

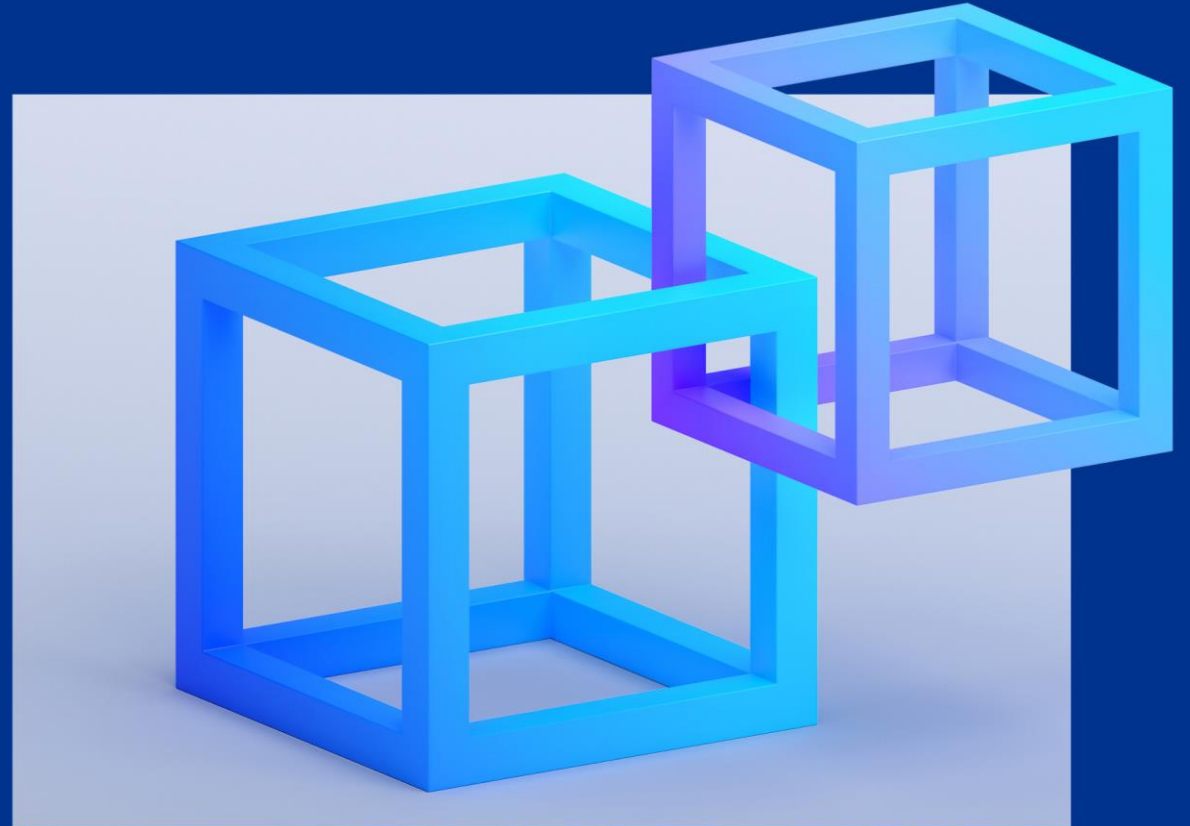


# Scottish Water

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

Annual report for the year ended 31 March 2025

3 July 2025



# Introduction

## To the Audit and Risk Committee of Scottish Water

We were pleased to have the opportunity to meet with you on 12 June 2025 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 2025.

This report should be read in conjunction with our audit plan and strategy report, presented on 25 March 2025.

## The engagement team

Our audit is now complete. There have been no significant changes to our audit plan and strategy.

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

Yours sincerely,

 **Cutler**  
**Partner**  
**KPMG LLP**  
**3 July 2025**

## 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.

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# 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 and endorsed International Financial Reporting Standards (IFRS) using the cost model for property, plant and equipment, as directed under the Scottish Water Governance Directions and International Financial Reporting Interpretations Committee (IFRIC) interpretations, and where otherwise appropriate, as interpreted and adapted by the Government Financial Reporting Manual (FReM) for the year ended 31 March 2025.

