vouchers for Commission staff, detailed at issue 5 in Exhibit 3~~Exhibit 3~~.

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Recommendation 4

Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions.

The current sub-lease agreement with Zero Waste Scotland does not include any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council

37. As part of our work on the IFRS 16 lease accounting requirements, issue 1 in Exhibit 3~~Exhibit 3~~, we reviewed the Commission's agreement with Stirling Council for the lease of Moray House. This identified that the agreement with Stirling Council included a clause that granted the Commission a 9-month rent free period after it had leased the premises for 10 years which occurred in 2021/22 and reduced the lease payments made during the year. It also included a standard clause relating to dilapidations that requires the Commission to return

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Moray House to its pre-lease condition when the lease agreement ends in March 2026.

38. During our discussions of the Commission's sub-lease agreement with Zero Waste Scotland we were advised by management that, prior to the original sub-lease being signed, it was agreed that if Zero Waste Scotland leased Moray House to the end of the Commission's original lease agreement with Stirling Council, then the full rent free period saving would be passed on to Zero Waste Scotland. We were also advised that there was an expectation that Zero Waste Scotland would make a contribution towards the dilapidation charge that the Commission will incur at the end of its lease agreement with Stirling Council, to reflect the element of the charge that relates to the period that they sub-leased the premises.

39. From our review of the current sub-lease agreement between the Commission and Zero Waste Scotland which runs until September 2024, we noted that this does not include a clause in relation to either the Commission passing on the rent free period to Zero Waste Scotland, or Zero Waste Scotland contributing towards the Commission's dilapidation charges at the end of the lease agreement with Stirling Council in March 2026. As such, neither organisation could enforce these conditions as there is no legally binding agreement between the parties in relation to them.

Recommendation 5

Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities of both parties for Moray House.

The Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period

40. Within the Corporate Plan 2021-27, published in December 2020, the Commission identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives:

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

41. The Performance Analysis section of the Performance Report in the 2022/23 Annual Audit Report detailed the Commission's progress against its 9 outcomes for the 2021-2027 regulatory period, including the achievement of key milestones expected during 2022/23.

The Accountable Officer needs to take immediate action to address the issues identified during the 2022/23 audit and to promote a culture of Best Value across the organisation

42. *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

43. As detailed in this report, we have identified multiple instances during the 2022/23 audit that indicate that the Commission is not currently demonstrating the highest standards of financial management and propriety in its business activities. The Accountable Officer needs to take immediate action to address these issues and to promote a culture of Best Value across the organisation.

Management has accepted the findings from the audit and agreed actions to address the weaknesses reported

44. Management has accepted the findings from the audit and agreed actions to address the weaknesses reported, as detailed in Appendix 1.

45. Management advised that it recognises that some of the processes that worked well when they were based in Moray House lapsed when the Commission started to work remotely. They have relied on the new Approvals Max system for review of expenditures and there was insufficient discussion of these expenditures. They acknowledge that this was clearly an oversight on their part. Previously, an approvals panel met regularly to discuss all significant expenditures. This always involved active debate. Management commits to restarting this approvals panel meeting in person at least fortnightly and ensuring that there is appropriate detailed scrutiny of all proposed expenditures. They also note that there is an opportunity to use the approvals panel to review potential future expenditures and ensure that they are aligned to the corporate plan and international activities.

46. Management also recognises that the work to support the Scottish Government's Hydro Nation initiative has grown faster than they could reasonably have foreseen. What they thought were ambitious corporate plan targets for the regulatory period have already been exceeded. However, this has required significant time from the senior management team. Ideally, office systems, processes, and legal structures would have been proactively tailored to deal with this growth. Management has committed to conducting a lessons learned exercise on what they could and should have done differently. This review will include the personal tax implications of staff working internationally for prolonged periods of time and the appropriate financial and legal disclosures required to be in place for staff prior to delivering such contracts. They will ensure that all appropriate training identified as part of this lessons learned exercise will be completed in the first half of 2024. Management are also in active discussions with Scottish Government officials to determine how the Commission should take forward the Hydro Nation ambitions of Government. Scottish Government is currently progressing legislation which will extend the expectations it has of the Commission in this area. Management is working closely with officials and the

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policy development team to ensure that the systems and processes required to deliver the Government's ambitions are established over the next 12 to 18 months.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Dilapidation provision for Moray House The provision calculation is based on the dilapidation costs that the Commission had to pay when it vacated a former office in April 2011. **Risk:** The value of the provision does not represent a reliable estimate of the dilapidation charge that the Commission will incur at the end of the current lease agreement.	Management should engage with the Estates Team from Stirling Council during 2023/24 to obtain a realistic estimate of what dilapidation payment they anticipate will be sought when the Commission vacate Moray House at the end of the lease in March 2026. Issue 2 in Exhibit 3~~Exhibit 3~~	We agree. We will reach out to the Estates Team at Stirling Council as soon as possible to obtain a realistic estimate of what dilapidation payment they anticipate. Management recognise that the current provision may not be appropriate and will ensure that the views of Stirling Council determine our future approach. We will liaise annually with Stirling Council to check that the amounts that we are provisioning remain reasonable. **Responsible officer:** Director of Corporate and International Affairs **Agreed date:** December 2023

