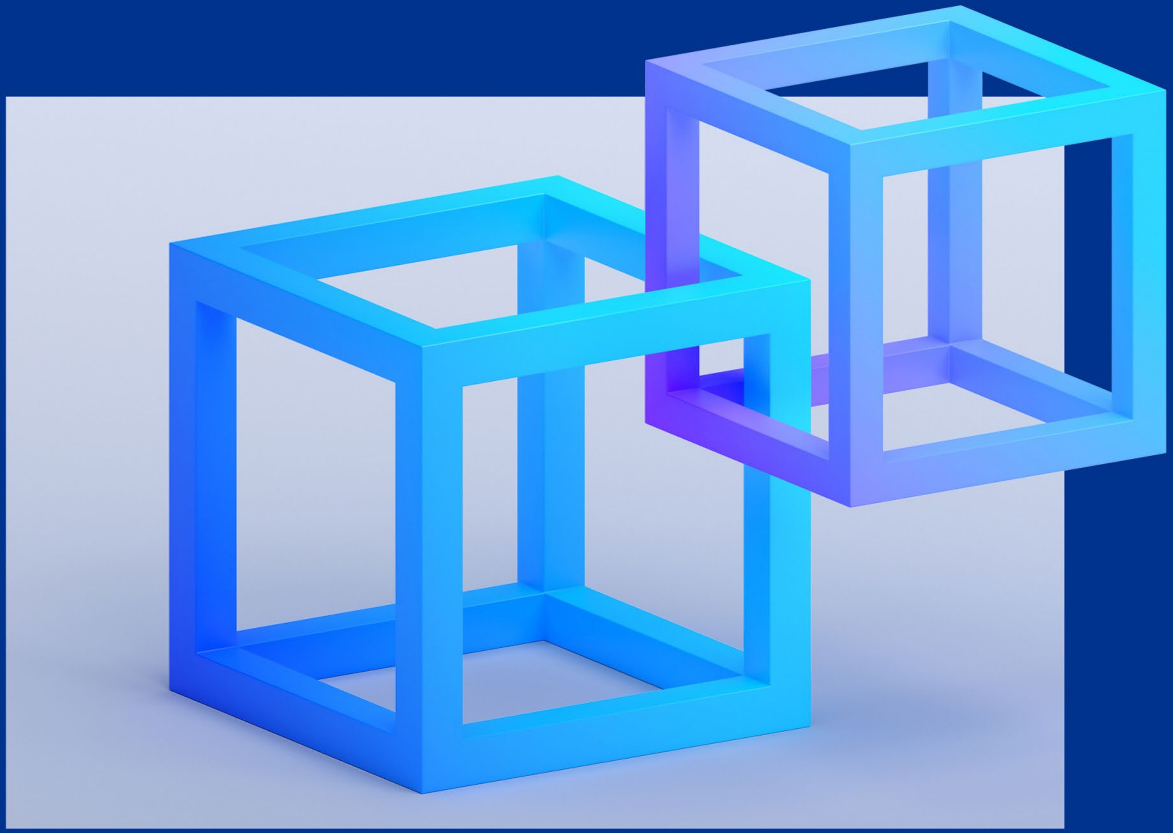
KPMG

Scottish Water



Annual Audit Report to the members of Scottish Water and the Auditor General for Scotland

Annual report for the year ended 31 March 2024

03 July 2024

Introduction

To the Audit and Risk Committee of Scottish Water

We were pleased to have the opportunity to meet with you on 13 June 2024 to discuss the results of our audit of the consolidated financial statements of Scottish Water (the Company) (and its subsidiaries (the Group), as at and for the year ended 31 March 2024.

This report should be read in conjunction with our audit plan and strategy report, presented on 26 March 2024

The engagement team

Our audit is now complete. There have been no significant changes to our audit plan and strategy other than those described on page 5.

We have issued an unmodified Auditor's Report.

We draw your attention to the important notice on page 3 of this report, which explains:

- The purpose of this report
- Limitations on work performed
- Restrictions on distribution of this report

Yours sincerely,

Timothy Cutler
Audit partner
03 July 2024

How we deliver audit quality

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

We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

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

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

Important notice

This report is presented under the terms of our audit appointment letter with Audit Scotland.

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

Purpose of this report

This Report has been prepared in connection with our audit of the consolidated financial statements of Scottish Water (the 'Company') (and its subsidiaries (the 'Group'), prepared in accordance with UK adopted international accounting standards, and, where otherwise appropriate, as interpreted and adapted by the 2023/24 FReM as at and for the year ended 31 March 2024.

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ('the Code').

This report is for the benefit of Scottish Water and is made available to Audit Scotland and the Auditor General (together 'the Beneficiaries'). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

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

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

Limitations on work performed

This Report is separate from our audit opinion and does not provide an additional opinion on the Group's financial statements, nor does it add to or extend or alter our duties and responsibilities as auditors reporting to the Entity's members.

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

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Tim Cutler, who is the engagement leader for our services to Scottish Water; email ttim.cutler@kpmg.co.uk, who will try to resolve your complaint. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Auditor General and Accountable Officer, Audit Scotland, Fourth Floor, 102 West Port, Edinburgh, EH3 9DN

Our audit findings

Significant audit risks		Page [6-20]

Significant audit risks	Risk change	Our findings
Capital additions (SW fraud risk)	No change	No material misstatement identified.
Management override of controls	No change	We identified that there is no evidence of the review of manual journals prior to posting. This has been raised as a control deficiency and is consistent with our finding in prior years.
Revenue recognition (SWBS fraud risk) ▼	Decrease	No issues identified
Bad debt provision (SW & SWBS: fraud risk)	No change	No issues identified – refer below to findings on key accounting estimates
Defined Benefit Pension (SW) ▲	Increase	Unfunded obligation identified and separately disclosed as a non current liability

Key accounting estimates	Page [21]
Impairment of trade receivables	SW: Management judgement considered neutral and within acceptable range SWBS: Management judgment considered optimistic and within acceptable range.
Defined benefit pension	Management's judgment considered neutral
Depreciation charge	Management's judgement considered cautious

Number of Control deficiencies	Page [28-30]
Significant control deficiencies	
Other control deficiencies	5
Prior year control deficiencies remediated	1

Audit Misstatements	Page [23]

There were no uncorrected audit misstatements
Corrected audit misstatements are detailed on page 23.

Misstatements in respect of Disclosures	Page [23]

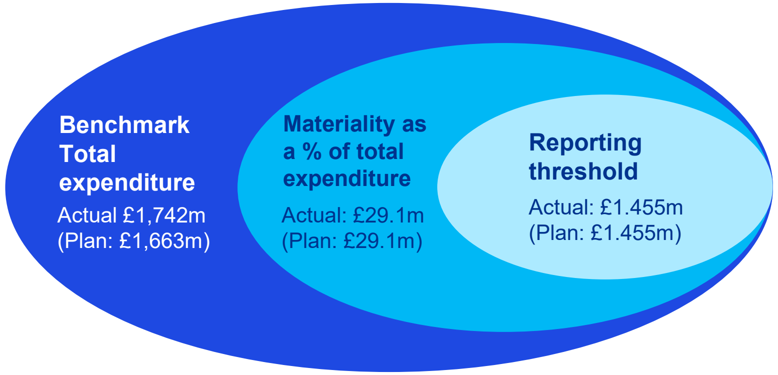
Corrected disclosure misstatements detailed on page 23

Key changes to our audit plan

We have not made any changes to our audit plan as communicated to you on 26 March 2024, other than as follows:

Materiality

Materiality has remained unchanged



Components

There has been no change to the scoping of components with only Scottish Water Business Stream Limited being included as a significant component for group reporting purposes.

Significant risks

There have been no changes to the significant risks as communicated on 26 March 2024.

Account process	Effect on audit plan	Effect on audit strategy and plan
Unfunded pension obligation	During testing of the defined benefit obligation, an unfunded obligation was identified relating to benefits provided to some employees taking voluntary redundancy in prior years, over and above those provided by the three pension funds. There are no investment funds built up to meet the unfunded liabilities.	• An additional procedure was performed to confirm the accounting for the unfunded obligation and a consultation with KPMG's technical department was performed to obtain guidance as to the disclosure requirements for the unfunded obligation (see page 20).
Capital additions	During testing of capital additions as well as the performance of deprecation testing, it was identified that there is a category of costs capitalised to "investigation/feasibility projects". Once these projects are completed, the costs are depreciated over a one year useful life.	• An additional procedure was performed to test the values of these "investigation/feasibility projects" at year end (see page 8)

Significant risks and Other audit risks

We discussed the significant risks which had the greatest impact on our audit with you when we were planning our audit.