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](mailto: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 [5-17]

Significant audit risks	Risk change	Our findings
Capital additions (SW fraud risk)	No change	The results of our testing were satisfactory. We considered the costs capitalised to additions to be acceptable.
Management override of controls	No change	The results of our test were satisfactory. We did not identify any instances of management override of controls.
Revenue recognition (SWBS)	Decrease	The results of our testing were satisfactory. We considered the amount of revenue recognised to be acceptable
Household bad debt provision (SW)	No change	The testing results were satisfactory, and the overall estimate was assessed to be neutral.
Defined Benefit Pension (SW)	No change	The results of our testing were satisfactory. We considered the assumptions to be balanced and agreed with the surplus restriction applied.

## Key accounting estimates Page [18]

Impairment of trade receivables	Management judgement considered cautious
Defined benefit pension	Management's judgment considered neutral
Depreciation	Useful lives considered cautious

## Uncorrected Audit Misstatements Page [21]

Understatement/ (overstatement)	£m	%
No P&L impact – Uncorrected Audit Misstatement detailed on page 21		
OCI impact – Corrected audit misstatement detailed on page 21		

## Misstatements in respect of Disclosures

Misstatement in respect of Disclosures	Our findings
No misstatements with respect to disclosures have been identified.	

## Number of Control deficiencies Page [26-29]

Significant control deficiencies	<span style="color: red; font-size: 24px;">●</span>
Other control deficiencies	<span style="color: orange; font-size: 24px;">7</span>
Prior year control deficiencies remediated	<span style="color: green; font-size: 24px;">1</span>

# 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.

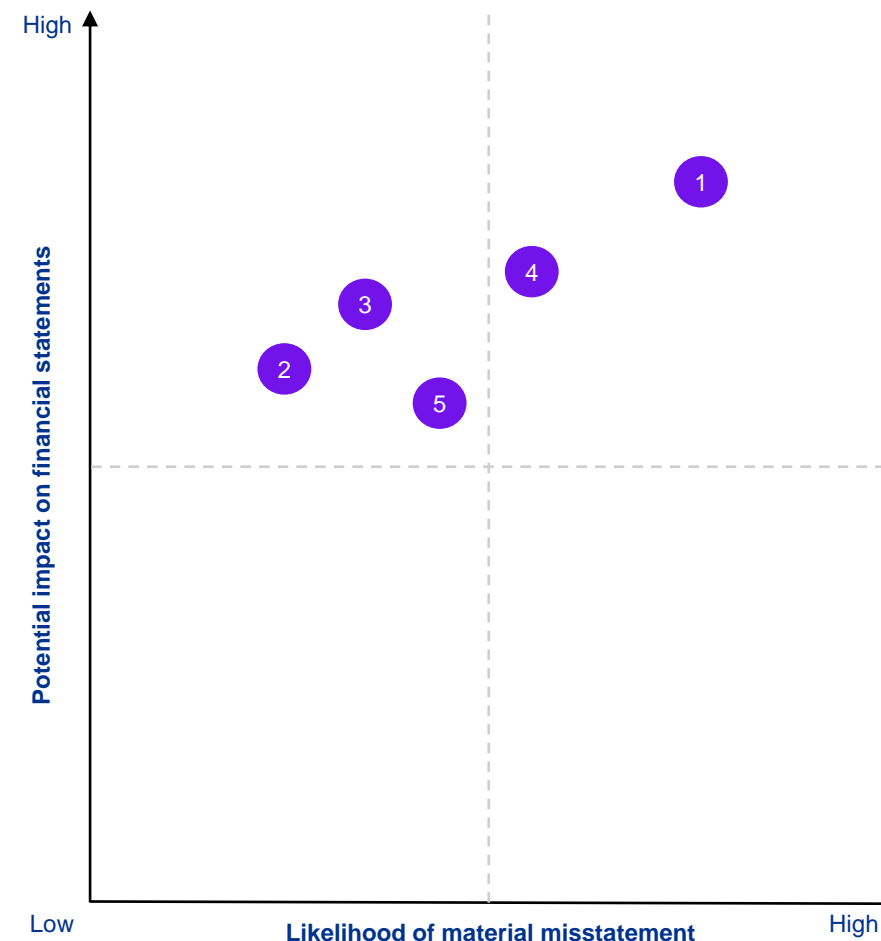
We also use our regular meetings with senior management to update our understanding and take input from local audit teams and internal audit reports.

## Significant risks

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

Key: # Significant financial statement audit risks

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) - fraud risk



### 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 and management are incentivised across a number of financial and other measures including Tier 1 actual costs being below plan by £30m.
- There is judgement involved in the allocation of expenditure (specifically payroll costs) between capital additions and revenue which can affect profit and Tier 1 cost measures reported in the financial statements.

