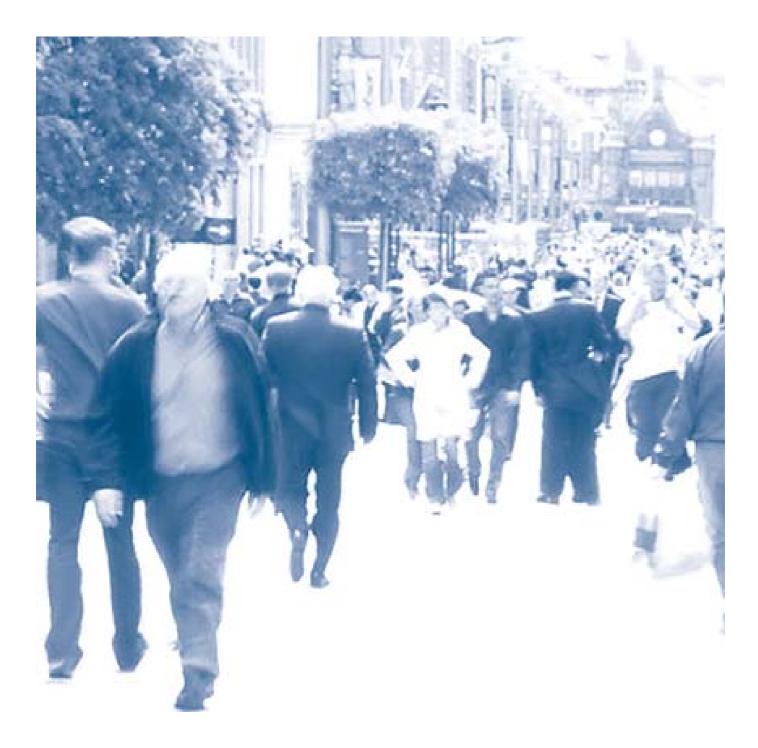
# Water Industry Commission for Scotland

Report on the 06/07 Audit



December 2007





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# **Executive Summary**

### Introduction

In 2006/07 we audited the financial statements of the Water Industry Commission for Scotland. Our responsibilities also include looking at aspects of performance management and governance as appropriate. This report sets out our key findings.

# **Financial Position**

The new Government Financial Reporting Manual (FReM) requirement to account for grant-in-aid as a credit to reserves has resulted in a net deficit for the year of £0.779 million in 2006/07 (2005/06 result restated to reflect the change in accounting policy: £1.051 million net deficit). The grant-in-aid credited to reserves for the year was £1.710 million (2005/06: £1.571 million).

## **Financial Statements**

We have given an unqualified opinion on the financial statements of the Water Industry Commission for Scotland for 2006/07.

### Performance

We confirmed that the Commission's performance monitoring framework includes reporting progress against planned activities on a regular basis.

#### Governance

As reflected in the Statement on Internal Control, the corporate governance and control arrangements for the Commission operated satisfactorily during the year. The Statement on Internal Control also records the clarification of Accountable Officer responsibilities in relation to Waterwatch Scotland; the relevant coverage of the Statement; and that there were on-going discussions with the Scottish Government in relation to these arrangements.

# **Looking Forward**

On 1 April 2008 non-household customers will be able to buy their water and sewerage services from retailers other than Scottish Water. In 2007/08 the Commission will finalise arrangements for the new retail market. Also, the outcome of the next price review, covering the four year period from 2010/11 to 2013/14, will be published in November 2009. The focus during the next year will be to develop further the methodology for the review. We will assess the impact of these and other developments as part of the planning for the 2007/08 audit.



# Introduction

- This report summarises the findings from our 2006/07 audit of the Water Industry Commission for Scotland (WICS). The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 14 March 2007. An updated Plan was presented to the Audit Committee on 13 June 2007 to reflect developments relating to the Central Market Authority and Waterwatch Scotland.
- 2. The Audit Plan described the work we planned to carry out, which can be summarised as:
  - audit of the financial statements and provision of an opinion on whether they present a true and fair view of the financial position of WICS and its expenditure and receipts for the year; and
  - a review of WICS's arrangements for corporate governance and performance.
- 3. Within the Audit Plan we identified main risk areas which informed our audit procedures. We have provided further comment on the outcome of our work in relation to these risks, as appropriate, in the relevant sections of this report.
- 4. Appendix A of this report sets out the issues highlighted in this report for management attention and the action planned by management to address them.
- 5. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of WICS during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, <u>www.audit-scotland.gov.uk</u>.

