

Water Industry Commission for Scotland

Annual Audit Plan 2023/24



 AUDIT SCOTLAND

Prepared for the Water Industry Commission for Scotland

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2023/24 external audit of the Water Industry Commission for Scotland (the Commission). The main elements of our work include:

- an audit of the 2023/24 annual report and accounts to support our opinions on the financial statements
- an audit of regularity and other statutory information published within the 2023/24 annual report and accounts, including the Performance Report, Governance Statement, and the audited part of the Remuneration and Staff Report
- consideration of arrangements in relation to the wider scope of public sector audit: financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes
- consideration of Best Value arrangements
- follow-up of the issues reported within the Auditor General for Scotland's Section 22 Report on the 2022/23 audit of the Water Industry Commission for Scotland.

Adding value

2. We aim to add value to the Commission through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. We also attend meetings of the Audit and Risk Committee and actively participate in discussions relevant to the audit. In so doing we intend to help the Commission promote improved standards of governance, better management and decision making and more effective use of resources.

Respective responsibilities of the auditor and the Commission

3. The [Code of Audit Practice](#) sets out in detail the respective responsibilities of the auditor and the Commission. Key responsibilities are summarised below.

Auditor responsibilities

4. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

5. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and accounts. We also review and report on the wider scope arrangements in place at the Commission. In doing this, we aim to support improvement and accountability.

The Commission's responsibilities

6. The Commission is responsible for maintaining adequate accounting records and internal controls, and preparing financial statements for audit that give a true and fair view. It must prepare other reports in the annual report and accounts in accordance with applicable requirements.

7. The Commission also has responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation, and establishing effective arrangements for governance, propriety, and regularity that enable them to deliver their objectives.

8. The audit of the annual report and accounts does not relieve management or the Audit and Risk Committee, as those charged with governance, of their responsibilities.

Communication of fraud or suspected fraud

9. In line with ISA 240, in presenting this plan to the Commission we seek confirmation from those charged with governance of any instances of actual, suspected or alleged fraud that should be brought to our attention. Should members of the Audit and Risk Committee have any such knowledge or concerns relating to the risk of fraud within the Commission, we invite them to communicate this to the appointed auditor for consideration. Similar assurances will be sought as part of the audit completion process.

Annual report and accounts

10. The annual report and accounts are an essential part of demonstrating the Commission's stewardship of resources and its performance in the use of those resources.

11. We perform an audit of the financial statements, consider other information within the annual report and accounts, and express a number of audit opinions in an Independent Auditor's Report in accordance with International Standards on Auditing (ISAs) in the UK, Practice Note 10 from the Public Audit Forum which interprets the ISAs for the public sector, and guidance from Audit Scotland.

12. We focus our work on the areas of highest risk. As part of our planning process, we perform a risk assessment highlighting the audit risks relating to each of the main financial systems relevant to the production of the financial statements.

Materiality

13. The concept of materiality is applied by auditors in planning and performing the audit, and in evaluating the effect of any uncorrected misstatements on the financial statements. We plan our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

Materiality levels for the 2023/24 audit

14. We assess materiality at different levels as described in [Exhibit 1](#) on page [6](#) which sets out the materiality values for the 2023/24 audit of the Commission.

Exhibit 1

Materiality levels for the 2023/24 audit

Materiality	Amount
<p>Planning materiality: This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements and is set based on our assessment of the needs of the users of the financial statements and the nature of the Commission's operations. Due to the issues identified during our financial statements audit last year, the overall materiality level has been set at 1 per cent of gross expenditure based on the audited 2022/23 financial statements. This is lower than the 2 per cent level set in the prior year.</p>	£40,000
<p>Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this could indicate that further audit procedures are required. Using our professional judgement, we have assessed performance materiality at 50 per cent of planning materiality. This reflects our planned level of testing for the 2023/24 audit.</p>	£20,000
<p>Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.</p>	£2,000

Source: Audit Scotland

Risks of material misstatement to the financial statements

15. Our risk assessment draws on our cumulative knowledge of the Commission, its major transaction streams, key systems of internal control, and risk management processes. It is also informed by our discussions with management, meetings with internal audit, attendance at committees, and review of other relevant information.

16. Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management, and where relevant, report them to those charged with governance.

17. Based on our risk assessment process, we identify significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. We also identify any other non-significant risks of material misstatement that require a specific audit response over and above our standard audit procedures. [Exhibit 2](#) on page 7 summarises the nature of the risks, the sources of assurance from management arrangements, and the further audit procedures we plan to perform to gain assurance over these risks.