Business risks related to audit risks include:

- Inappropriate amounts capitalised



### Our response

- Confirmed our understanding of the capital additions process by flowcharting and completing walkthroughs of the key capitalisation activities.
- Tested the design and implementation of key controls: the capital approval processes and allocation of internal costs, including indirect overheads.
- Tested the design and operating effectiveness of controls over:
  - the approval stages of capital expenditure on projects;
  - the appropriateness of reclassification from assets under construction;
- Used sampling methods to evaluate the appropriateness of the classification of expenditure as capital by considering the nature of the expenditure to ensure it was enhancing with reference to supplier invoices, certificates or timesheets and considering the application of the relevant policies and accounting standards;
- Used KPMG's D&A (data and analytics) capabilities to analyse the general ledger transactions for capital additions and tested outliers by agreeing transactions back to valid source documents, such as invoices, certificates, contracts, timesheets.
- Tested the judgement applied to the basis of payroll costs allocated to capital additions by reference to the roles of the underlying staff whose costs were capitalised and the basis of the allocation (e.g. time basis or other allocation method). The audit team challenged management, where appropriate, on the judgements applied. The audit team re-calculated the accuracy of the allocated payroll costs and agreed such costs to underlying payroll and HR records.
- Tested capital accruals at year end by agreeing a sample of accruals to supporting contracts, supplier certificates and other valid project details to confirm the existence and accuracy of capital additions over the year end period.
- Tested indirect costs allocated to capital additions by vouching a sample of costs to supplier invoices, timesheets and other relevant supporting documentation to confirm the validity and appropriateness of such costs capitalised.

# Audit risks and out audit approach (cont.)



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



### Significant 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 and management are incentivised across a number of financial and other measures including Tier 1 actual costs being below plan by £30m.
- There is judgement involved in the allocation of expenditure (specifically payroll costs) between capital additions and revenue which can affect profit and Tier 1 cost measures reported in the financial statements.

Business risks related to audit risks include:

- Inappropriate amounts capitalised



### Our findings

- We tested the design and operation of key controls and found them to be effective. The controls we tested were:
  - (1) the appropriateness of approvals of capital expenditure on projects, and
  - (2) the appropriateness of reclassification of assets from the category "assets under construction" to the relevant asset category by inspection of signed completed capital approval forms.
- A sample of direct capital expenditure costs were agreed to valid supporting documentation, being supplier invoices, supplier work certificates, time sheets and/or contracts, to test that such items met the requirements for capitalisation per IAS16. No misstatements were identified.
- The sample of indirect overheads were agreed to valid supporting documentation (e.g. time sheets) and the appropriateness of the classification of expenditure as capital or expenditure was found to be appropriate.
- The judgement applied to the basis of payroll costs allocated to capital additions was tested by reference to the role of the underlying staff whose costs were capitalised and the basis of the allocation (e.g. time basis or other allocation method). The audit team re-calculated the allocated payroll costs and agreed the cost per employee to the underlying payroll and HR records.

## 2 Management override of controls (SW and SWBS)

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



### Significant audit risk

#### The risk that the financial statements are misstated due to management override of controls

- 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.
- We have not identified any specific additional risks of management override relating to this audit.
- As in prior years, there is no enforced segregation of duties of journal entries at the point of posting into the general ledger.



### Our response

- Our audit methodology incorporates the risk of management override as a default significant risk.
- Assess accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias. There will be a particular focus on the provision for doubtful debt estimate for Scottish Water.
- Evaluate the selection and application of accounting policies.
- In line with our methodology, evaluate the design and implementation of controls over journal entries and post closing adjustments.
- Inquire with staff who business or process manual journals as to whether they have been requested to process unusual or unsupported journal entries.
- Assess the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.
- Assess 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.
- Identify journal entries to test based on high-risk criteria and comparing the identified entries to valid supporting documentation as well as considering whether such journals are appropriately authorized and have a valid business rationale.
- Audit of manual journals relating to capital additions which meet our high-risk criteria (i.e. capital additions journals with unexpected account pairings).
- Material post close and consolidation journals, as well as those meeting our high-risk criteria, were selected for testing.

# Audit risks (cont.)



## 2 Management override of controls (SW and SWBS)

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



### Significant audit risk

#### The risk that the financial statements are misstated due to management override of controls

- 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.
- We have not identified any specific additional risks of management override relating to this audit.
- 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 29 journal entries and other adjustments meeting our high-risk criteria for Scottish Water and 12 high-risk criteria journals for SWBS. Our examination did not identify unauthorised, unsupported or inappropriate entries for SW or SWBS.
- As a result of the journal testing performed, we did not identify any disconfirming audit evidence indicating management override of controls in relation to journal entries and other adjustments.
- Our procedures did not identify any significant unusual transactions.
- Post close and consolidation journals were found to be appropriate.

