

# Water Industry Commission for Scotland

2018/19 Annual Audit Report



 AUDIT SCOTLAND

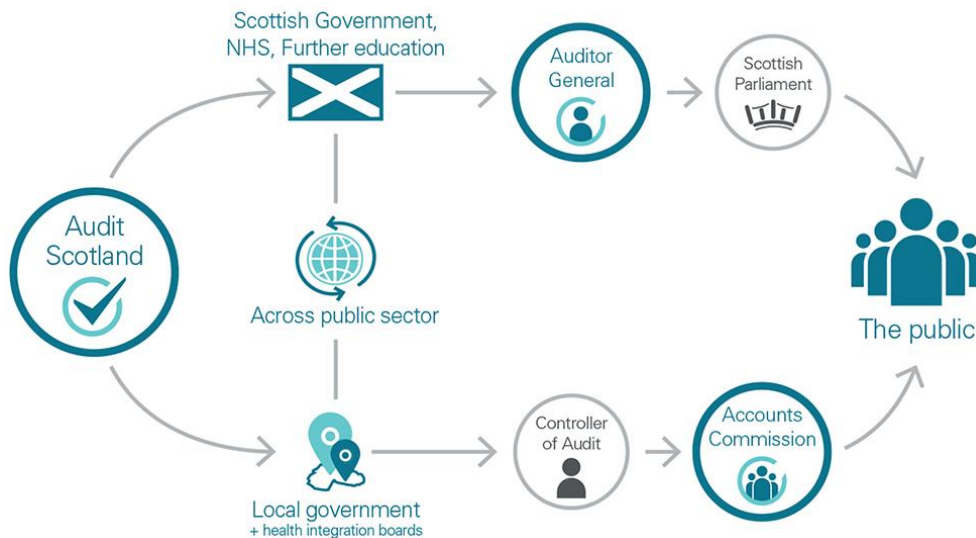
Prepared for the Water Industry Commission for Scotland and the Auditor General for Scotland

September 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## 2018/19 annual report and accounts

- 1** The financial statements of the Water Industry Commission for Scotland (WICS) give a true and fair view and were properly prepared; expenditure and income were in accordance with applicable enactments and guidance.
- 2** The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements.

## Financial sustainability

- 3** WICS has appropriate financial planning and monitoring arrangements in place.
- 4** We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by Scottish Ministers.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of the Water Industry Commission for Scotland (WICS).

2. The scope of our audit was set out in our Annual Audit Plan presented to the Audit and Risk Committee on 29 January 2019. This report comprises the findings from:

- an audit of the WICS annual report and accounts
- our consideration of the financial sustainability and the appropriateness of the governance statement.

## Adding value through the audit

3. We add value to WICS through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- Providing clear conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

4. In so doing, we aim to help WICS promote improved standards of governance, better management and decision making and more effective use of resources.

## Responsibilities and reporting

5. WICS has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from Scottish Ministers. WICS is also responsible for compliance with legislation and putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

6. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), along with supplementary guidance and International Standards on Auditing in the UK.

7. As public-sector auditors we give independent opinions on the annual report and accounts and conclude on securing financial sustainability and appropriateness of the governance statement disclosures. In doing this, we aim to support improvement and accountability.

8. The [Code of Audit Practice 2016](#) (the Code) includes provisions relating to the audit of small bodies. Where the application of the full wider audit scope is judged by auditors not to be appropriate to an audited body then the annual audit work can focus on the appropriateness of the disclosures in the governance statement and

the financial sustainability of the body and its services. As highlighted in our 2018/19 Annual Audit Plan, due to the volume and lack of complexity of the financial transactions, we applied the small body provisions of the Code to the 2018/19 audit.

**9.** The weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**10.** Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.

**11.** We confirm that we comply with the Financial Reporting Council's Ethical Standard. We have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £13,160 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**12.** This report is addressed to WICS and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**13.** We would like to thank the management and staff for their cooperation and assistance during the audit.