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Issue/risk	Recommendation	Agreed management action/timing
2. Scottish Government approval of expenditure Our audit identified two items of expenditure incurred during 2022/23 that required Scottish Government which had not been obtained. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expenditure incurred is in accordance with the requirements of the Commission's Finance Policies and Guidelines, and the rules and guidance set out in the Scottish Public Finance Manual (SPFM). Where there is any dubiety as to whether this is the case, approval should be sought from the sponsor division prior to the expenditure being incurred. Issue 5 in Exhibit 3~~Exhibit 3~~.	There was an oversight on both instances which we accept and regret. Reverting to our approvals panel should ensure that such oversights do not happen in future. Management also commits to reviewing its delegated authorities with the board to help ensure greater board oversight of such expenditures. We will provide training to management and staff with respect to financial rules and expectations, particularly with respect to expenditure over £20,000 which isn't competitively tendered. Separately, as mentioned above, we will work with Scottish Government officials to ensure that appropriate rules and procedures for our international activities are put in place. **Responsible officer:** Chief Executive **Agreed date:** Approvals Panels will be implemented immediately and the minutes shared with the board / Audit and Risk Committee at all subsequent meetings. Training will be provided by the end of January 2024. Three months after the passing of the government's water bill for agreeing and implementing the appropriate arrangements for international activities.

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Issue/risk	Recommendation	Agreed management action/timing
3. Expense claim issues We identified widespread issues with staff submitting expense claims that significantly exceed the approved subsistence rates and were not supported by itemised receipts. **Risk:** The Commission incurs expenditure that is not in accordance with applicable enactments and guidance issued by Scottish Ministers.	Management should ensure that all expense claims are supported by itemised receipts and staff are only reimbursed at the approved subsistence rates set out in the Commission's Finance Policies and Guidelines. Paragraphs 31. to 33.	Management recognise that there has been insufficient clarity between expenses which relate to normal travel and subsistence, and expenses arising both internationally and further strengthening working relationships with key advisers. Management regret this lack of clarity and will ensure that all future expenditures are properly explained and justified. The new expenses policy, which was trialled from 1 January 2023, has proven to be successful and has been implemented permanently having been approved by the Audit and Risk Committee and the Board. With immediate effect, management will ensure that the revised expense policy is adhered to, which includes guidance on itemised receipts, and increase its monitoring and reporting in this area to the Audit and Risk Committee. Management will revise the expense policy to ensure that there is a separate policy relating to hospitality and events so that there is sufficient distinction made between this type of expenditure and regular subsistence expenses. This will help ensure that a retirement dinner as referenced in section 32 is treaded differently to a subsistence allowance.

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Issue/risk	Recommendation	Agreed management action/timing
		Management commits to ensuring that all staff are appropriately trained in this area, including how to tag and describe expenses to ensure that there is clarity between subsistence expenses and expenditure relating to business development or hospitality/events. Management also commits to sharing the minutes of our approvals panel with the Audit and Risk Committee. **Responsible officer:** Director of Strategy and Governance **Agreed date:** Training to be completed by 30 January 2024.
4. Identification of taxable benefits to staff The Commission identified an obligation of £8,818 in respect of the UK tax and national insurance contributions due on previous payments, dating back as far as 2018/19, that should have been treated as taxable benefits to staff. **Risk:** The Commission incurs additional costs that should be met by the individual employees receiving the taxable benefit.	Management should ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. Paragraphs 34. to 36.	We agree. Management will take further advice to establish appropriate rules and procedures. Management will ensure that this advice is implemented in full and ensure adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions. **Responsible officer:** Chief Executive **Agreed date:** 30 January 2024 for the advice and March 2024 for its implementation.
5. Sub-lease agreement The current sub-lease agreement with Zero Waste Scotland does not include	Management should ensure that any future sub-lease agreement with Zero Waste Scotland accurately reflects the obligations and liabilities	Management accept that it is likely that Zero Waste Scotland may not contribute

Issue/risk	Recommendation	Agreed management action/timing
any requirement for it to contribute to dilapidations costs at the end of the Commission's lease with Stirling Council. **Risk:** The Commission will be unable to obtain a payment from Zero Waste Scotland towards the dilapidation charge from Stirling Council.	of both parties for Moray House. Paragraphs 37. to 39. ~~39.~~	towards the dilapidation charge. When the contract next comes up for renewal, we will again explore the dilapidations question with Zero Waste Scotland. Management's focus at the time was to ensure that it could recover some of the costs of its lease and the contract with Zero Waste Scotland was the only deal available. **Responsible officer:** Chief Executive **Agreed date:** Contract renewal September 2024

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Water Industry Commission for ScotlandWater Industry Commission for Scotland

2022/23 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:
www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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From: Jon.Rathjen@gov.scot
To: David Satti
Cc: Directors
Subject: [EXT] RE: [EXT] News release for information - Auditor General report
Date: 20 December 2023 07:36:33

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

David,

Certainly wise to respond, happy to discuss further but that seems appropriate at this point.