# Audit risks (cont.)



## 3 Revenue recognition (SWBS only)

### Fraud risk related to existence and accuracy of revenue



#### 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 revenue recognition.
- Accrued revenue involves subjective measurement as it is calculated from annualised revenue data from the market, allocated on a pro-rata basis to the period between the last billing date and the year-end

Business risks related to audit risks include:

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



#### Our response

- Confirmed our understanding of the revenue streams by flowcharting and completing walkthroughs of each separately identifiable revenue stream.
- Considered the design and implementation of key controls, the revenue recognition processes, and management's calculation of accrued and deferred revenues.
- Reviewed cash receipts-to-revenue predictive analysis on revenue recognised during the year, along with a reconciliation of all cash, debtors, and accrued revenue for the year.
- Performed year-end cut-off testing to assess whether sales transactions were recognised in the correct accounting period.
- Assessed the deferral of revenue recognised in respect of advanced billing to ensure it was appropriate and accurately calculated.
- Recalculated accrued income based on third party market data on consumption.

#### **We rebut the revenue recognition risk in respect of Scottish Water**

We rebut 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.

# Audit risks (cont.)



## 3 Revenue recognition (SWBS only)

Fraud risk related to existence and accuracy of revenue



### 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 measurement as it is calculated from annualised revenue data from the market, allocated on a pro-rata basis to the period between the last billing date and the year-end.



### Our findings

#### SWBS revenue testing:

- We reviewed a 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 following the year-end date, 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.
- Based on the audit procedures performed, no material misstatements were identified in relation to revenue recognised during the year.

#### 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 Household trade receivables - valuation(SW)

Significant risk due the judgemental nature of the bad debt provision calculation



**Significant  
audit risk**

### The risk that household receivables are overstated

Provision for Household doubtful debts at 31/03/2025:  
Scottish Water: £485.5m

- 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.

Business risks related to audit risks include:

- Increased economic and financial pressures increase the risk of default by customers resulting in financial loss to the business.



**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 2024-25, as recorded in Scottish Water's records, to confirmations received from individual local authorities.

### Planned response:

- 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:

0 Prior year  Current year



# Audit risks (cont.)



## 4 Impairment of Household trade receivables – valuation (SW)

Significant risk due the judgemental nature of the bad debt provision calculation



### Significant audit risk

#### The risk that household receivables are overstated

Provision for Household doubtful debts at 31/03/2025:  
Scottish Water: £485.5m

- 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.

#### Business risks related to audit risks include:

- Increased economic and financial pressures increase the risk of default by customers resulting in financial loss to the business.



### Our findings

- We tested the design and implementation of the monthly impairment provision for trade receivables. The design and implementation of the control was 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 2024/25 year were agreed to confirmations received from individual Councils. The data is assessed as reliable and relevant.
- As at 31 March 2025, the average forecast collection rate applied to billings was 96.96% resulting in an in-year charge of £19m and a resultant household bad debt provision of £485.5m against total debt outstanding of £559.3m. This is an increase of 0.08% 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 0.08% increase in average forecast collection rate in the context of the cost-of-living crisis and increased tariffs. We note that changes to household disposable income does not necessarily have a direct material impact on collection rates based on historical collection data analysis. The historical collection rates utilised in management's model have seen a long-term trend of actual collection rates improving.
- We compared the actual collection rates of the Councils over the past 25 years to that of Scottish Water and noted that they follow a similar increasing trend.
- The increased actual collection rates have continued to improve over time which has supported the increase in the forecast collection rate by 0.08% at 31 March 2025.

Key:

Prior year Current year

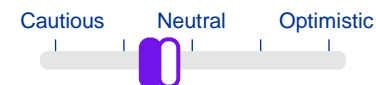


# Audit risks (cont.)



## 4 Impairment of Household trade receivables – valuation (SW)

Significant risk due the judgemental nature of the bad debt provision calculation



### Significant audit risk

#### The risk that household receivables are overstated

Provision for Household doubtful debts at 31/03/2025:  
Scottish Water: £485.5m

- 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.

#### Business risks related to audit risks include:

- Increased economic and financial pressures increase the risk of default by customers resulting in financial loss to the business.