# Part 1

## Audit of 2018/19 annual report and accounts



### Main judgements

**The financial statements of the Water Industry Commission for Scotland (WICS) give a true and fair view and were properly prepared; expenditure and income were in accordance with applicable enactments and guidance.**

**The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements.**

The annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

### Audit opinions on the annual report and accounts

**14.** The annual report and accounts for the year ended 31 March 2019 were approved by the board on 5 September 2019. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income are regular and in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.
- we have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

### Submission of annual report and accounts for audit

**15.** We received the unaudited annual report and accounts on 7 June 2019 in line with our agreed audit timetable.

**16.** The unaudited annual report and accounts provided for audit were complete and of a good standard and finance staff provided good support to the audit team which helped ensure the final accounts audit process ran smoothly.

### Risks of material misstatement

**17.** [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

**18.** We have no issues to report from our work on the risks of material misstatements highlighted in our 2018/19 Annual Audit Plan.

## Materiality

**19.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. When deciding on what is material, we consider both the amount and nature of the misstatement.

**20.** We carried out our initial assessment of materiality for the annual report and accounts during the planning phase of the audit. On receipt of the annual report and accounts we reviewed our materiality calculations and amended them based on the figures contained within the unaudited accounts. These are summarised in [Exhibit 1](#).

## Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£60,000
Performance materiality	£45,000
Reporting threshold	£3,000

## Significant findings from the audit (ISA 260)

**21.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.

### Qualitative aspects of the audit

**22.** We identified two issues to report to those charged with governance. WICS currently lease their office accommodation, with a break point in the lease in 2021. WICS planned to refurbish their existing leased office accommodation and engaged a project management team to help design and deliver the project. However, during the year WICS decided to delay the project to allow them to explore alternative accommodation options, including potential sharing with other public sector organisations. A cancellation fee of £30,000 was incurred as a consequence, relating to the costs incurred by the project management team on work to date. WICS obtained legal advice prior to paying this fee. As part of our audit we considered the nature of the transaction and whether this would require additional disclosures in the financial statements. We are satisfied that the current level of disclosure meets the requirements of the financial reporting manual.

**23.** As part of public sector pension reform in 2015, final salary pension schemes were replaced by Career Average Revalued Earnings (CARE) schemes. Transitional arrangements for individuals nearing retirement age were put in place, protecting some of the benefits received under final salary arrangements. In December 2018, the Court of Appeal (in the McCloud case) ruled that these arrangements with firefighter and judiciary pensions schemes were discriminatory on the basis of age. In June 2019, the government were refused leave to appeal this decision.

**24.** Whilst different protections are in place in the Local Government Pension Scheme, it is anticipated the statutory underpin arrangement will be reviewed. The



potential liability to employers is subject to a range of variables, including the proposed remedy from the government, the membership profile and the maturity of the organisation. Following clarification of the legal position in June 2019, the pension fund scheme actuary has estimated the potential increase in WICS pension liability as £25,000. This has been recognised as a contingent liability within the audited financial statements.

## Misstatements

**25.** Following completion of our audit fieldwork, WICS received a 2018/19 SEPA invoice relating to the European funded Romanian project. This invoice had not been reflected in the accounts presented for audit. Adjustments were made to the financial statements to accrue this expenditure of £70,754. An income accrual of £83,276 was also made to recognise the grant income to fund this invoice and the associated administration charge. The impact of these adjustments was an increase in net surplus of £12,522 with a corresponding increase in the general reserve. There were no other material adjustments to the unaudited annual report and accounts arising from our audit.

## Follow up of prior year recommendations

**26.** We have reported WICS' progress in implementing prior year actions in Appendix 1. They are identified by the prefix b/f (brought forward).

**27.** Two actions were raised in 2017/18. One action relating to the review of the travel and subsistence policy has been fully implemented. However, there has been limited progress in addressing the action around performance management and development of KPIs. A revised response and timescale for this action has been agreed with management and is set out in Appendix 1.