# **Financial Statements**

6. In this section we summarise key outcomes from our audit of WICS' financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

### **Our Responsibilities**

- 7. We audit the financial statements and give an opinion on whether:
  - they give a true and fair view of the financial position of WICS and its expenditure and income for the period in question;
  - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
  - the regularity of the expenditure and receipts.
- 8. We also review the statement on internal control by:
  - considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control; and
  - assessing whether disclosures in the statement are consistent with our knowledge of WICS.

#### **Overall Conclusion**

9. We have given an unqualified opinion on the financial statements of WICS for 2006/07.

### **Financial Position**

#### 2006/07 outturn

- 10. The new Government Financial Reporting Manual (FReM) requirement to account for grant-in-aid as a credit to reserves has resulted in net expenditure for the year of £0.779 million in 2006/07 (2005/06 result restated to reflect the change in accounting policy: £1.051 million excess expenditure). The grant-in-aid credited to reserves for the year was £1.710 million (2005/06: £1.571 million).
- 11. WICS received operating income of £4.903 million during 2006/07 (2005/06: £2.268 million). The majority of income arises from a contribution from Scottish Water of £4.879 million (2005/06: £2.251 million). This contribution includes £1.479m (2005/06: £nil) in relation to the establishment of a Central Market Agency and £0.648 million for the activities of Waterwatch Scotland.
- 12. Total operating costs of £5.706 million (2005/06: £3.327 million) show an increase of £2.379 million compared to the previous year. This movement is mainly attributable to the establishment of framework agreements with external consultants in order to respond flexibly and cost effectively to the



demands of the price review and licensing costs associated with preparations for the new retail market. Also, 2005/06 WICS figures are for only 9 months activity, reflecting the new arrangements for the Commission, which was established on 1 July 2005.

13. WICS' balance sheet at 31 March 2007 showed net assets of £0.810 million (2005/06: £0.119 million). This movement is mainly attributable to an increase in the year end bank balance arising from an excess of income over expenditure in relation to the establishment of a Central Market Agency. This balance has been carried forward to meet expenditure in 2007/08.

#### 2007/08 budget

14. Grant in aid of £2.004 million and a contribution of £3.554 million from Scottish Water has been agreed with the Scottish Government for 2007/08. The contribution from Scottish Water includes a levy of £0.716 million and a one off payment of £0.050 million in relation to Waterwatch Scotland.

### **Issues Arising from the Audit**

#### **Prior Period Adjustments**

- 15. In line with changes to the FReM which require NDPBs to regard grant in aid received as a financing flow, and no longer as income, prior year figures have been restated to show grant in aid of £1.571m as a credit to the general reserve.
- 16. The prior year figures have been restated to include the results of Waterwatch Scotland, which was established under statutory arrangements but has no separate legal status. Net expenditure in 2005/06 increased by £0.039 million to reflect this adjustment.

#### **Central Market Agency**

- 17. Income and expenditure relating to the establishment of the Central Market Agency Ltd (CMA) is included in WICS accounts for 2006/07. The CMA was incorporated on 1 August 2007 and assets transferred from WICS to the CMA on 26 September 2007. Establishment of the CMA as a separate legal entity is regarded as a non adjusting post balance sheet event and appropriate disclosures are included in the financial statements.
- 18. Early consideration should be given to the technical accounting adjustments and disclosure which will be required to reflect the separation of the CMA in the 2007/08 accounts.

Action Point 1



### **Statement on Internal Control**

19. The Statement on Internal Control provided by WICS' Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out WICS' approach to this. The Statement on Internal Control also records the clarification of Accountable Officer responsibilities in relation to Waterwatch Scotland; the relevant coverage of the Statement; and that there were on-going discussions with the Scottish Government in relation to these arrangements.