### Our findings

#### Scottish Water

- We compared the forecast collection rate to the “collection trend excluding the last 5 years collection” and note that the “collection trend excluding the last 5 years collection” has increased over time and was 97.03% at FY25 which is comparable to the forecast collection rate applied of 96.96%.
- 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 0.12%. The likelihood of this level of change is considered remote based on historical data as well as the improved economic outlook.
- 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 collection trend, the provision is deemed cautious but within an acceptable range and is not materially misstated.
- The audit team challenged management to consider sensitivity disclosure of the forecast collection rate to represent a realistic change as has been actually applied over the past financial years.

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



### 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.
- 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 response

Our audit approach to IAS 19 included:

- Testing the design and operating effectiveness of controls over the provision of membership information to management's actuary who uses it, together with the assumptions, to calculate the pension obligation.
- Review of management's expert used in the valuation of the defined benefit pension obligation.
- Challenging, 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.
- Challenging 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.
- Considering the adequacy of the disclosures in respect of the sensitivity of the surplus/deficit to these assumptions.
- Our approach to the audit of pension schemes continues to include enhanced quality procedures, accordingly, we will liaise with the scheme actuaries and fund auditors regarding the underlying data and procedures at those entities. Given the current volatile market conditions caused by local and global economic uncertainty, we expect some fluctuations in the measurement of the pension liability/surplus.

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



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.
- 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 20)

### Surplus recognition

- We have assessed the methodology, data and assumptions used in the valuation of the defined benefit obligation and the resulting surplus.
- At the balance sheet date, the funded surplus has been restricted to £nil due to the asset ceiling (i.e. the undisputed right to a refund). We have considered the employer's approach adopted for the calculation of recognisable surplus and the presentation of unfunded liabilities and consider it to be reasonable. The unfunded obligation at 31 March 2025 was £68.4m.

### Employer contributions

- As in prior years, Scottish Water prepay employer contributions and the audit team requested management to detail this fact in the pension note disclosure. During the FY25 year, employer contributions of £27.3m in respect of financial year 2024/25 and £29.8m in respect of financial year 2025/26 were prepaid to the pension funds.

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



**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.
- 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**

### 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.
- While performing pension asset testing, we identified variances of £23m (£14m in LPF and £9m in SPF) in the expected closing asset balance for both schemes and the reported balance in the IAS19 report. Management requested their actuary to correct the IAS 19 report and the financial statements, including disclosures, were updated. Refer to page 21 for the corrected audit misstatement.

Key:

 Prior year  Current year



# Key accounting estimates and management judgements- Overview



Key:  
  Prior year     Current year

## 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.



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)		485.5	11.1		The forecast collection rate has increased by 0.08% in the current year which reflects the continued increase in the actual collection rate.
Defined Benefit – Pension Asset		2,377.8	42.6		Defined benefit pension assets were found to be fairly stated after the corrected audit misstatement as detailed on page 21.
Defined Benefit - Pension Liability		(1,292.9)	202.5		Actuarial assumptions applied were found to be balanced and within acceptable ranges (refer to page 20)
Depreciation charge		375.5	31.2		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. See further detail on page 19.
Capitalised payroll costs		150	10		Management exercise judgement in the capitalisation of payroll costs to capital additions of PPE during the financial year. Certain staff working directly on the capital investment programme and many other staff work a portion of their time on the capital investment programme and thus there is judgement applied in the allocation of these costs as capital additions.

# Key accounting estimates and management judgements– Overview

## Depreciation

Depreciation is a key accounting estimate with management judgement applied to the useful lives of items of property, plant and equipment

### Audit procedure performed:

- Recalculate depreciation expense for the year ended 31 March 2025, considering appropriateness of useful lives

### Findings:

#### Catch up depreciation:

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. The impact of this “catch-up” depreciation in the current year was £2.5 million. This amount was not considered material against total depreciation of £373m. The amount of catch-up depreciation is also lower than prior years as management have focussed on reducing the time between when the assets are available for use and eligible for depreciation and when they are transferred out of capital WIP.

#### Fully depreciated assets:

It was identified that the entity has fully depreciated assets totalling £959m 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 £274m with £1.1m fully depreciated assets being held for longer than 5 years. Whilst this could indicate some prudence 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.