Jon

From: David Satti [redacted]@wics.scot>
Sent: Tuesday, December 19, 2023 4:56 PM
To: Jon Rathjen <Jon.Rathjen@gov.scot>
Cc: Directors [redacted]s@wics.scot>
Subject: FW: [EXT] News release for information - Auditor General report

Hi Jon

I'm guessing you've seen this already. We have drafted a response and discussed it with the board:

We acknowledge and accept the Auditor General for Scotland's Section 22 report on our Annual Report and Accounts for 2022/23 and the issues highlighted in the report. We take the Auditor General's findings seriously and will work with Audit Scotland and the Scottish Government to address these.

Any thoughts or advice is appreciated.

Regards
David

From: [redacted]@audit-scotland.gov.uk>
Sent: Tuesday, December 19, 2023 10:51 AM
To: enquiries <enquiries@wics.scot>
Subject: [EXT] News release for information - Auditor General report

CAUTION: This email originated from outside the organisation. Do not click links or open attachments unless you recognise the sender and know the content is safe.

Good morning,

As promised, here is the news release that will accompany the publication of the

Auditor General's s22 report on WICS.

The news release is for information.

I'd be grateful if WICS could share any media lines worked up in response to the report.

I will copy this email address into the distribution to media contacts tomorrow morning, once the reports have been laid in Parliament.

We're expecting media interest in the story and I will let you know if we receive any broadcast bids.

[redacted]

News release

For immediate release, 20 December 2023

Unacceptable financial management at water industry watchdog

Auditors have found unacceptable use of public funds by senior officials at the Water Industry Commission for Scotland.

The Commission is the economic regulator of Scottish Water. Its job is to ensure long-term value and excellent levels of service for customers and communities.

Auditors reported that, in 2022/23, the Commission needed retrospective approval from the Scottish Government for around £80,000 of spending. This included:

- £77,350 for the chief operating officer to attend a training course at Harvard Business School

- £2,600 on £100 Christmas gift vouchers for each member of staff.

Expenses claims exceeding set rates were also found to have been submitted and approved without itemised receipts, including by the Chief Executive. One claim was for a dinner where the cost per head exceeded £200 per person. This, and other claims, included the purchase of alcohol.

Stephen Boyle, Auditor General for Scotland, said:

“Value for money should always be central to public bodies’ spending decisions.

“But these findings highlight unacceptable behaviour by senior Commission officials in the use of public funds.

“I expect appropriate action to be taken to address the issues reported by the auditor.”

For further information contact [redacted]. Tel: [redacted] or media@audit-scotland.gov.uk

Notes to Editor:

- The Auditor General has prepared the report on the Scottish Water Commission for Scotland’s 2022/23 under Section 22 of the Public Finance and Accountability (Scotland) Act 2000. This allows the Auditor General to bring to the Parliament’s and the public's attention matters of public interest related to the financial statements of public bodies.

- Section 22 reports are submitted to Scottish Ministers for laying in the Parliament along with the accounts of the relevant body. While there are statutory deadlines for these reports, the actual timing of publication is determined by when the report is laid in the Scottish Parliament by Scottish Ministers.

- The Water Industry Commission for Scotland requires Scottish Government approval for any service above £20,000 that has not been awarded via a competitive tender exercise.

- The Commission’s delegated limit for gifts is £75, which is the requirement of the Scottish Public Finance Manual. Gifts over this amount should have been approved by the Scottish Government. The Christmas gift vouchers also represented a non-salary reward and should have been treated as a taxable benefit.

- Unusually for a public body, the Commission’s existing policies do not explicitly prohibit the purchase of alcohol as a business expense.

Audit Scotland has prepared this report for the Auditor General for Scotland. All Audit Scotland reports published since 2000 are available at www.audit-scotland.gov.uk

The Auditor General for Scotland appoints auditors to Scotland's central government and NHS bodies; examines how public bodies spend public money; helps them to manage their finances to the highest standards; and checks whether they achieve value for money. The Auditor General for Scotland is independent and is not subject to the control of the Scottish Government or the Scottish Parliament

Audit Scotland is a statutory body set up in April 2000, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission for Scotland.