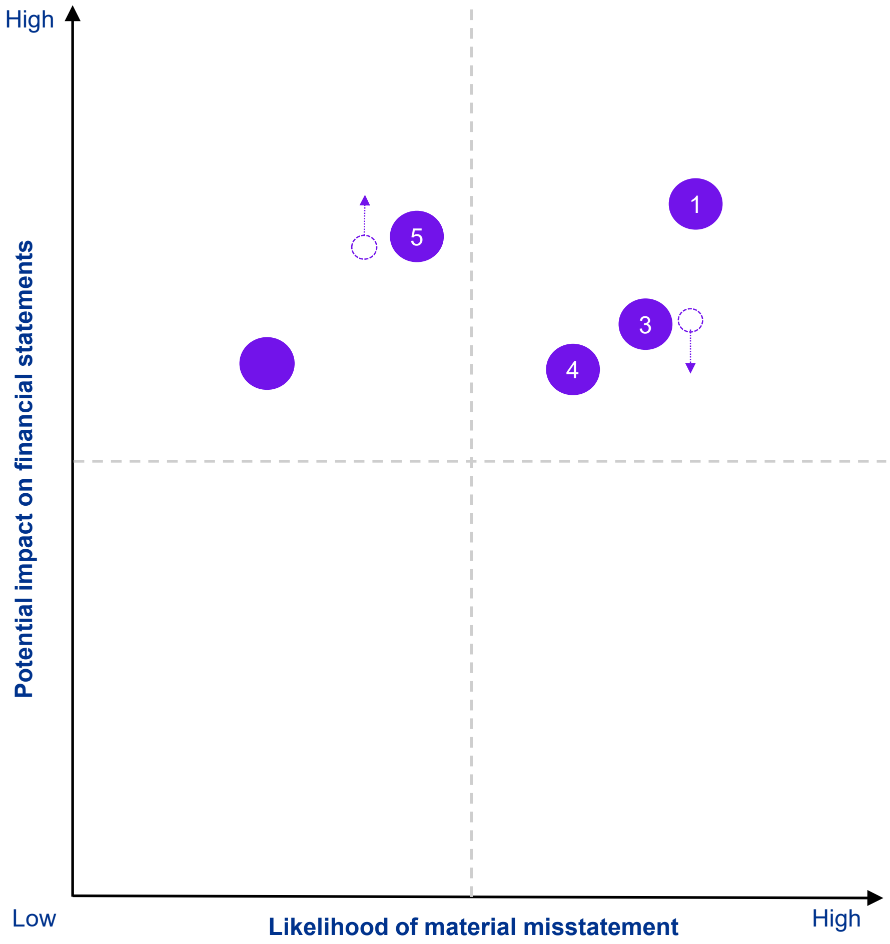
Our risk assessment draws upon our historic knowledge of the business, the industry and the wider economic environment in which Scottish Water operates.

We also use our regular meetings with senior management to update our understanding and take input from local audit teams and internal audit reports.

Significant risks	
1.	Capital additions (SW)
2.	Management override of controls (SW & SWBS)
3.	Revenue Recognition (SWBS)
4.	Bad debt provision (SW & SWBS)
5.	Defined benefit pension (SW)

Key:

- # Significant financial statement audit risks
- # Key audit matter and significant financial statement audit risk
- # Significant financial statement audit risks
- Increasing or decreasing risk compared with planning
- # Other audit risk
- # New [key audit matter]/[significant audit risk]/[other audit risk]



See the following slides for the cross-referenced risks identified on this slide.

Audit risks and our audit approach

1 Capital Additions [SW only] - Existence and accuracy of amounts capitalised to property, plant and equipment (PPE)

The above risk includes a fraud risk

Cautious | Neutral | Optimistic

Significant audit risk

The risk that additions to property, plant and equipment are recorded inappropriately when: the expenditure is not eligible for capitalisation, the Items are not accurately recorded, the entity does not have the rights to the assets or the assets do not exist.

- Capital additions are significant, comprising the largest element of Scottish Water's annual expenditure, related to the delivery plan for regulated activities.
- Members are incentivised across a number of financial and other measures including the level of "tier 1" costs* and completion of capital investment programmes.
- There is judgement involved in the allocation of expenditure between capital additions and expenditure, of which tier 1 costs are a key measurement for incentive remuneration.

Business risks related to audit risks include:

- Inappropriate amounts capitalised and deviation from delivery plan

Our response

- Tested the design and operating effectiveness of controls over the allocation of costs between capital and revenue within the financial ledger at the project initiation stage and on an ongoing basis;
- Tested the design and operating effectiveness of controls over the consistency between total capital expenditure reported in the financial statements and that reported to the Executive Leadership Team (ELT) as part of ongoing capital project monitoring;
- Tested the design and operating effectiveness of controls over:
  - the approval stages of capital expenditure on projects;
  - the allocation of costs between capital and revenue;
  - the appropriateness of reclassification from assets in the course of construction/progress;
- Reconciled the reports of Scottish Water's capital project monitoring group to the capital additions recorded in the financial statements;
- Used sampling methods to evaluate the appropriateness of the classification of expenditure as capital by considering the nature of the expenditure to ensure it is enhancing with reference to supplier invoice, certificate or timesheets and considered the application of the relevant policies and accounting standards;
- Audit of manual journals relating to capital additions which meet our high risk criteria (i.e. capital additions journals with unexpected account pairings); and
- Use of KPMG's D&A capabilities to analyse the general ledger transactions and tested any outliers by agreeing transactions back to valid source documents, such as invoices, certificates, contracts, timesheets.

Key:
Prior year | Current year

Audit risks and out audit approach (cont.)

1 Capital Additions [SW only] – Existence and accuracy of amounts capitalised to property, plant and equipment (PPE)

The above risk includes a fraud risk

Cautious | Neutral | Optimistic

Significant audit risk

The risk that additions to property, plant and equipment are recorded inappropriately when: the expenditure is not eligible for capitalisation, the Items are not accurately recorded, the entity does not have the rights to the assets or the assets do not exist.

- Capital additions are significant, comprising the largest element of Scottish Water's annual expenditure, related to the delivery plan for regulated activities.
- Members are incentivised across a number of financial and other measures including the level of "tier 1" costs* and completion of capital investment programmes.
- There is judgement involved in the allocation of expenditure between capital additions and expenditure, of which tier 1 costs are a key measurement for incentive remuneration.

Business risks related to audit risks include:

- Inappropriate amounts capitalised and deviation from delivery plan

Our findings

- The design and operating effectiveness of controls over the allocation of costs between capital and revenue within the financial ledger at the project initiation stage and on an ongoing basis were found to be effective.
- The design and operating effectiveness of controls over the consistency of reporting of capital expenditure in the financial statements and that reported to those charged with governance as part of ongoing capital project monitoring were found to be effective.
- The design and operating effectiveness of controls over: (1) the approval stages of capital expenditure on projects, (2) the allocation of costs between capital and revenue, and (3) the appropriateness of reclassification of assets from the category "assets under construction" to the relevant asset category were found to be effective.
- During the testing of capital additions to source documents (invoices, contracts, timesheets etc.), it was identified that there are a category of assets which are considered "investigations" (feasibility/exploratory) projects. These costs are capitalised and once the project is completed, the costs are transferred to the PMV (plant, machinery, vehicles) category with a one year useful life. We challenged management as to the basis for capitalising such costs as well as the appropriateness of the one year useful life period. As a result of identifying this matter, we audited a further sample of PMV assets with 1 year useful life and it was identified that there were capitalised costs with a net book value of up to £16m which could not be linked to specific assets but could be attributed to the entire capital asset programme and thus met the requirements of IAS 16.11.
- As a result of the above matter, the audit team analysed "investigation" projects within capital WIP at year end which amounted to £52.9m. A sample of these capitalised costs were audited and all projects could be linked to specific assets and met the capitalisation requirements of IAS16.

Key:
Prior year | Current year

Audit risks and out audit approach (cont.)

1 Capital Additions [SW only] – Existence and accuracy of amounts capitalised to property, plant and equipment (PPE)

The above risk includes a fraud risk

Cautious Neutral Optimistic

Significant audit risk

The risk that additions to property, plant and equipment are recorded inappropriately when: the expenditure is not eligible for capitalisation, the Items are not accurately recorded, the entity does not have the rights to the assets or the assets do not exist.

- Capital additions are significant, comprising the largest element of Scottish Water's annual expenditure, related to the delivery plan for regulated activities.
- Members are incentivised across a number of financial and other measures including the level of "tier 1" costs* and completion of capital investment programmes.
- There is judgement involved in the allocation of expenditure between capital additions and expenditure, of which tier 1 costs are a key measurement for incentive remuneration.

Business risks related to audit risks include:

- Inappropriate amounts capitalised and deviation from delivery plan

Our findings

- During additions testing, a large credit to additions was selected for testing which related to infrastructure charges of £5m. We challenged management as to the accounting basis for reducing the carrying value of capital assets by these charges. Infrastructure charges are a legislative charge paid by developers to increase capacity of the existing network. Management have applied their judgement in applying IAS20 as the basis for reducing the carrying value of assets by the infrastructure charges. In KPMG's view, even though these transactions do not meet the definition of a government grant, government grant accounting should be applied as there is no other applicable standard for assets or resources received from third parties that do not meet the requirements of IFRS 15. Total value of infrastructure charges released to reduce PPE for FY24 was £18.4m and we agree with the accounting treatment. We challenged management to increase disclosure within the accounts relating to these infrastructure charges and the impact on PPE. Additional disclosures have been included in the accounts.
- The sample of indirect overheads were agreed to valid supporting documentation and the appropriateness of the classification of expenditure as capital or expenditure was found to be appropriate.
- The audit of high risk manual journals to capital additions identified no issues.
- Depreciation testing was performed on items of property, plant and equipment and it was identified (as in the prior year), that there is an element of "catch-up" depreciation due to the timing of the finalisation of the capital asset finance form which triggers depreciation. The impact is that certain assets may have higher depreciation in a year whereas a portion of this depreciation should have been recognised in prior periods. The impact of this "catch-up" depreciation in the current year was £5.5 million. This amount was not considered material against total depreciation of £342m.