#### **Action Point 2**

### **Regularity Assertion**

20. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



# Performance

- 21. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we may plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
- 22. Accountable officers have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

#### Performance

23. The Commission's principal statutory functions as economic regulator are to:

Promote the interests of water and sewerage customers;

License the provision of retail water and sewerage services to non-household customers; and

Determine limits on Scottish Water's charges.

24. The Commission's performance monitoring framework includes reporting progress against planned activities on a regular basis. In particular, we note that there are monthly updates on the development of the methodology for the price review. There is regular monitoring of Scottish Water's outputs and quarterly updates on Scottish Water's financial performance. In addition, the Commission is kept up to date with the licensing project and the development of market arrangements.



# Governance

#### **Overview of arrangements**

25. This section sets out our main findings arising from our review of WICS' governance arrangements as they relate to key systems of internal control and review of internal audit.

### Systems of internal control

- 26. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2006/07, Scott Moncrieff, the internal auditors, provided an opinion that WICS has established a framework of control which provides adequate assurance regarding the effective and efficient achievement of the Commission's objectives. In forming this opinion, internal audit have taken into account the audits undertaken in the year, informal follow up work in respect of previous audits and that all material recommendations arising from internal audit work have been accepted by the Commission.
- 27. As part of our audit we carried out an assessment of systems and controls in relation to payroll and non-payroll expenditure, including sample testing of a small volume of high value travel and subsistence payments. The nature of documentation provided in support of travel and subsistence claims was discussed with management and it was agreed that current arrangements for documentation of claims would be improved.

#### **Action Point 3**

#### **Internal audit**

28. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on WICS' internal audit function. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on internal audit in a number of areas.



# Looking Forward

- 29. WICS faces a number of challenges in 2007/08, which include:
  - Opening up the market on 1 April 2008 non-household customers will be able to buy their water and sewerage services from retailers other than Scottish Water. In 2007/08 the Commission will finalise arrangements for the new retail market. Successful licence applicants will be able to compete for customers and negotiate pre-agreements during the year. In addition, WICS aims to raise further awareness with both customers and potential licence applicants about the opportunities that exist for them under the new framework.
  - Central Market Agency to facilitate the transfer of customer information in the new retail market the Central Market Agency Ltd (CMA) was incorporated on 1 August 2007. Assets were transferred from WICS to the CMA on 26 September 2007. We will consider the technical accounting arrangements for this transfer during our 2007/08 audit.
  - 2010-2014 price review the outcome of the next price review, covering the four year period from 2010/11 to 2013/14, will be published in November 2009. The focus during the next year will be to develop further the methodology for the review. WICS aims to complete the methodology consultation process by publishing conclusions on 20 December 2007.
  - Waterwatch Scotland discussions are on-going with the Scottish Government with a view to clarifying the responsibilities in relation to the Commission's relationship with Waterwatch Scotland. We will continue to monitor progress in this area.
  - Crerar Review the Scottish Executive announced in June 2006 that an independent review of regulation, audit, inspection and complaints handling across all public services in Scotland would be undertaken by Professor Lorne Crerar. WICS is one of the scrutiny bodies covered by this review. A report was issued in September 2007 and Audit Scotland will be considering the recommendations made in it.



# Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	Early consideration should be given to the technical accounting adjustments and disclosure which will be required to reflect the separation of the CMA in the 2007/08 accounts.	WICS will seek advice from Scott Moncrieff to ensure 07- 08 Accounts reflect the separation of the CMA	Katherine Russell	March 08
2	Clarification of WICS' relationship with Waterwatch Scotland, including the Chief Executive's responsibilities as Accountable Officer, is under discussion with the Scottish Government.	WICS to inform Audit Scotland of any progress made with regards Waterwatch	Katherine Russell	March 08
3	The nature of documentation provided in support of travel and subsistence payments was discussed with management and it was agreed that current arrangements for documentation of claims would be improved.	Documentation requirements will be reviewed, including checks on ensuring the business reason for expenses is described appropriately.	Katherine Russell	January 08