### Recommendation 1

**WICS should continue to develop performance reporting and improve the performance related information included in the annual report and accounts.**

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# Part 2

## Financial sustainability



### Main judgements

**WICS has appropriate financial planning and monitoring arrangements in place.**

**We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by Scottish Ministers.**

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.

### Financial performance in 2018/19

**28.** The main financial objective for the WICS is to ensure that the financial outturn for the year is within the budget approved by the Scottish Government. Total income for the year 2018/19 was £4,292,010 whilst gross expenditure was £4,165,687.

**29.** WICS budgeted for a deficit of £389,592 during the financial year, to be funded by utilising existing cash balances. However, lower than anticipated spending on consultancy costs, remuneration costs and the European funded Romanian project resulted in a net surplus for the year of £130,424 after tax.

### Short term financial planning

**30.** WICS is funded directly by way of a statutory contribution paid by Scottish Water, as directed by Scottish Ministers. Licensing activity is funded by a levy charged to licensed providers. Additional European funding is received in relation to the project with the Romanian Public Services Commission (ANRSC).

**31.** The Commission approved the 2019/20 budget in April 2019 with budgeted income, including funding from Scottish Water and levies on licensed providers, totalling £3,759,503.

**32.** Budgeted expenditure for 2019/20 is £4,249,166, resulting in a budgeted deficit for the year of £489,663. This deficit is to be funded from existing cash balances in accordance with the Corporate Plan 2018-24, which recognises the need to reduce cash balances over the short to medium term.

### Medium to long term financial planning

**33.** We reviewed the financial planning systems and assessed how effective they are in identifying and addressing risks to financial sustainability across the medium and long term.

**34.** During the year 2017/18 WICS re-assessed its high-level medium to long term financial plans. Budget requirements were outlined in the Corporate Plan for the period 2018-24. The Corporate Plan was approved by Scottish Ministers in April 2018.

**35.** Whilst preparing the 2019/20 budget, the finance team conducted a high-level review of expenditure requirements to 31 March 2024. Detailed budget requirements are reviewed every three years for approval by Scottish Ministers.

**36.** WICS have considered the significant level of cash balances held at the year end and have factored this into their medium to long term financial plans in the Corporate Plan 2018-24, where budgeted deficits for future periods are to be funded from the existing cash balance.

**37.** We have concluded that WICS has adequate medium to longer term financial planning arrangements in place.

## Governance

**38.** Our review of the governance statement assessed the assurances which are provided to the Chief Executive as Accountable Officer regarding the adequacy and effectiveness of the Commission's system of internal control which operated in the financial year.

**39.** We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by the Scottish Minister.

**40.** WICS continue to review their governance framework. Progress has been made in 2018/19 with a number of key governance, financial and staff related policies being reviewed and updated. However, a number of key documents still require to be updated, this includes the Rules of Procedure which were last revised in 2014. An update of the review of the governance framework was provided to the Audit and Risk committee in April 2019, and a further presentation was made to the July 2019 committee. Internal Audit's final report on the governance review will be considered at the October 2019 Audit and Risk Committee.

**41.** The nature of WICS business operations, including involvement in the ANRSC project, requires an element of travel for officers, with associated business expenditure. This type of cost is an area of reputational risk, particularly for officers and organisations in the public sector. It is therefore important that an appropriate framework is in place to demonstrate governance and value for money around spending decisions. As part of the governance framework review, WICS adopted a new travel and subsistence policy which came into effect on 1 April 2019. This revised policy enhances existing arrangements by using reference to Scottish Government limits for different categories of expenditure. WICS should ensure that any transactions outwith this framework are subject to appropriate approval, to minimise the reputational risk for individuals and the organisation.