It was also identified that the entity has fully depreciated assets totalling £920m at year end. The entity considers fully depreciated assets over a five-year period to consider whether they are still in use or should be disposed. The total of fully depreciated assets held up to 5 years totalled £917m with £3.1m fully depreciated assets being held for longer than 5 years. Whilst this could indicate some prudency in the estimation of asset lives, given the length of total asset lives, the impact of this is negligible given the net book value is nil on these assets.

Key:
Prior year Current year

Audit risks (cont.)

2 Management override of controls (SW and SWBS)[a]

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

Significant audit risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- As in prior years, there is no enforced segregation of duties of journal entries at the point of posting into the general ledger.

Note: (a) Significant risk that professional standards require us to assess in all cases.

Our response

- Our audit methodology incorporates the risk of management override as a default significant risk.
- Assessed accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.
- Evaluated the selection and application of accounting policies.
- In line with our methodology, evaluated the design and implementation of controls over journal entries and post closing adjustments.
- Assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.
- Assessed the business rationale and the appropriateness of the accounting for significant transactions that are outside the component's normal course of business, or are otherwise unusual.
- Made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.
- Screened all journal entries for high-risk attributes using KPMG Clara General Ledger Analysis.
- Discussed and understood the Executive Leadership Team (ELT) incentive scheme noting that members of the ELT can achieve a bonus of up to 40% of their remuneration, based on the achievement of corporate and individual objectives. We understood the objectives and assessed whether these would provide any incentive for management to override controls to achieve them. We designed audit procedures to address any areas of concern.

Audit risks (cont.)

2 Management override of controls (SW and SWBS)[a]

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

Significant audit risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- As in prior years, there is no enforced segregation of duties of journal entries at the point of posting into the general ledger.

Our findings

- We identified that there were no enforced segregation of duties of journal entries into the accounting system at the point of posting. Control deficiencies identified are communicated on page 28.
- We identified 39 journal entries and other adjustments meeting our high-risk criteria for Scottish Water and 26 high-risk criteria journals for SWBS. Our examination did not identify unauthorised, unsupported or inappropriate entries.
- As a result of the journals testing performed we obtained sufficient and appropriate audit evidence over the risk of management override of controls relating to journal entries and other adjustments.
- Management are incentivised over a number of key performance measures which are financial and non-financial. The main financial incentive measure is that actual tier 1 costs are lower than plan. Thus there is a possible incentive for management to understate tier 1 costs. (Tier 1 costs are: Operating costs, PFI and interest, excluding responsive repair and refurbishment, developer contributions and tax). As noted in the first significant risk, Capital additions, extensive audit work has been performed over capitalised costs and management judgements applied to this process have been challenged as detailed in this section.
- Our procedures did not identify any significant unusual transactions.

Note: (a) Significant risk that professional standards require us to assess in all cases.

Audit risks (cont.)

3 Revenue recognition (SWBS only)

Fraud risk related to misstatement of revenues

Significant audit risk

The risk that revenue is recognised for arrangements that do not exist or do not meet the definition of a contract under the standard.

- Professional standards require us to presume (unless rebutted) that the fraud risk from revenue recognition is a significant risk.
- Performance-based remuneration gives management an incentive to achieve certain financial results which increases the risk of fraudulent premature revenue recognition.
- Accrued revenue includes subjective measurements as it is estimated based on historical data from past bills to create an expectation of the unbilled amount between the last bill and the year end. Thus requiring management to exercise significant judgment with respect to this estimation.

Business risks related to audit risks include:

- Risk of incorrect revenue recognition resulting in erroneous financial reporting.

Our response

- Considered the design and implementation of key controls in the revenue recognition processes and management's calculation of accrued and deferred revenues;
- Performed cash receipts to revenue predictive analysis on revenue recognised in the year; a reconciliation of all cash, debtors and accrued revenue for the year, to confirm existence of revenue.
- Performed year end cut off testing to assess whether sales transactions are recognised in the correct period;
- Considered the deferral of revenue recognised in respect of advanced billing to ensure this is complete and accurately calculated;
- Challenged the data used in calculating the accrued revenue in relation to the unbilled portion of revenue at the year end and reperformance of the calculations used by management to assess the existence and accuracy of the revenue recognised

We rebutted the revenue recognition risk in respect of Scottish Water

We rebutted the revenue fraud risk in Scottish Water as there is limited opportunity for management to manipulate revenue recognised and revenue transactions are non complex with low level of judgement and estimation.

- For Scottish Water, we obtained confirmation of household and wholesale revenue from individual local authorities and licenced providers respectively.

KPMG

Audit risks (cont.)

3 Revenue recognition (SWBS only)

Fraud risk related to misstatement of revenues

Significant audit risk

- **Revenue is recognised for arrangements that; do not exist or do not meet the definition of a contract under the standard.**
- Professional standards require us to presume (unless rebutted) that the fraud risk from revenue recognition is a significant risk.
- Performance-based remuneration gives management an incentive to achieve certain financial results which increases the risk of fraudulent revenue recognition.
- Accrued revenue includes subjective measurements as it is estimated based on historical data from past bills to create an expectation of the unbilled amount between the last bill and the year end. Thus requiring management to exercise significant judgement with respect to this estimation.

Note: (a) Presumed risk that professional standards require us to assess in all cases and which can be rebutted if there is no entity-specific significant risk relating to revenue recognition.

Our findings

SWBS revenue testing:

- We audited management's reconciliation of cash receipts received in the period to revenue recorded with the difference in the reconciliation being within our acceptable range.
- We performed sales cut off testing by selecting a sample of bills raised in the month preceding and month proceeding the year end date and assessing whether revenue was recognised in the appropriate period. We found that the revenue had been recorded in the appropriate period for the sampled items.
- We sampled Accrued revenue amounts and performed a recalculation of the accrual amount and agreed key data elements within the calculation to invoices and market data. We found that the accrued revenue amounts recorded were accurate.

Scottish Water revenue testing:

- We rebut the revenue fraud risk for Scottish Water and obtained confirmations from Councils and Licenced Providers for household and wholesale revenue. No significant matters were identified.

Audit risks (cont.)

4 Impairment of trade receivables - valuation(SW and SWBS)

Significant risk due the judgemental nature of the bad debt provision calculation (there is a fraud risk linked to SWBS provision for doubtful debts)

Cautious | Neutral | Optimistic

Significant audit risk

The risk that receivables are overstated

Provision for doubtful debts at 31/03/2024:

Scottish Water: £477m

Scottish Water Business Stream: £43m

- There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data.

Scottish Water

Household bad debt provision.

- Household water debt is a statutory debt recoverable from the occupier. The household billing and cash collection is performed by local authorities and cannot be influenced by Scottish Water.

Scottish Water Business Stream

- The bad debt provision for SWBS is highly judgemental in nature and there are a number of assumptions included in the calculation. The most sensitive of these assumptions is the overall forecast collection rate based on historical data.
- There is therefore an inherent risk of error such that inappropriate assumptions are made to inform the valuation of the provision.
- The data relied upon is voluminous and management have made changes to the calculation of the loss rate in the year. Management have changed to a flow rate calculation which places heavier reliance on the accuracy of the P1 to P11 ledgers in addition to the P12 ledger.

Our response

Scottish Water household bad debt provision (risk of error):

- Tested the design and implementation of controls over the review and approval of the provision and associated assumptions, by those charged with governance during the year and at the year end.
- Sample tested the reconciliation of information provided on a monthly basis by local authorities for household bad debt provision in respect of amounts billed and collected. This historical information forms the basis of the forecast collection rate.
- We agreed the total amount billed and collected in respect of 2023-24, as recorded in Scottish Water's records, to confirmations received from individual local authorities.

Scottish Water Business Stream bad debt provision (risk of fraud and error):

- Compared the information on historical collection rates as the basis for the current flow rate used within the provision calculation.
- Assessed the appropriateness of method used for the impairment calculation.
- Tested the relevance and reliability of underlying data used for the computation of the flow rate for periods P1 to P12 across a variety of ageing brackets.

Planned response for both SW and SWBS:

- We performed walkthroughs of management's process for collating data, identifying relevant assumptions and calculating the bad debt provision.
- We performed sensitivity analysis and challenged management in respect of the forecast collection rate by increasing and decreasing it based on our judgement and assessing the impact on the provision.
- We assessed the disclosure of sensitivities and description of the provision in the financial statements.

Key:

Prior year | Current year

Audit risks (cont.)