#### Investigative type assets with short useful lives:

At 31 March 2025, there were “investigation” assets with a cost of £61.7m and net book value of £20.5m. The audit team inspected supplier invoices and/or supplier work certificates for these costs and agreed that these met the requirements of IAS 16 for capitalisation of items of PPE (Property, plant and equipment). The audit team challenged management with respect to the one-year useful life period applied to these assets as costs that meet the requirements of capitalisation per IAS 16 imply a useful life of longer than one year. The audit team challenged management to consider the useful life in line with the asset being supported or to consider a period within or aligned with the regulatory period. The financial impact of extending the useful life by more than one year for these projects is not expected to be material for the FY25 year, however with the increase in investigative projects for SR27, this value is expected to increase for the FY26 year. Refer to page 26 for recommendations to management.

## Provisions

Scottish Water entity and group have a number of provisions (e.g. the income uncertainty provision) which is viewed as prudent. The group has not provided for a supply contract which is impacted by fluctuating market prices due to the volatility of pricing and complexity of estimating a fair value. This is viewed as optimistic. Thus on an overall basis, provisions at a Scottish Water group level, which are not material, are viewed as balanced.



# Pension actuarial assumptions

Level of prudence compared to KPMG central assumptions



Underlying assessment of individual assumptions		Methodology	Consistent methodology to prior year?	Compliant methodology with accounting standard?	Employer	KPMG central	Assessment	Significant assumptions
							Balanced	
Discount rate		AA yield curve	✓	✓	5.80%	5.75%		✓
CPI inflation		Deduction to RPI inflation curve	✓	✓	2.75%	2.74%		✓
Pension increases		In line with CPI	✓	✓	2.75%	2.82%		✓
Salary increases		Employer best estimate	See next page	✓	FY 25/26: 5.40% FY 26/27: 4.40% FY 27/28: 3.80% FY 28/29: 3.50% FY 29/30 – 32/33: 3.20% 3.75% thereafter	In line with long-term remuneration policy		
Mortality	Base tables	In line with most recent Fund valuation	See page 13	✓	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 13	✓	CMI 2023 projections model, 1.50% (LPF / SPF / NESPF) long-term trend rate, initial additional parameter of 0.25% and default other parameters	CMI 2023, 1.25% long-term trend rate and default other parameters		✓
Other demographics		In line with most recent Fund valuation	✓	✓	In line with the approach taken by each Fund at the latest triennial Valuation	In line with Fund experience		

# Audit Misstatements

We have identified one factual audit misstatement that was subsequently corrected for **Scottish Water** and is summarised in the table below.

One uncorrected factual audit misstatement was identified relating to **Scottish Water Business Stream** and is summarised in the table below.

Disclosure testing is ongoing therefore no findings are included in relation to Financial Statement disclosures.

In line with ISA (UK) 450 we request that you correct uncorrected misstatements.

## Corrected Audit Misstatement:

	Account Name	Dr	Cr
1	Remeasurement of defined benefit liability (asset) – Other Comprehensive Income (OCI)	23,409,000	
	Gross defined benefit plan assets		23,409,000

An error was identified in the closing balance of pension assets (£14m in LPF and £9m in SPF) per the IAS 19 actuary report. This was corrected by the actuary issuing an updated report and the financial statements, including related disclosures were corrected.

## Uncorrected Audit Misstatement:

	Account Name	Dr	Cr
1.	Trade Debtors	1,792,578	
	Revenue Bank Account		1,792,578

Reclassification of direct debits to trade receivables, as the related bank transactions cleared after year-end. Due to timing of management's process this is likely a recurring reclassification misstatement.

### 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, Alex Plant. The CFO is Alan Dingwall who was appointed in June 2024.

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.

### **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*

At 31 March 2025, there was an ongoing pay dispute within the union which was still not resolved at the time of concluding the audit. Management have accrued for the pay increase offer at year end. The entity complies with public sector pay guidance and the 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.

The board delegates responsibility for business activities to directors and managers and employees through a Delegated Levels of Authority (DLA) Scheme. This control was found to be operating effectively.

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.

Repair costs continue to increase in line with budget and commensurate with the scale and value of the asset base and audit procedures included performing tests of detail to agree the expenses to valid, approved supplier invoices.

#### **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 significant 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 Company's internal control.

### Key:

- 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.
- 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 5 of such deficiencies in the current year.
- 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.

### ● Investigative assets – short useful life (SW)

Investigative assets are depreciated over a period of one year. However, the nature of costs capitalised in terms of IAS 16 implies a useful life of more than one year. The audit team challenged management to consider the useful life in line with the asset being supported or to consider a period within or aligned with the regulatory period.

#### Management's response:

The approach used for investigative assets aligns with IAS 16 Property, Plant and Equipment as depreciation spans more than one accounting period. Further review in relation to asset life will be undertaken during the 2025/26 year.