Exhibit 2**Significant and non-significant risks of material misstatement for the 2023/24 financial statements**

Nature of risk	Management's sources of assurance	Planned audit response
Significant risks of material misstatement		
<p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in ISA (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<ul style="list-style-type: none"> • Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluation of significant transactions outside the normal course of business.
Other non-significant risks of material misstatement		
<p>2. Risk of fraud in expenditure</p> <p>Practice Note 10 extends the requirements of ISA 240 to include consideration of fraud in expenditure for public bodies.</p> <p>Due to the extent of the expenditure issues identified as part of our 2022/23 audit, we believe there is an increased risk that expenditure could be misstated in the 2023/24 financial statements. There is also a risk that expenditure has not been incurred in accordance with applicable enactments and guidance</p>	<p>Management has taken a range of actions to address the expenditure issues reported from the 2022/23 audit, including:</p> <ul style="list-style-type: none"> • Reviewing and revising the Commission's financial policies and guidelines. • Reinstating an approval panel to ensure that all potential expenditure that requires approval or is novel or contentious has unanimous agreement by a quorum of Directors. 	<ul style="list-style-type: none"> • Substantive testing of expenditure transactions across the full financial year. • Focussed testing of travel and subsistence expenditure. • Targeted substantive testing of expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Substantive testing of accruals and prepayments. • We will review the results of the above testing alongside the findings from the Commission's internal review of transactions for the first 9 months of the financial year 2023/24 to establish the need for any further expenditure testing. This

Nature of risk	Management's sources of assurance	Planned audit response
issued by the Scottish Ministers.	<ul style="list-style-type: none"> • Revising approval form templates and staff guidance. • Training of all staff on the Commission's financial rules and expectations, including expenses policies and procedures. • Strengthening the Commission's expenses policy and the records maintained for all such expenditure. • Enhancing compliance and enforcement of expenses policy. • A review of financial transactions for the first 9 months of the financial year 2023/24 to identify areas of non-compliance. 	will include consideration of the regularity of expenditure incurred by the Commission during the year.

Source: Audit Scotland

Consideration of the risk of fraud over the recognition of income and the risk of fraud in expenditure

18. As set out in *International Standard on Auditing (UK) 240: The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. We have considered the risk over income recognition and the risk of fraud in expenditure (in accordance with Practice Note 10 (Audit of Financial Statements and Regularity in Public Sector Bodies in the UK)).

19. We have rebutted the presumed risk of fraud over the recognition of income for the Commission as the majority of its income is through Scottish Water statutory contributions and licence holder levies which are agreed in advance by Scottish Government, which limits the opportunity for manipulation. The other key income stream for the Commission is Hydro Nation income which is largely determined by the various contract arrangements agreed with the overseas water authorities and other agencies, again limiting the potential for manipulation of misstatement.

20. We have not, therefore, incorporated specific work into our audit plan in this area over and above our standard audit procedures. Our audit testing will maintain an oversight of any unusual income transactions or accounting entries.

21. In 2022/23 we also rebutted the risk of fraud in expenditure as many of the Commission's expenditure transaction streams should be low risk, for example staff costs, with limited opportunity to manipulate the way expenditure is recognised. However, due to the extent of the expenditure issues identified as part of our 2022/23 audit, we have been unable to rebut this risk this year as we believe there is an increased risk that expenditure could be misstated in the 2023/24 financial statements. Audit procedures have therefore been designed to address this risk as detailed at risk 2 in [Exhibit 2](#).

Regularity

22. Auditors are required by the Public Finance and Accountability (Scotland) Act 2000 to report on whether expenditure and income were incurred or applied, in all material respects, in accordance with applicable enactments and guidance issued by the Scottish Ministers (generally referred to as the regularity opinion).

23. We will adopt an integrated audit approach to meeting this responsibility and use work on the audit of the financial statements supplemented by additional testing for any irregular transactions, where necessary.

Financial settlement paid to former Chief Executive

24. The former Chief Executive and Accountable Officer tendered his resignation with effect from 31 December 2023. As part of the terms of his departure he received a financial settlement from the Commission. As part of our 2023/24 audit we will review this payment to ensure the regularity of this expenditure.

Audit of Performance Report, Governance Statement, and audited part of the Remuneration and Staff Report

25. In addition to the appointed auditor's opinion of the financial statements, the Auditor General for Scotland prescribes that the appointed auditor should provide opinions as to whether the Performance Report, Governance Statement, and the audited part of the Remuneration and Staff Report, have been compiled in accordance with the appropriate regulations and frameworks and are consistent with the financial statements.

26. To inform these opinions we will consider whether the disclosures within each statement comply with the requirements of the applicable guidance, and confirm that relevant information reflects the contents of the financial statements and other supporting documentation.

27. Based on our knowledge of the audit, and the established procedures in place to produce these statements, we have identified a risk in relation to the arrangements in place to produce the Governance Statement. The Scottish Public Finance Manual requires that the preparation of the Governance Statement should be informed by assurances from senior staff through a certificate of assurance from each Director. These were not completed by Commission staff last year and there was no formal process for the Accountable

Officer to obtain assurances from the senior management team to inform the disclosures within the Governance Statement.