4 Impairment of trade receivables – valuation (SW and SWBS)

Significant risk due the judgemental nature of the bad debt provision calculation (there is a fraud risk linked to SWBS provision for doubtful debts)

Cautious Neutral Optimistic

Significant audit risk

The risk that receivables are overstated

Provision for doubtful debts at 31/03/2024:

Scottish Water: £477m

- There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data.

Household bad debt provision.

- Household water debt is a statutory debt recoverable from the occupier. The household billing and cash collection is performed by local authorities and cannot be influenced by Scottish Water.

Our findings

Scottish Water

- We have tested the design and implementation of the monthly impairment provision for trade receivables. The design and implementation of the control is effective.
- Management use the forecast collection rate to calculate the impairment for household bad debt. We assessed this as being appropriate.
- The data used for the impairment computation is historical household billing and collection data. Total amounts billed and collected in respect of households for the 2023/24 year were agreed to confirmations received from individual Councils. The data is assessed as reliable and relevant.
- As at 31 March 2024, the average forecast collection rate applied to billings was 96.88% resulting in an in-year charge of £21m and a resulting household bad debt provision of £477m against total debt outstanding of £529m. This is an increase of 0.07% in average forecast collection rate from the prior year. The relevant accounting standard, IFRS 9 and associated guidance expects a weighted average model, considering different collection scenarios, to be used in order to calculate the expected credit loss. Management's model uses historical collection rates and trends which are considered to be the best method to predict future collection as household debt collection is controlled and managed by the Councils.
- We challenged management over the selection of 0.07% increase in average forecast collection rate in the context of the cost-of-living crisis. On consideration of management's responses and rationale, we note the average five year collection rate has increased higher than pre-COVID levels to 96.44% at 31 March 2024.
- We compared the actual collection rates of the Councils over the past 24 years to that of Scottish Water and noted that they follow a similar trend and have been increasing over time, with the exception of the years impacted by COVID.

Key:

Prior year Current year

Audit risks (cont.)

4 Impairment of trade receivables – valuation (SW and SWBS)

Significant risk due the judgemental nature of the bad debt provision calculation (there is a fraud risk linked to SWBS provision for doubtful debts)

Cautious Neutral Optimistic

Significant audit risk

The risk that receivables are overstated

Provision for doubtful debts at 31/03/2024:

Scottish Water: £477m

- There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data.

Household bad debt provision.

- Household water debt is a statutory debt recoverable from the occupier. The household billing and cash collection is performed by local authorities and cannot be influenced by Scottish Water.

Our findings

Scottish Water

- We compared the actual collection rate against the forecast collection rate and noted that historically the actual collection rate over time was higher than the forecast collection rate up to 2020/2021.The actual collection rate from 2020/2021 dipped due to the impact of COVID and the delay by Councils in collecting outstanding debt. In addition, collections from subsequent years are to be considered to accurately compare the actual average collection rate to the forecast average collection rate as household debt is collected over several years.
- We have performed a reverse stress-test over the forecast collection rate and note that for it to be materially misstated the rate would have to experience a year-on-year change in average collection rate above 0.11%. The risk of such a change in the forecast collection rate is considered unlikely due to the fact that even though collections have increased over time, the increase has flattened as higher collection rates have been achieved. There is also no indication, based on historical collection data analysis, that collection rates should decline due to the current cost of living crisis. The UK economy is recovering post COVID with inflation decreasing over the past two quarters and interest rates expected to decrease over the coming year.
- We are satisfied with the approach adopted by management in arriving at the bad debts provision for the current year. Based on historical actual collection trends which have been higher than the forecast collection rates in those years, as well as the increasing “last five year average collection rate”, the provision is deemed to be relatively neutral, but to the more cautious side of neutral but within an acceptable range.

Key:

Prior year Current year

Audit risks (cont.)

4 Impairment of trade receivables – valuation (SW and SWBS)

Significant risk due the judgemental nature of the bad debt provision calculation (there is a fraud risk linked to SWBS provision for doubtful debts)

Cautious Neutral Optimistic

Significant audit risk

The risk that receivables are overstated

Provision for doubtful debts at 31/03/2024:

Scottish Water Business Stream: £43m

- There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data.

Scottish Water Business Stream

- The bad debt provision for SWBS is highly judgemental in nature and there are a number of assumptions included in the calculation. The most sensitive of these assumptions is the overall forecast collection rate based on historical data.
- There is therefore an inherent risk of error such that inappropriate assumptions are made to inform the valuation of the provision.
- The data relied upon is voluminous and management have made changes to the calculation of the loss rate in the year. Management have changed to a flow rate calculation which places heavier reliance on the accuracy of the P1 to P11 ledgers in addition to the P12 ledger.

Our findings

Scottish Water Business Stream

- We have tested the design and implementation of monthly impairment provision for trade receivables. Due to the change in provision model this was not performed for the entirety of the year.
- Management use the provision matrix to calculate the impairment calculation. We assessed this as being appropriate.
- The data used for the impairment computation is assessed as reliable and relevant. KPMG tested a total sample of 60 Debt balances across the 12 Debtors ledgers at each month end and validated the amount and ageing of the debt to the relevant invoice to the customer.
- Our audit testing concluded that management were optimistic in their judgement over the flow rate and loss rates used within the calculation, however overall the judgement was appropriate and we did not identify any material differences to the balance included in the financial statements.

Key:

Prior year Current year

Audit risks (cont.)

5 Defined Benefit Pension

The risk that the valuation of the defined benefit obligation/surplus is misstated

Cautious | Neutral | Optimistic

Significant audit risk

An inappropriate amount is estimated and recorded for the defined benefit obligation

- Small changes in the main assumptions and estimates (i.e. discount rate, inflation rate and mortality rate) used to value the pension obligation would have a significant effect on the net pension liability.
- Employees of Scottish Water participate in the Scottish Local Government Pension Scheme through three funds; North East Scotland pension fund; the Lothian pension fund; and the Strathclyde pension fund.
- There is a triennial valuation impacting the 2023/24 year end. Updated membership data will be taken into account , together with updated "experience" adjustments.
- Recognition of any surplus as an asset requires consideration and application of IFRIC14 requirements.
- Employees of Scottish Water Business Stream participate only in the Strathclyde Pension Fund.

Business risks related to audit risks include:

- Market volatility and wider economic uncertainty increases the risk of pensions being misstated.

Our response

- Evaluated the design and implementation of controls in place for the entity to determine the appropriateness of the assumptions used by the actuaries in valuing the liability.
- Reviewed management's expert used in the valuation of the defined benefit pension obligation.
- Challenged, with the support of our own actuarial specialists, the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy against externally derived data.
- Assessed the impact of the triennial valuation and performed risk assessment procedures over changes to underlying membership data to assess extent of further testing, if any, to be performed.
- Challenged the rate of increase in the pensionable salaries assumption, by comparing it to other evidence such as the regulatory delivery plan and our understanding of Scottish Government expectations.
- Considered the adequacy of the disclosures in respect of the sensitivity of the assumptions.
- Understood the processes the entity have in place to review the recognition of the pension asset
- Obtained an accounting paper from the management setting out how they obtained a financial benefit from the asset and therefore the justification of surplus recognition
- Challenged managements judgements around pension surplus recognition in line with IAS 19.
- Our approach to the audit of pension schemes continues to include enhanced quality procedures, we performed inquiries of the accounting actuaries to assess the methodology and key assumptions made, including actual figures where estimates have been used by the actuaries, such as the rate of return on pension fund assets;

Key:

Prior year | Current year

Audit risks (cont.)

5 Defined Benefit Pension

The risk that the valuation of the defined benefit obligation/surplus is misstated

Cautious Neutral Optimistic

Significant audit risk

An inappropriate amount is estimated and recorded for the defined benefit obligation

- Small changes in the main assumptions and estimates (i.e. discount rate, inflation rate and mortality rate) used to value the pension obligation would have a significant effect on the net pension liability.
- Employees of Scottish Water participate in the Scottish Local Government Pension Scheme through three funds; North East Scotland pension fund; the Lothian pension fund; and the Strathclyde pension fund.
- There is a triennial valuation impacting the 2023/24 year end. Updated membership data will be taken into account ,together with updated “experience” adjustments.
- Recognition of any surplus as an asset requires consideration and application of IFRIC14 requirements.

Business risks related to audit risks include:

- Market volatility and wider economic uncertainty increases the risk of pensions being misstated.

Our findings

Subjective valuation

- The overall assumptions applied by management for Scottish Water are considered to be balanced relative to our central rates and within our acceptable range (refer to page 22)

Pension assets

- We have reviewed the gross pension assets for consistency and confirmed the share of scheme assets for the last three years to the current year. We compared the employer's assets to the total value of the pension fund to check consistency with the expected percentage share. We have independently verified the rate of return from the LGPS fund and compared that with the one used in the IAS 19 report. Based on the procedures performed, the results were within our acceptable range.

Triennial valuation

- The latest triennial valuation of Scottish LGPS funds has been completed during the year. This has resulted in updates to the demographic assumptions used by the actuaries, updates to the membership data, coming through as experience items in the year and new contribution commitments for each participation. We have tested the impact of the new data on the DBO, which is within our expected tolerance levels. We have also assessed the impact of the new contribution commitments on asset ceiling calculations under IFRIC 14.