### ● Bank reconciliations – timely preparation and evidence of review (SW)

- Two bank reconciliations were identified as being prepared late during the financial year and for several months there was no evidence of review of the monthly bank reconciliations. There is a risk that unreconciled items on the bank accounts are not identified and resolved timeously.
- We recommend management considers their policy with respect to preparation and review of bank reconciliations

#### Management Response:

Management will review the policy relating to bank reconciliations. Management consider that balance sheet reconciliation reviews by the Group Finance team and reviews of balance sheet movements on a month by month basis mitigate the risk.

### ● Reasonable cost contribution (RCC) provision – timing of release of accumulated provision

- The RCC provision is utilised when developers reclaim their costs. Amounts not claimed by developers are maintained for the current and previous two regulatory periods and thereafter released to assets. Where more than two regulatory periods have passed since the projects have been completed, the likelihood of the developers claiming such costs is considered remote.
- We recommend management monitor the ageing of the provision on a more detailed basis (e.g. per year) and to monitor the utilisation of the provision to more accurately maintain a realistic provision, considering the likelihood of claims from developers.

#### Management Response:

The RCC provision reflects financial agreements contractually agreed with developers and are site specific. Developments are progressed over a period of years at the discretion of developers and market conditions. Developers make claims for RCC over extended periods. Management have a detailed analysis of the RCC by site and developer and review long standing balances with a view to release those which are considered to be no longer required.

# Other significant matters (cntd)



## ● 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 controls were in place that could be relied upon for audit purposes 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 matter 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.

## ● Management Review Controls – Written off during the year (SWBS)

KPMG has assessed the Management Review Controls (MRCs) related to debt write-offs during the year. We have not placed reliance on these controls due to the lack of documented evidence in some instances—both regarding whether the review occurred and how it was performed. While these controls may be achieving management's intended objectives (though we have not been able to confirm this with sufficient certainty), they do not meet the definition of an effectively designed control under FRC auditing standards. This is primarily due to limitations in evidencing the review and challenges in achieving the necessary level of precision, particularly given the size of the balance relative to materiality.

### **Management Response:**

Proposed debt write offs are collated monthly by the Credit Management team. These are reviewed in detail by the Finance Team each month to verify amongst other things that all accounts are finalised, the customer has no other active accounts, and that the customers are not household names, with queries being raised to the Credit Management team for discussion. A meeting is held to discuss and agree the final write off, which is then emailed for approval. In line with our delegated authority, individual values in excess of £50k are required to be approved by the CEO, and anything over £100k is approved by the Board. We will review documentation of the process going forward to see how this can be improved.

# Other significant matters (cntd)



## ● 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. 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:**

The ECL model assumptions remain broadly unchanged on the prior year, with some refinement for audit recommendations. Throughout the year we have considered a range of assumptions and presented these as part of our month end close review process with the CFO and CEO, determining the most appropriate basis to be used. We are satisfied that appropriate reviews were in place, but that these could be more effectively evidenced.

## ● Twinfield - Privileged Access (SWBS)

Through our IT and process walkthroughs, we noted that administrator privileges within the Twinfield application are assigned to members of the Finance team. The absence of segregation between IT administrative access and business process roles presents a risk that users may execute inappropriate or unauthorized activities. This could compromise the control environment and affect the integrity of financial data.

We recommend that privileged IT access is restricted to an appropriate group of users within the IT department, who do not perform operational or financial transactions within the system.

### **Management Response:**

Twinfield administrator access will be transferred to IT with immediate effect. The Twinfield system is limited in functionality and is planned to be replaced in the next two to three years. Due to this, we do not plan to invest further in it. System controls and workflow access will be requirements of the new system.

# Other significant matters (cntd)



## ● Estimation of Meter Read (SWBS)

The Gentrack Cloud for Water (GCW) system is configured to include only prior billed actual reads when calculating estimated reads for the period between the last validated reads and the billing date. GCW is not considering validated actual reads if they have not been billed to customer. KPMG performed audit procedures over the revenue and accrued revenue recognized during the year, and no disconfirming evidence was found as all the meter reads are validated with market data. However, there is an inherent risk of misstatement, as the GCW does not incorporate the latest validated reads, which could lead to less precise estimations.

We recommend updating the GCW to include all validated actual reads to improve estimation accuracy.

### **Management Response:**

The current configuration of GCW is fully compliant with market regulation and practice and is the unmodified specification of the system. We do not consider that this is a material risk to the accuracy of customer statements.