### Recommendation 2

**WICS should complete the review of governance, and agree a future review programme, to ensure that key governance documents are kept up to date.**

**WICS should implement any recommendations made by internal audit in their review of governance arrangements.**

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# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Performance management</b></p> <p>The Financial Reporting Manual (FReM) requires bodies to include a performance analysis within their annual report and accounts, including details of how they measure performance</p> <p>In our 2016/17 and 2017/18 annual audit reports, we noted it was not clear how WICS monitors and reports performance and progress in delivering core functions in the corporate plan. Performance is not reported against KPIs.</p> <p><b>Risk</b> - WICS is not complying with the reporting requirements of the FReM.</p>	<p>WICS should continue to develop performance reporting and improve the performance related information included in the annual report and accounts.</p> <p><a href="#">(refer paragraph 27)</a></p>	<p>The work of the Commission does not lend itself well to being measured against set targets. As part of the annual report and accounts we endeavour to explain our progress against our statutory objectives in as much detail as possible. However, we do understand the importance of setting meaningful KPIs against which we can monitor our performance, in line with the National Performance Framework. Our recent efforts have been focussed on improving and clarifying our governance framework. Once we are satisfied that this is in place, we can turn our attention to defining useful KPIs for inclusion in the 2019/20 annual report.</p> <p>Head of Finance and Governance</p> <p>March 2020</p>
2	<p><b>Review of governance framework</b></p> <p>A number of key governance and financial policies have not been reviewed or updated for a number of years. This includes the Rules of Procedure which were last revised in 2014.</p> <p>Officers have informed us that all policies are being reviewed as part of the ongoing review of the governance framework. Although progress has been made with the review in 2018/19, it has still to be completed.</p>	<p>WICS should complete the review of governance, and agree a future review programme, to ensure that key governance documents are kept up to date.</p> <p>WICS should implement any recommendations made by internal audit in their review of governance arrangements.</p> <p><a href="#">(refer paragraph 41)</a></p>	<p>Following receipt of the Framework Document from the Scottish Government a year ago, we have been updating our full governance framework. We have worked closely with our internal audit team on this work. Internal audit has performed a thorough review of our governance arrangements and the review has taken the views of all relevant stakeholders on board, including Board Members, Audit and Risk Committee Members and Scottish Government. The final review will be used to complete the work on governance</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p><b>Risk</b> - There is a risk that existing policies may not be fit for purpose and do not reflect current guidance or requirements in relevant areas.</p>		<p>arrangements. Running concurrently with this review, has been an overhaul of our financial, security, incident management records management and staff policies. All this work is still on-going, it is expected to be complete by the end of 2019.</p> <p>Head of Finance and Governance</p> <p>December 2019</p>

### Follow up of prior year recommendations

b/f	<p><b>1. Travel allowance</b></p> <p>WICS currently pay all staff a monthly travel allowance of £68.50 (net of tax). Section 2 of the WICS 'Travel subsistence and expenses policy' states 'The Commission will reimburse for all necessary travel expenses, with the exception of those incurred by the employee from home to the employee's usual place of work' There is no reference to the travel allowance in this policy.</p> <p><b>Risk</b> - Travel allowance payments may not comply with the Travel, subsistence and expenses policy.</p>	<p>WICS should review this arrangement to determine whether the award of a flat travel allowance to all staff complies with their Travel, subsistence and expenses policy. If a decision is taken to maintain the policy this should be agreed by the Commission and formalised in the policy.</p>	<p>A new travel and subsistence policy has been put in place which refers to the travel allowance.</p> <p>This issue is now closed.</p>
b/f	<p><b>2. Performance Management</b></p> <p>WICS is required to include performance measurement analysis within its annual report. In our 2016/17 annual audit report, we noted that it was not clear how WICS currently monitors and reports performance and progress against delivering their core functions as established in the corporate plan. There is a risk that WICS may not be able to sufficiently monitor performance and identify areas for improvement.</p>	<p>The Performance Report should be updated in 2017/18 to consider how WICS monitors and reports performance and delivery of its core functions. This could involve consideration of findings of Internal Audit's review of business performance management.</p>	<p>WICS should work to improve progress in this area.</p> <p><b>(Refer to Recommendation 1 in <a href="#">Appendix 1</a>)</b></p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>We did not identify any issues relating to management override of controls from our audit testing of journal entries, accounting estimates, accruals and prepayments.</p>
<p><b>2 Risk of fraud over income</b></p> <p>WICS receives the majority of its funding from two sources. These are the statutory contributions from Scottish Water and the levies charged to licensed providers. However, in accordance with ISA 240, the extent of income means there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>We did not identify any issues relating to fraud over income from our analysis of income streams and audit testing of revenue.</p>
<p><b>3 Risk of fraud over expenditure</b></p> <p>The revised version of Practice Note 10, Audit of Public Sector Bodies in the UK, states that there is a risk that misstatements may arise from fraudulent financial reporting where the audited body may manipulate its results to meet externally set targets. Therefore, there is a risk of material misstatement due to fraud related to expenditure.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>We did not identify any issues relating to fraud over expenditure from our analysis of expenditure and audit testing of revenue including accruals and prepayments.</p>
<p><b>4 New financial system</b></p> <p>WICS introduced a new integrated financial system which includes the general ledger and income and expenditure modules. The system was</p>	<p>Review of internal audit work on the implementation of the new financial system.</p> <p>Documentation and assessment of key controls</p>	<p>We reviewed internal audit's work on the implementation of the new financial system.</p> <p>We also carried out a high-level walkthrough of the key</p>