Key:

Prior year Current year

Audit risks (cont.)

5 Defined Benefit Pension

The risk that the valuation of the defined benefit obligation/surplus is misstated

Cautious | Neutral | Optimistic

Significant audit risk

An inappropriate amount is estimated and recorded for the defined benefit obligation

- Small changes in the main assumptions and estimates (i.e. discount rate, inflation rate and mortality rate) used to value the pension obligation would have a significant effect on the net pension liability.
- Employees of Scottish Water participate in the Scottish Local Government Pension Scheme through three funds; North East Scotland pension fund; the Lothian pension fund; and the Strathclyde pension fund.
- There is a triennial valuation impacting the 2023/24 year end. Updated membership data will be taken into account , together with updated “experience” adjustments.
- Recognition of any surplus as an asset requires consideration and application of IFRIC14 requirements.

Business risks related to audit risks include:

- Market volatility and wider economic uncertainty increases the risk of pensions being misstated.

Our findings

Unfunded obligation

- During testing of the defined benefit obligation, it was identified that the unfunded pension liability which has always been recognised by Scottish Water when it was in a deficit position, should not have been netted against the funded asset for 2022/23. 2022/23 was the first year Scottish Water had a net pension surplus. As such in 2022/23, an unfunded liability of £81.2m should have been reflected in the non current liability section of the Balance Sheet. The 2022/23 financial statements have not been restated as the balance sheet impact of recognising the unfunded obligation is negligible as a proportion of net assets, the impact on other comprehensive income is not relevant as the actuarial gain/(loss) does not follow any trends, is subject to market fluctuations and is not a key metric. There is also no cashflow impact or impact on profit/loss. The impact is not qualitatively material and the detail provided in the pensions note of the accounts is considered sufficiently informative for users of these financial statements to remove the need for restatement of the FY23 accounts

Surplus recognition

- We have assessed the methodology, data and assumptions used in the valuation of the defined benefit obligation and the resulting surplus.
- During audit testing of the surplus, it was identified that the asset ceiling was calculated by management’s actuarial specialist, Hymans, on a simplified basis that allowed for the current rate of negative secondary contribution rate (spreading surplus) to continue in perpetuity. We would expect this to only last for the term of the “funding time horizon” used in the funding valuation. This was much shorter than the perpetuity period used last year, and would reduce the amount of recognisable surplus to nil. This impacted the Strathclyde scheme, as the other schemes were already recognising a nil surplus. As a result, management corrected the surplus of £126.4 initially recognised for the Strathclyde scheme to £nil.

Key:

Prior year Current year

Key accounting estimates and management judgements– Overview

Our view of management judgement

Our views on management judgments with respect to accounting estimates are based solely on the work performed in the context of our audit of the financial statements as a whole.

Key: Prior year Current year

Cautious Neutral Optimistic

Asset/liability class	Our view of management judgement	Balance (£m)	YoY change (£m)	Our view of disclosure of judgements & estimates	Further comments
Impairment of trade receivables (SW)	Cautious Neutral Optimistic	477.4	11.2	Needs improvement Neutral Best practice	The last five year average collection rate reflects an increase for 2023/24 to 96.44% which is higher the five year average collection rate pre COVID. Historical actual collection rates have been higher than the forecast collection rate and with inflation and interest rates expected to decrease over the coming years, the provision for doubtful debts is considered to be relatively neutral, but to the more cautious side of neutral but within an acceptable range
Impairment of trade receivables (SWBS)		42.9	(7.2)		The change in the model of the Bad Debt Provision to the flow rate calculation has led to a reduction in the provision without a significant change in the ageing profile of the debt. Therefore the provision is deemed as optimistic but still within an acceptable range and is not materially misstated.
Defined Benefit - Pension Asset		2,358.2	217.2		Defined benefit pension assets were found to be fairly stated.
Defined Benefit - Pension Liability		(1,495.4)	(217.2)		Actuarial assumptions applied were found to be balanced and within acceptable ranges (refer to page 22)
Depreciation charge		344.3	34.4		Management are cautious in the application of depreciation. This is evidenced by a high level of fully depreciated assets and investigative project costs written off over one year.

Defined benefit assumptions

Level of prudence compared to KPMG central assumptions

Audit misstatement | *Cautious* | *Balanced* | *Optimistic* | *Audit misstatement*

Reasonable range

Overall assessment of assumptions for audit consideration							Balanced	
Underlying assessment of individual assumptions		**Methodology**	**Consistent methodology to prior year?**	**Compliant methodology with accounting standard?**	**Employer**	**KPMG central**	**Assessment**	**Significant assumptions**
Discount rate		AA yield curve	✓	✓	4.80%	4.81%		✓
CPI inflation		Deduction to inflation curve	✓	✓	2.80%	2.85%		✓
Pension increases		In line with CPI	✓	✓	2.80%	2.88%		✓
Salary increases		Employer best estimate	See next page	✓	FY 24/25: 4.60% FY 25/26: 4.80% FY26/27: 4.80% 2.80% thereafter	In line with long-term remuneration policy		
Mortality	Base tables	In line with most recent Fund valuation	See page 14	✓	LPF / SPF: Fund-specific Club Vita curves NESPF: S3PA mortality tables with category-specific weightings	In line with Fund best-estimate		✓
	Future improvements	In line with most recent Fund valuation	See page 14	✓	CMI 2022 projections model, 1.50% (LPF / SPF) and 1.75% (NESPF) long-term trend rate, initial additional parameter of 0.25% and default other parameters	CMI 2022,1.25% long-term trend rate and default other parameters		✓
Other demographics		In line with most recent Fund valuation	See page 14	✓	In line with the approach taken by each Fund at the latest triennial Valuation	In line with Fund experience		

Audit Misstatements

We have identified no uncorrected audit misstatements.

The corrected misstatements are noted in the table on the right.

Corrected Audit Misstatements (£m):

1.	Account Name	Dr	Cr
	Other comprehensive income (net of deferred tax)	57.3	
	Deferred tax liability	19.1	
	Retirement benefit obligation		76.4
Recognition of unfunded pension obligation at 31 March 2024			

2.	Account Name	Dr	Cr
	Other comprehensive income	126.4	
	Defined benefit pension assets		126.4
Reduction of surplus recognised on Strathclyde scheme to £nil.			

Corrected disclosure misstatements (Scottish Water):

1. The pensions accounting policy and note was updated to provide detail with respect to the unfunded pension liability
2. The PPE accounting policy was updated to include detail about “investigation type” assets with a short useful life
3. The accounting estimates and judgements note was expanded to detail judgement applied to investigation type assets
4. The PPE note was updated to include detail of infrastructure charges income recognised during the financial year

Types of misstatement

Factual: Misstatements about which there is no doubt

Projected: Our best estimate of misstatements in the audited populations

Judgemental: Differences arising from judgments of management that we consider unreasonable or inappropriate

Other significant matters related to our audit approach

The Code of Audit Practice sets out four areas that constitute the wider scope of public audit in Scotland. These are summarised below:

1. Financial Management

Entities are required to have sound budgetary processes and should have a clear understood financial environment where internal controls are operating effectively.

Auditors response:

To consider whether the body has effective arrangements to secure sound financial management including the strength of the financial management culture, accountability and arrangements to prevent and detect fraud, error and other irregularities, bribery and corruption.

Auditors findings:

Assessing the budget setting and monitoring processes: The budget setting and monitoring process demonstrates strong financial management in the short, medium and longer term. The process for preparation is clearly set out in budget guidance. Revenue and capital monitoring reports receive appropriate review by committees. The approved budget is set out together with a reconciliation to the final determination, summarising planned outperformance and non-regulated activities.

Consideration of the finance function and financial capacity within Scottish Water: The accountable officer is the CEO and Alex Plant was appointed from 1 June 2023. Key members of the finance function are suitably experienced and qualified. The finance function's capacity is considered to be appropriate and activity is appropriately delegated to operational areas. A new CFO has been appointed from 3 June 2024.

Arrangements for maintaining standards of conduct and the prevention and detection of fraud and corruption

Scottish Water has a number of policies in place which are reviewed regularly, these are: Anti-Slavery, Code of Ethical Conduct, Whistleblowing and Fraud Management which are also supported by routine mandatory compliance training.

Management and members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise, to their work at Scottish Water.

The Audit and Risk committee receives reports in respect of whistleblowing and fraud, as well as relevant internal audit reports.

National fraud initiative ('NFI')

The National Fraud Initiative ('NFI') is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches.

Prevention and detection of fraud

No material fraud or other irregularities were identified during the year.

Conclusion:

Scottish Water has a good internal control environment and appropriate capacity. It is engaged with the NFI process and has a good structure of controls in place to prevent and detect fraud.