# Appendix A

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# 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 2025 can be analysed as follows:

	2025	2024
	£'000	£'000
Audit fee – Audit Scotland allocation	386.5	371.0
Review fee - Half year	26.5	24.5
Audit fee – other areas of scope	26.0	25.0
Audit fee – subsidiary entities	<u>275.6</u>	<u>216.0</u>
	<b>714.6</b>	<b>636.5</b>
Non-audit services	<u>2.5</u>	<u>2.5</u>
Total fees	<b>717.1</b>	<b>639.0</b>

# Required communications with the Audit and Risk Committee



Type	Response
<b>Our management representation letter</b>	<input checked="" type="checkbox"/> 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 2025
<b>Adjusted audit differences</b>	<input checked="" type="checkbox"/> OK There was one adjusted audit difference See page 21..
<b>Unadjusted audit differences</b>	<input checked="" type="checkbox"/> OK The aggregated profit impact of unadjusted audit differences would be £nil In line with ISA 450 we request that you adjust for these items. However, they will have no effect on the opinion in the auditor's report, individually or in aggregate. See page 21.
<b>Related parties</b>	<input checked="" type="checkbox"/> OK There were no significant matters that arose during the audit in connection with the entity's related parties.
<b>Other matters warranting attention by the Audit Committee</b>	<input checked="" type="checkbox"/> 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.
<b>Control deficiencies</b>	<input checked="" type="checkbox"/> 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 in writing on 29 May 2025.
<b>Actual or suspected fraud, non-compliance with laws or regulations or illegal acts</b>	<input checked="" type="checkbox"/> OK No actual or suspected fraud involving group or component 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
<b>Significant difficulties</b>	<input checked="" type="checkbox"/> OK No significant difficulties were encountered during the audit.
<b>Modifications to auditor's report</b>	<input checked="" type="checkbox"/> OK None.
<b>Disagreements with management or scope limitations</b>	<input checked="" type="checkbox"/> OK The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
<b>Other information</b>	<input checked="" type="checkbox"/> OK No material inconsistencies were identified related to other information in the annual report, Strategic and Members' reports. The Strategic report is fair, balanced and comprehensive, and complies with the law.
<b>Breaches of independence</b>	<input checked="" type="checkbox"/> OK No matters to report. The engagement team have complied with relevant ethical requirements regarding independence.
<b>Accounting practices</b>	<input checked="" type="checkbox"/> OK Over the course of our audit, we have evaluated the appropriateness of the Group's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate.
<b>Significant matters discussed or subject to correspondence with management</b>	<input checked="" type="checkbox"/> OK The 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

# Newly effective accounting standards and relevant IFRIC items



Standards	Expected impact				Effective for years beginning on or after			Early adoption permitted
	High	Moderate	Low	None	01 Jan 2025	01 Jan 2026	1 Jan 2027	
Lack of exchangeability (Amendments to IAS 21) <i>The Effects of Changes in Foreign Exchange Rates</i>	●	●	●	○	✓			✓
Amendments to the Classification and Measurement of Financial Instruments – Amendments to IFRS 9 <i>Financial Instruments</i> and IFRS 7 <i>Financial Instruments: Disclosures</i> **	●	●	●	○		✓		✓
Annual Improvements to IFRS Accounting Standards – Amendments to: <ul style="list-style-type: none"> <li>IFRS 1 <i>First-time Adoption of International Financial Reporting Standards</i>;</li> <li>IFRS 7 <i>Financial Instruments: Disclosures and its accompanying Guidance on implementing IFRS 7</i>;</li> <li>IFRS 9 <i>Financial Instruments</i>;</li> <li>IFRS 10 <i>Consolidated Financial Statements</i>; and</li> <li>IAS 7 <i>Statement of Cash flows</i></li> </ul>	●	●	●	○		✓		✓
IFRS 18 <i>Presentation and Disclosure in Financial Statements</i> **							✓	✓
IFRS 19 <i>Subsidiaries without Public Accountability: Disclosures</i> **	●	●	●	○			✓	✓
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 <i>Consolidated Financial Statements</i> and IAS 28 <i>Investments in Associates and Joint Ventures</i> ) *	●	●	●	○	TBD*			✓

\*The effective date for these amendments was deferred indefinitely. Early adoption continues to be permitted.

\*\*Not yet endorsed by the UK Endorsement Board



**Some or all of the services described herein may not be permissible for KPMG audited entities and their affiliates or related entities.**



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