28. As part of our 2023/24 audit we will review the assurance arrangements in place to inform the disclosures within the Governance Statement, and consider the accuracy and completeness of these based on our knowledge of the Commission.

Wider Scope and Best Value

29. Reflecting the fact that public money is involved, public audit is planned and undertaken from a wider perspective than in the private sector. The [Code of Audit Practice](#) sets out the four areas that frame the wider scope of public sector audit, and requires auditors to consider and conclude on the effectiveness and appropriateness of the arrangements in place for each wider scope area in audited bodies.

30. In summary, the four wider scope areas are:

- **Financial management** – this means having sound budgetary processes. We will consider the 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.
- **Financial sustainability** – we will look ahead to consider whether the body is planning effectively to continue to deliver services and comment on financial sustainability in the medium (two to five years) to longer term (longer than five years) in our Annual Audit Report.
- **Vision, leadership, and governance** – we conclude on the clarity of plans in place to deliver the vision, strategy, and priorities adopted by the Commission. We also consider the effectiveness of the governance arrangements to support delivery.
- **Use of resources to improve outcomes** – we will consider how the Commission demonstrates economy, efficiency, and effectiveness through the use of financial and other resources.

Wider scope risks

31. Our planned work on our wider scope responsibilities is risk based and proportionate. We have identified three areas for specific focus as part of the 2023/24 audit of the Commission.

Strategic leadership and culture of the organisation

32. The Auditor General for Scotland issued a [Section 22 Report on the 2022/23 audit of the Water Industry Commission for Scotland](#) in December 2023. This highlighted that: *“The financial management and governance issues found at the Commission fall far short of what is expected of a public body. Immediate action is required to address the issues and promote a culture of Best Value across the organisation.”*

33. Following the publication of the Section 22 Report, the former Chief Executive and Accountable Officer tendered his resignation with effect from 31 December 2023. From January 2024 the Commission operated without a Chief

Executive or Accountable Officer until the Director of Strategy and Governance was appointed interim Chief Executive and Accountable Officer on 20 March 2024. He is now tasked with providing strategic leadership for the Commission and promoting a culture of Best Value across the organisation until a permanent appointment is made.

34. As part of our 2023/24 audit we will consider the strategic direction of the organisation and the progress made in tackling the cultural issues reported by the Auditor General for Scotland in 2022/23. We will report our conclusions from this work in our 2023/24 Annual Audit Report.

Effectiveness of the Board and the Audit and Risk Committee

35. The issues identified as part of our 2022/23 audit highlighted a lack of oversight and scrutiny by the Board, and the Audit and Risk Committee (ARC), of the wider activity of the Commission and the related expenditure. A key factor contributing to this was a lack of appropriate information being shared with the Board and the ARC by officers, and a lack of transparency over the operations of the Commission.

36. As part of our 2023/24 audit we will monitor the completeness and transparency of reporting to the Board and ARC, and assess the levels of scrutiny and challenge of officers by non-executive members.

Finance capacity

37. The Commission agreed a workplan with the Scottish Government in December 2023 to respond to the issues reported in our 2022/23 Annual Audit Report and highlighted in the Auditor General for Scotland's Section 22 report.

38. The short-term actions required to address the financial management issues reported from the 2022/23 audit were taken between January and March 2024 and have placed a significant additional burden on the finance team. We would expect these demands to reduce as the new financial management arrangements bed in and officers across the Commission take responsibility for ensuring compliance with the revised financial policies and guidelines. However, we will continue to monitor the demands on the finance team during the course of the audit and report our conclusions on the finance capacity of the organisation within our 2023/24 Annual Audit Report.

Duty of Best Value

39. [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that Accountable Officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will consider whether such arrangements are in place within the Commission.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

40. Audit reporting is the visible output for the annual audit. This Annual Audit Plan, the other outputs detailed in [Exhibit 3](#), and any other outputs on matters of public interest will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

41. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft reports will be shared with the relevant officers to confirm factual accuracy, prior to the issue and publication of the final reports.

42. We will provide an independent auditor's report (audit certificate) to the Commission, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual report and accounts. We will also provide the Commission and the Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

43. [Exhibit 3](#) outlines the target dates for our audit outputs and reflects our aim to issue the independent auditor's report by 21 November 2024.

Exhibit 3 2023/24 Audit outputs

Audit Output	Target date	Audit and Risk Committee Date
Annual Audit Plan	31 March 2024	28 May 2024
Independent Auditor's Report	5 November 2024	12 November 2024
Annual Audit Report	5 November 2024	12 November 2024 (Board meeting on 21 November)



Source: Audit Scotland

Timetable

44. To support an efficient audit, it is critical that a timetable is agreed with management for the production and audit of the annual report and accounts. A proposed timetable for the audit that reflects our discussions with management is included at [Exhibit 4](#).