Other significant matters related to our audit approach

Wider scope of public audit in Scotland (continued)

2. Financial Sustainability

Entities are required to be able to meet the needs of the present without compromising the ability of future needs not being met.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Scottish Water is regarded as a public sector organization of trading nature. It borrows from the Government to deliver essential services mainly to the Scottish community. Considering financial sustainability of Scottish Water we performed the following work:

Auditors response:

The audit team performed audit procedures over financial forecasts and models, considering levels of capital investment planned.

Auditors findings:

The main business and strategic planning processes cover the regulatory period to March 2027, based on key assumptions in respect of the funding of the business. In December 2020, the WICS published their Final Determination for the 2021-27 period. Management consider forecasts and the performance of the group, as well as liquidity levels over the regulatory period. Particular focus and time is spent assessing the affordability and phasing of the 6 year rolling investment programme.

Our audit testing identified the high level of repairs which are disclosed in the annual report. The increased consumer demand, climate change challenges and an ageing asset basis contribute to increased repairs required on the network. Continued capital investment is essential to meet these challenges.

Conclusion:

Significant work has been completed by management and those charged with governance in respect of medium and longer term financial planning via financial modelling. These plans consider funding from revenue and government loans and the significant capital investment program. Members' clearly communicate the challenges foreseen with key stakeholders of the entity.

Other significant matters related to our audit approach

Wider scope of public audit in Scotland (continued)

3. Vision, Leadership and Governance

Entities are required to have a clear vision and strategy, and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Auditors response:

To consider the clarity of plans to implement the vision, strategy and priorities adopted by the leaders of Scottish Water. The audit team also considered the effectiveness of governance arrangements for delivery, which includes openness and transparency of decision-making; robustness of scrutiny and shared working arrangements; and reporting of decisions and outcomes, and financial and performance information.

Auditors findings:

The audit team performed inquiries of those charged with governance, inspected board and committee meeting minutes, inspected evidence of communication of the entity’s vision and strategy to staff and to the public via reports and website communication.

The entity identifies key risks at corporate and functional levels. Risks are evaluated by considering their consequences, in terms of impact and likelihood, against risk appetite for the achievement of service delivery and business objectives. The risk register and risk management processes are reviewed annually by the Board, and twice a year by the Audit and Risk Committee and the Executive Leadership Team.

Pay and grading structure

During the 2023/24 financial year, the entity reached an agreement to modernize their pay and grading structure. This was agreed with Trade Unions after industrial action took place. The entity complies with public sector pay guidance and the new CEO contract and remuneration was approved by Scottish Government. The entity has a robust remuneration committee which considers the remuneration arrangements for Executive Members and other related remuneration matters.

Internal audit

Internal audit is conducted by an in-house team. Extensive reviews are undertaken and reported throughout the year on a range of financial and non-financial topics. The breadth and depth of reviews are good and follow up reviews and performed timeously.

Conclusion:

We consider the governance framework to be appropriate and that the governance statement is in accordance with guidance and reflects our understanding of the organisation. We are also content that the internal audit function is operating as appropriate.

Other significant matters related to our audit approach

Wider scope of public audit in Scotland (continued)

4. Use of Resources to Improve Outcomes

Entities need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency and effectiveness through the use of financial and other resources, and reporting performance against outcomes.

Auditors response:

To consider the clarity of the arrangements in place to ensure that resources are deployed to improve strategic outcomes, meet the needs of service users taking account of equalities, and deliver continuous improvements in priority services.

Auditors findings:

A key way in which resources are used to improve outcomes is through the effectiveness of procurement. Scottish Water incurs significant annual capital expenditure related to the investment program.

We considered fraud risk around procurement and tested a range of controls around the process in respect of new capital project assessment from the approvals process through to initiation, monitoring and payment, including performing test of details.

Key performance indicators include a variety of measures related to use of resources, through effective improvement in customer service and water quality.

The entity monitors key performance measures, such as water quality, customer satisfaction ratings, leakage and other reported incidents, to name a few. This monitoring is performed by third party professionals which are independent to the entity.

Monitoring of KPIs against targets supports improving performance.

Continued capital investment in accordance with the Delivery Plan is essential for the entity to continue to provide high quality water and waste water services. The executives communicate challenges to stakeholders on a regular basis and provide regular updates to stakeholders with respect to anticipated resource constraints.

Conclusion:

Through oversight by and reporting to various regulators we consider use of resource to improve outcomes to be embedded in Scottish Water’s operations.

Engagement with stakeholders also supports the efficient use of resources including water and wastewater services.

Other matters

Control deficiencies

We obtain an understanding of internal control to design appropriate audit procedures, but not to express an opinion on the effectiveness of the Group's internal control.

Key:

- (Red) These are significant control deficiencies which increase the likelihood and potential magnitude of a material misstatement in the financial statements. We have not identified any significant control deficiencies in the current year.
- (Amber) These are matters of sufficient importance to note such as weaknesses which were subsequently corrected and matters that could be significant in the future if left unaddressed. We have identified 4 of such deficiencies in the current year.
- (Green) These are less significant weaknesses but which we considered to be of sufficient importance to merit management's attention. We have raised 1 related observations in the current year.

No enforced segregation of duties of journal entries into the accounting system at point of posting (SW and SWBS) (raised in the prior year) *

- Through our review of the journals process we noted there is no enforced segregation of duties of journal entries at the point of posting into the general ledger. Management do have controls in place around the Financial Reporting process which mitigate the risk; this is a detective control rather than a preventative control.
- KPMG recommend that all journals require segregation of duties between the preparer and authoriser of each journal prior to that journal being posted to the ledger, and that a trail of audit evidence is maintained.

Management's response:

SW: There is an audit tral for all journals processed and current mitigating controls are considered sufficient to address the risk.

SWBS: Twinfield does not have the functionality to create an automated two step approval process for journals. This would require manual approval outside of the system which would be a far less effective form of control. Our current review processes for month end involve a detailed review of all accounts relative to budget, prior month and prior year by line managers, and Head of Finance. Detailed results are also reviewed by the CFO and CEO. This level of review provides an effective detect control.

* We will not raise this point again in future periods but consider this as part of our risk assessment audit procedures.

No separate category of "investigation/feasibility" projects for capitalised costs that are subsequently written off over a one year useful life period (SW)

- Capitalised costs for "investigative/assessment of options/feasibility" projects are included within the category of PMV (plant, machinery, vehicle) assets and are not separately identifiable within the financial statements. These assets have a useful life period of one year and this visibility is lost within the PMV category.
- KPMG recommend that the accounting policy is enhanced or a note added that details theses assets which are included within PMV, including detail of their short useful life. This will enhance transparency within the financial statements.

Management response::

Management will consider KPMG's recommendation during 2024/25.

Other significant matters (cont.)

Management Review Controls – Expected Credit Losses (SWBS)

- KPMG have assessed the Management Review Control ("MRCs") over Expected Credit Losses. We do not place reliance on these because of the absence of documented evidence of the review process occurring and how it is conducted and the lack of clear or appropriate precision in the operation of the management review control especially given the change to the model in the period. Whilst these controls may be achieving the control objective set by management (we have not confirmed this), due to the way they are performed and/or evidenced, they do not meet the requirements for an effectively designed control as defined by the FRC in its auditing standards. This is due to the difficulty in achieving an appropriate level of precision, particularly when considering the size of the balance relative to materiality
- We recommend management considers whether further amendments should be made to the design and implementation of these MRCs in order to meet the FRC standards.

Management Response:

This was the first year of implementation of the ECL model. The methodology applied and the modelling was reviewed in detail by the CFO. The approach was discussed and agreed with the CEO, Board and Audit Committee. We are therefore satisfied that there was considerable review of the model. We will review this process for the coming year to determine how this review is evidenced most effectively.

No manual control over billing calculation within GCW (SWBS)

- As billing calculations are performed automatically by Gentrack and no SOC report exists to cover the sales calculation KPMG noted that no manual control was in place to determine if invoices had been calculated correctly.
- KPMG recommend that while a SOC report cannot be obtained a manual control is put in place to address the risk of incorrect calculation. KPMG note that controls are in place over inputs to the calculation on both the tariffs and consumption volumes used in calculation. KPMG also recalculated a sample of invoices and noted no exceptions in calculation therefore do not believe this would result in a material misstatement.

Management's response:

There are preventative controls operating to verify billing accuracy, including validation checks prior to issue of invoices. In addition to this, the review by account of wholesale to retail identifies any significant variances which are investigated by the settlements team and any required action taken. This is an effective detect control to identify any issues. Any changes to GCW go through a formal change validation process, with testing completed by our in-house prior to go live.

Other significant matters (cont.)

Depreciation captured in incorrect financial period (SW)

It was identified (as in the prior year), that there is an element of “catch-up” depreciation due to the timing of the finalisation of the capital asset finance form.. The impact is that certain assets will have higher depreciation in a year whereas a portion of this depreciation should have been recognised in prior periods. The impact of this “catch-up” depreciation in the current year was £5.5 million. Depending on the value of projects and the timing of finalisation of the capital asset finance forms, there is a risk that this “catch up” depreciation could accumulate to a significant value.

We recommend that management consider implementing a control to reduce the delayed timing of finalisation of the asset forms so that the impact of “catch up” depreciation is reduced.