Audit risk	Assurance procedure	Results and conclusions
<p>implemented midway through the 2018/19 financial year.</p> <p>This system contains the information which is used to prepare the financial statements.</p> <p>There is a risk that information has not been migrated correctly to the new ledger system and this could lead to errors in financial reporting.</p>	<p>and processes in the new financial system.</p>	<p>controls operating within the new financial system.</p> <p>We did not identify any issues.</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

<p><b>5 Performance management</b></p> <p>WICS is required to include information on how performance is measured within its annual report.</p> <p>In our 2016/17 and 2017/18 annual audit reports, we noted it was not clear how WICS monitors and reports performance and progress in delivering core functions in the corporate plan.</p> <p>There is a risk that the performance report within the 2018/19 annual report may not fully comply with the FReM requirements.</p>	<p>The Commission is developing formal KPIs as part of the review of the overall governance framework. These will be agreed by the Board in due course and KPIs could be in place for the financial year beginning 1 April 2019.</p>	<p>WICS are still working to develop performance indicators as part of the overall review of its governance framework which is in progress.</p> <p><b>(Refer to Recommendation 1 in <a href="#">Appendix 1</a>)</b></p>
<p><b>6 Review of governance framework</b></p> <p>A number of key governance and financial policies have not been reviewed or updated for a number of years. These include the rules of procedure, travel, subsistence and expenses policy and the staff handbook.</p> <p>Officers have informed us that all policies are being reviewed as part of the ongoing review of the governance framework. However, this review is still to be completed.</p> <p>There is a risk that existing policies may not be fit for purpose and do not reflect current guidance or requirements in relevant areas.</p>	<p>Monitor progress of the governance framework review.</p>	<p>WICS are still working to complete the review of the governance framework. A number of policies were updated in 2018/19, however a number of key governance, financial and staff related policies require to be updated and approved by the board.</p> <p><b>(Refer to Recommendation 2 in <a href="#">Appendix 1</a>)</b></p>

# Appendix 3

## Summary of national performance reports 2018/19

### 2018/19 Reports

Local government in Scotland: Challenges and performance 2018		<b>Apr</b>	
Councils' use of arm's-length organisations		<b>May</b>	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		<b>Jun</b>	
		<b>Jul</b>	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		<b>Aug</b>	 Major project and procurement lessons
Children and young people's mental health		<b>Sept</b>	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		<b>Oct</b>	
Health and social care integration: update on progress		<b>Nov</b>	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		<b>Mar</b>	 Local government in Scotland: Challenges and performance 2019



# Water Industry Commission for Scotland

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