Exhibit 4

Proposed annual report and accounts timetable

 Key stage	 Provisional Date
Latest submission date of the unaudited annual report and accounts with complete working papers package	30 August 2024
Latest date for final clearance meeting with Accountable Officer and Head of Finance	29 October 2024
Agreement of audited annual report and accounts for consideration by the Audit and Risk Committee	5 November 2024
Issue of Proposed Annual Audit Report to those charged with governance (along with template letter of representation and proposed independent auditor's report)	5 November 2024
Audit and Risk Committee meeting to consider proposed Annual Audit Report and audited annual report and accounts	12 November 2024
Board meeting to approve and sign audited annual report and accounts	21 November 2024
Independent auditor's report certified by appointed auditor and Annual Audit Report finalised and issued	21 November 2024

Source: Audit Scotland

Audit fee

45. As advised in our [2022/23 Annual Audit Report](#), due to the extent of the issues we identified during the year, both in terms of the financial statements and wider audit issues, we had to use additional resources to deliver the 2022/23 audit. We have taken account of this when setting the fee for the 2023/24 audit and also considered the additional work required by the local audit team to follow-up on the issues reported in the Section 22 report. Based on this we have set a fee of £22,460 for the 2023/24 audit of the Commission as shown in [Exhibit 5](#) on page [15](#). The Commission will receive a fee rebate of £111 in respect of unspent 2022/23 travel budgets. This can be offset against the 2023/24 audit fee meaning the net charge to the Commission for the year will be £22,349.

46. In setting the fee, we have assumed that the Commission will prepare a comprehensive and accurate set of annual report and accounts for audit in line with the agreed timetable. The audit fee also reflects our assumption that there will be no major change in respect of the scope of the audit during the year. Where our audit cannot proceed as planned a supplementary fee may be levied.

Exhibit 5
2023/24 audit fee

	Fees (£)	
	2022/23	2023/24
Audit fee	18,200	22,460
Fee rebate in respect of unspent 2022/23 travel budgets	0	-111
Net charge to the Commission for the year	18,200	22,349

Source: Audit Scotland

Other matters

Internal audit

47. It is the responsibility of the Commission to establish adequate internal audit arrangements. The Commission's internal audit function is provided by Grant Thornton.

48. While we are not planning to place formal reliance on the work of internal audit in 2023/24, we will review internal audit reports and assess the impact of the findings on our financial statements and wider scope audit responsibilities.

Independence and objectivity

49. Auditors appointed by the Auditor General for Scotland or Accounts Commission must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors.

50. Audit Scotland has robust arrangements in place to ensure compliance with Ethical Standards including an annual *'fit and proper'* declaration for all members of staff. The arrangements are overseen by the Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

51. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. The appointed auditor for the audit of the Water Industry Commission for Scotland is Richard Smith, Senior Audit Manager. We are not aware of any such relationships pertaining to the audit of the Commission.

Audit Quality

52. Audit Scotland is committed to the consistent delivery of high-quality public audit. Audit quality requires ongoing attention and improvement to keep pace with external and internal changes. A document explaining the arrangements for providing assurance on the delivery of high-quality audits is available from the [Audit Scotland website](#).

53. The International Standards on Quality Management (ISQM) applicable to Audit Scotland for 2023/24 audits are:

- ISQM (UK) 1 which deals with an audit organisation's responsibilities to design, implement and operate a system of quality management (SoQM) for audits. Our SoQM consists of a variety of components, such as: our governance arrangements and culture to support audit quality, compliance with ethical requirements, ensuring we are dedicated to

high-quality audit through our engagement performance and resourcing arrangements, and ensuring we have robust quality monitoring arrangements in place. Audit Scotland carries out an annual evaluation of our SoQM and has concluded that we comply with this standard.

- ISQM (UK) 2 which sets out arrangements for conducting engagement quality reviews, which are performed by senior management not involved in the audit to review significant judgements and conclusions reached by the audit team, and the appropriateness of proposed audit opinions of high-risk audit engagements.

54. To monitor quality at an individual audit level, Audit Scotland also carries out internal quality reviews of a sample of audits. Additionally, the Institute of Chartered Accountants of England and Wales (ICAEW) carries out independent quality reviews.

55. Actions to address deficiencies identified by internal and external quality reviews are included in a rolling Quality Improvement Action Plan which is used to support continuous improvement. Progress with implementing planned actions is regularly monitored by Audit Scotland's Quality and Ethics Committee.

56. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the appointed auditor.

Water Industry Commission for Scotland

Annual Audit Plan 2023/24

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

www.audit-scotland.gov.uk/accessibility

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