Management Response:

Management will consider the recommendation of KPMG during 2024/25. As per business processes which were established at the formation of Scottish Water in 2002, the processing of Completion Analysis Forms (CAF) is progressed once the project has delivered outputs and providing services to customers. The CAF provides the analysis of the assets delivered with depreciation commencing with the in-service date when assets commenced service. Due to the potential delay between in-service date and the date of reclassification of assets under construction to their asset category based on the CAF, "catch-up" depreciation can occur. Catch up depreciation is the correct financial recognition of the "consumption" of the asset during the period between in-service and the processing of the CAF. This can result in an immaterial depreciation charge being recognised in different financial years. The impact of this “catch-up” depreciation in the current year was £5.5 million. It is recognised that depending on the value of projects and the timing of finalisation of the capital asset finance forms, there is a risk that this “catch up” depreciation could accumulate to a significant value. Controls are in place to ensure that the timing difference is minimised, but further controls will be considered by management during 2024/25.

Management Review Controls (SW) (raised in the prior year) *

We have assessed a number of management review controls in significant risk areas and estimates (i.e. review of provisions and pension assumptions). Whilst these controls may be achieving the control objective set by management, due to the way they are performed and/or evidenced, they do not meet the requirements for an effectively designed control as defined by the FRC. This is due to the difficulty in achieving an appropriate level of precision, in particular when considering the size of the balance relative to materiality.

We recommend management consider adopting a policy to standardise the review process and pre-set threshold that are sufficiently precise for these management review controls.

Management Response:

The group makes use of actuarial specialists as well as other specialists as and when required and the current processes are considered adequate to address the risk even if the FRS requirements of a MRC are not met.

* We will not raise this point again in future periods but consider this as part of our risk assessment audit procedures.

Appendix A

Contents

Confirmation of independence

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

Assessment of our objectivity and independence as auditor of Scottish Water and its subsidiary entities

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

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

Summary of fees

We have considered the fees charged by us to Scottish Water and its subsidiary entities for professional services provided by us during the reporting period. Total fees charged by us for the period ended 31 March 2024 can be analysed as follows:

	2024	2023
	£'000	**£'000**
Audit fee – Audit Scotland allocation	376.3	355.0
Review fee - Half year	24.5	17.6
Audit fee – other areas of scope	26.5	25.0
Audit fee – subsidiary entities	216.0	135.8
Audit fee – regulatory reporting	18.5	17.0
	661.8	**550.4**
Non-audit services	2.5	2.5
Total fees	**664.3**	**552.9**

Required communications with the Audit Committee

Type		Response
Our management representation letter	OK	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2024.
Adjusted audit differences	OK	Adjusted audit differences are detailed on page 23.
Unadjusted audit differences	OK	There were no unadjusted audit differences.
Related parties	OK	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee	OK	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	OK	We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	OK	No actual or suspected fraud involving management, employees with significant roles in internal control, or where fraud results in a material misstatement in the financial statements identified during the audit.

Type		Response
Significant difficulties	OK	No significant difficulties were encountered during the audit.
Modifications to auditor's report	OK	None.
Disagreements with management or scope limitations	OK	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	OK	Other information was found to be consistent with the financial statements.
Breaches of independence	OK	No matters to report. The engagement team and others in the firm, as appropriate, the firm and, when applicable, KPMG member firms have complied with relevant ethical requirements regarding independence.
Accounting practices	OK	Over the course of our audit, we have evaluated the appropriateness of the entity's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate.
Significant matters discussed or subject to correspond-dence with management	OK	The significant matters arising from the audit were discussed, or subject to correspondence, with management.

KPMG's Audit quality framework

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

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

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

Commitment to continuous improvement

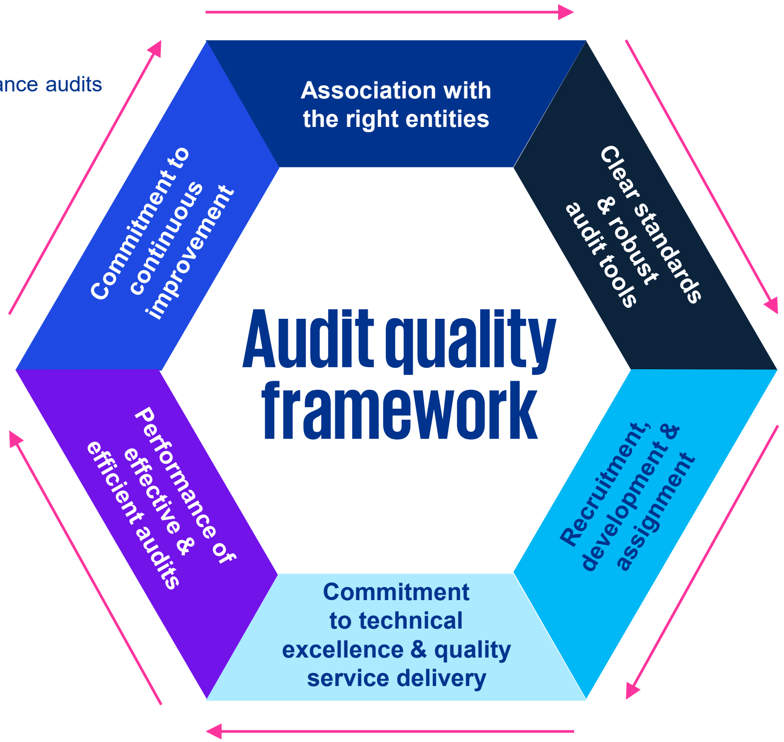
- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

Performance of effective & efficient audits

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

Commitment to technical excellence & quality service delivery

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



Association with the right entities

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

Clear standards & robust audit tools

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

Recruitment, development & assignment of appropriately qualified personnel

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

ISA (UK) 315 Revised: changes embedded in our practices

Summary

In the prior period, ISA (UK) 315 Revised "Identifying and assessing the risks of material misstatement" was introduced and incorporated significant changes from the previous version of the ISA.

These were introduced to achieve a more rigorous risk identification and assessment process and thereby promote more specificity in the response to the identified risks. The revised ISA was effective for periods commencing on or after **15 December 2021**.

The revised standard expanded on concepts in the existing standards but also introduced new risk assessment process requirements – the changes had a significant impact on our audit methodology and therefore audit approach.

What impact did the revision have on audited entities?

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities (and their governance structures) becoming more complicated, standard setters recognised that audits need to have a more robust and comprehensive risk identification and assessment mechanism.

The changes result in additional audit awareness and therefore clear and impactful communication to those charged with governance in relation to (i) promoting consistency in effective risk identification and assessment, (ii) modernising the standard by increasing the focus on IT, (iii) enhancing the standard's scalability through a principle based approach, and (iv) focusing auditor attention on exercising professional scepticism throughout risk assessment procedures.

Implementing year 1 findings into the subsequent audit plan

Entering the second year of the standard, the auditors will have demonstrated, and communicated their enhanced insight into their understanding of your wider control environment, notably within the area of IT.

In year 2 the audit team will apply their enhanced learning and insight into providing a targeted audit approach reflective of the specific scenarios of each entity's audit.

A key area of focus for the auditor will be understanding how the entity responded to the observations communicated to those charged with governance in the prior period.

Where an entity has responded to those observations a re-evaluation of the control environment will establish if the responses by entity management have been proportionate and successful in their implementation.

Where no response to the observations has been applied by entity, or the auditor deems the remediation has not been effective, the audit team will understand the context and respond with proportionate application of professional scepticism in planning and performance of the subsequent audit procedures.

What will this mean for our on-going audits?

To meet the on-going requirements of the standard, auditors will each year continue to focus on risk assessment process, including the detailed consideration of the IT environment.

Subsequent year auditor observations on whether entity actions to address any control observations are proportionate and have been successfully implemented will represent an on-going audit deliverable.

Each year the impact of the on-going standard on your audit will be dependent on a combination of prior period observations, changes in the entity control environment and developments during the period. This on-going focus is likely to result in the continuation of enhanced risk assessment procedures and appropriate involvement of technical specialists (particularly IT Audit professionals) in our audits which will, in turn, influence auditor remuneration.

ISA (UK) 600 Revised: Summary of changes

Summary

ISA (UK) 600 (Revised): Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) is effective for periods commencing on or after 15 December 2023.

The new and revised requirements better aligns the standard with recently revised standards such as ISQM 1, ISA (UK) 220 (Revised) and ISA (UK) 315 (Revised). The revisions also strengthen the auditor's responsibilities related to professional skepticism, planning and performing a group audit, two-way communications between the group auditor and component auditors, and documentation.

Area	Summary of changes and impact	Effect on audit effort
Risk-based approach	The nature and extent of risk assessment procedures performed by the group auditor at group level may increase, which may include further inquires of group and/or component management and those charged with governance; analytical procedures, attendance of walkthroughs at components, and inspection and/or observation of additional component information. Consequently, while we will continue to work across the group audit to be as efficient in our interactions with you as possible, group and component management will typically receive additional, and more specific/granular requests, for information from both the group and component auditors.	
Group auditor responsibilities	Through a more targeted audit response to address the group Risks of Material Misstatement, we may perform audit work and communicate with component management at a greater number of components within the group, and we may request less information from component management at certain components where we previously performed full scope audits for the Group audit, if we determine that a full scope audit is no longer necessary. While statutory audit requirements will still apply, this change may be beneficial for overall audit effort where a statutory audit is not required.	
Flexibility in defining components	You may also see changes in the planned scope and timing of the audit in communications to group management and those charged with governance, such as changes to the identification of components and the work to be performed on their financial information, and/or changes to the nature of the group auditor's planned involvement in the work to be performed by component auditors. The impact will be greater where there are more components.	
Quality management	Enhanced leadership, direction, supervision and review responsibilities of the group engagement partner may result in the group engagement partner needing to engage more extensively with group management, your component management and component auditors throughout the audit.	
Robust communication	If the group auditor determines that the increased work effort is needed, this determination will impact how much, and the type of, information you will need to provide to the group auditor or component auditors. The group auditor is required to prescribe required work at a more granular level. This may mean there is increased work for component auditors, particularly in year one, to align the requirements of the group audit and local statutory audits. We will continue to work closely to minimise this.	
Application of materiality and aggregation risk	Changes in component performance materiality may result in changes to the nature, timing and extent of component auditor's work. If so, this may impact how much, and the type of, information you will need to provide to the group auditor or component auditors.	
Revised independence principles	This may make it more challenging to address auditor rotation and other independence requirements for component auditors we may plan to involve in the group audit and mean more matters impacting independence may need to be communicated to you. Potential changes to the component auditor firms engaged to perform work on financial information of components.	

ISA (UK) 240 Revised: changes embedded in our practices

Ongoing impact of the revisions to ISA (UK) 240

- ISA (UK) 240 (revised May 2021, effective for periods commencing on or after 15 December 2021) *The auditor's responsibilities relating to fraud in an audit of financial statements* included revisions introduced to clarify the auditor's obligations with respect to fraud and enhance the quality of audit work performed in this area. These changes are embedded into our practices and we will continue to maintain an increased focus on applying professional scepticism in our audit approach and to plan and perform the audit in a manner that is not biased towards obtaining evidence that may be corroborative, or towards excluding evidence that may be contradictory.
- We will communicate, unless prohibited by law or regulation, with those charged with governance any matters related to fraud that are, in our judgment, relevant to their responsibilities. In doing so, we will consider the matters, if any, to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud.

Matters related to fraud that are, in our judgement, relevant to the responsibilities of Those Charged with Governance

Our assessment of the risks of material misstatement due to fraud may be found on page 4. We also considered the following matters required by ISA (UK) 240 (revised May 2021, effective for periods commencing on or after 15 December 2021) *The auditor's responsibilities relating to fraud in an audit of financial statements* , to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud:

- Concerns about the nature, extent and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to address appropriately the identified significant deficiencies in internal control, or to respond appropriately to an identified fraud.
- Our evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

Based on our assessment, we have no matters to report to Those Charged with Governance.

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KPMG LLP
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2 July 2024

Dear Tim

This representation letter is provided in connection with your audit of the Group and Parent Company financial statements of Scottish Water ("the Company"), for the year ended 31 March 2024, for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2024 and of the Group's and Company's profit or loss for the financial year then ended;
ii. whether the financial statements have been properly prepared in accordance with UK-adopted international accounting standards, and, where otherwise appropriate, as interpreted and adopted by the 2023-24 Government Financial Reportng Manual ("the 2023/24 FReM"); and
iii. whether the financial statements have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

These financial statements comprise the consolidated and separate statement of financial position as at 31 March 2024, the related consolidated and separate income statements, consolidated and separate statements of comprehensive income, the consolidated and separate statements of changes in equity and the consolidated and separate statements of cash flows for the year then ended, and the notes comprising material accounting policies and other explanatory information.

The Board confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Board confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

1. The Board has fulfilled its responsibilities, as set out in the terms of the requirements of the Water Industry (Scotland) Act 2002 and the Scottish Water Governance Directions 2023, for the preparation of financial statements that:

    i. give a true and fair view of the state of the Group's and of the Parent Company's affairs as at the end of its financial year and of the Group's and Parent's profit or loss for that financial year;
    ii. the Group and Parent financial statements have been properly prepared in accordance with UK adopted international accounting standards, and, where otherwise appropriate, as interpreted and adapted by the 2023-24 FReM; and
    iii. have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

    The financial statements have been prepared on a going concern basis.

2. The methods, the data and the significant assumptions used in making accounting estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework.

3. All events subsequent to the date of the financial statements and for which IAS 10 *Events after the reporting period* requires adjustment or disclosure have been adjusted or disclosed.

4. There were no uncorrected misstatements for the group or parent company.

Information provided

5. The Board has provided you with:

    - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
    - additional information that you have requested from the Board for the purpose of the audit; and
    - unrestricted access to persons within the Group and the Parent Company from whom you determined it necessary to obtain audit evidence.

6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

7. The Board confirms the following:

    i) The Board has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Included in the Appendix to this letter are the definitions of fraud, including misstatements arising from fraudulent financial reporting and from misappropriation of assets.

ii) The Board has disclosed to you all information in relation to:

a) Fraud or suspected fraud that it is aware of and that affects the Group and the Parent Company and involves:
- management;
- employees who have significant roles in internal control; or
- others where the fraud could have a material effect on the financial statements; and

b) allegations of fraud, or suspected fraud, affecting the Group and the Parent Company's financial statements communicated by employees, former employees, analysts, regulators or others.

In respect of the above, the Board acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Board acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error, and we believe we have appropriately fulfilled those responsibilities.

8. The Board has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

9. The Board has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements, in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

10. The Board has disclosed to you the identity of the Group and of the Parent Company's related parties and all the related party relationships and transactions of which it is aware. All related party relationships and transactions have been appropriately accounted for and disclosed in accordance with IAS 24 *Related Party Disclosures,* considering the requirements of the FReM.

    Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as we understand them and as defined in IAS 24.

11. The Board confirms that:

a) The financial statements disclose all of the matters that are relevant to the Company's and the Group's ability to continue as a going concern, including the key risk factors, assumptions made and uncertainties surrounding the Company's and the Group's ability to continue as a going concern, as required to provide a true and fair view and to comply with IAS 1 *Presentation of Financial Statements*.

b) No material uncertainties related to events or conditions exist that may cast significant doubt upon the ability of the Company and the Group to continue as a going concern.

12. On the basis of the process established by the Board and having made appropriate enquiries, the Board is satisfied that the actuarial assumptions underlying the valuation of defined benefit obligations are consistent with its knowledge of the business and are in accordance with the requirements of IAS 19 Employee Benefits.

The Board further confirms that:

a) all significant retirement benefits, including any arrangements that are:
- statutory, contractual or implicit in the employer's actions;
- arise in the UK and the Republic of Ireland or overseas;
- funded or unfunded; and
- approved or unapproved,

have been identified and properly accounted for; and

b) all plan amendments, curtailments and settlements have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Board of Directors on 26 June 2024.

Yours faithfully,

Alex Plant
Chief Executive

<u>Appendix to the Board Representation Letter of Scottish Water: Definitions</u>

Financial Statements

IAS 1.10 states that "a complete set of financial statements comprises:

- a statement of financial position as at the end of the period;
- a statement of profit or loss and other comprehensive income for the period;
- a statement of changes in equity for the period;
- a statement of cash flows for the period;
- notes, comprising material accounting policies and other explanatory information;
- comparative information in respect of the preceding period as specified in IAS 1 paragraphs 38 and 38A; and
- a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with IAS 1 paragraphs 40A-40D.

An entity may use titles for the statements other than those used in this Standard. For example, an entity may use the title 'statement of comprehensive income' instead of 'statement of profit or loss and other comprehensive income'.

Material Matters

Certain representations in this letter are described as being limited to matters that are material.

IAS 1.7 and IAS 8.5 state that:

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:

a) information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;
b) information regarding a material item, transaction or other event is scattered throughout the financial statements;
c) dissimilar items, transactions or other events are inappropriately aggregated;

d) similar items, transactions or other events are inappropriately disaggregated; and
e) the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances.

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena."

Fraud

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation.

Error

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorised for issue; and
b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Management

For the purposes of this letter, references to "management" should be read as "management and, where appropriate, those charged with governance".

Related Party and Related Party Transaction

Related party:

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to in IAS 24 *Related Party Disclosures* as the “reporting entity”).

a) A person or a close member of that person’s family is related to a reporting entity if that person:
   i. has control or joint control over the reporting entity;
   ii. has significant influence over the reporting entity; or
   iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
b) An entity is related to a reporting entity if any of the following conditions applies:
   i. The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
   ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
   iii. Both entities are joint ventures of the same third party.
   iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
   v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
   vi. The entity is controlled, or jointly controlled by a person identified in (a).
   vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
   viii. The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

A reporting entity is exempt from the disclosure requirements of IAS 24.18 in relation to related party transactions and outstanding balances, including commitments, with:

a) a government that has control or joint control of, or significant influence over, the reporting entity; and
b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

Related party transaction:

A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.