

# Water Industry Commission for Scotland

2017/18 Annual Audit Report



 AUDIT SCOTLAND

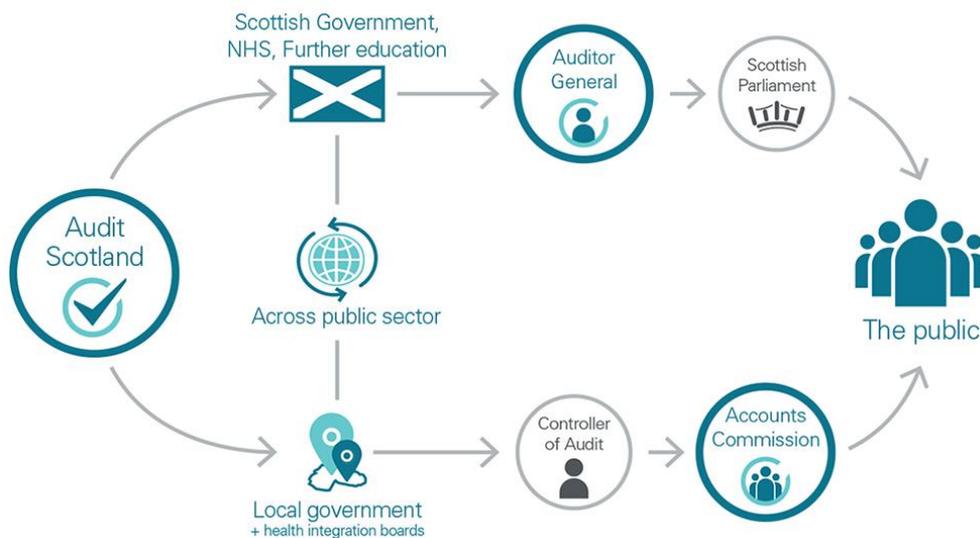
Prepared for the Water Industry Commission for Scotland and the Auditor General for Scotland

18 September 2018

## 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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## 2017/18 annual report and accounts

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

## Financial sustainability and governance statement

- 3** We concluded that adequate financial planning arrangements are in place. However WICS should continue to monitor delivery of financial plans to ensure that retained cash balances are drawn down and demonstrate compliance with the Financial Memorandum requirements.
- 4** We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by the Scottish Ministers.

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# Introduction

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**1.** This report summarises the findings from our 2017/18 audit of the Water Industry Commission for Scotland.

**2.** The scope of our audit was set out in our Annual Audit Plan presented to the Audit & Risk Committee on 17 April 2018. This report comprises the findings from:

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

**3.** Our standard audits are based on four audit dimensions that frame the wider scope of public sector audit requirements. These are:

- financial sustainability
- financial management
- governance and transparency
- value for money.

**4.** 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.

**5.** As highlighted in our 2017/18 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 2017/18 audit of the WICS.

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

**7.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and guided by the auditing profession's ethical guidance.

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

**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 2017/18 audit fee of £12,910, as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

### **Adding value through the audit**

**12.** Our aim is to add value to WICS by providing insight and foresight on financial sustainability and by identifying areas of improvement and recommending / encouraging good practice. In so doing, we aim to help the WICS promote improved standards of financial planning, better management and decision making.

**13.** 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.

**14.** We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

**15.** Audit Scotland has published a number of national performance reports during the year 2017/18. A summary of these reports has been detailed at [Appendix 3](#).

# Part 1

## Audit of 2017/18 annual report and accounts



### Main judgements

**In our opinion WICS's financial statements give a true and fair view and were properly prepared; expenditure and income was in accordance with applicable enactments and guidance.**

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

### Audit opinions on the annual report and accounts

**16.** The annual report and accounts for the year ended 31 March 2018 were approved by WICS on 24 August 2018. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income
- 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 accounts direction
- we have nothing to report in respect of those matters which we are required by the Auditor General to report by exception.

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.

### Submission of annual report and accounts for audit

**17.** We received the unaudited annual report and accounts on 1 June 2018 in line with our agreed audit timetable.

**18.** 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

**19.** [Appendix 2](#) provides a description of areas we assessed as being at risk of material misstatement at the planning stage, how we addressed them and our conclusions thereon. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and how the efforts of the audit team were directed.

### Materiality

**20.** 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.

**21.** 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 and revised our planning materiality calculations, these are summarised in [Exhibit 1](#).

## Exhibit 1

### Materiality values

Materiality level	Amount
Overall materiality	£34,000
Performance materiality	£25,500
Reporting threshold	£2,000

Source: 2017/18 WICS Unaudited financial statements

### How we evaluate misstatements

**22.** Three misstatements which exceeded our reporting threshold were identified during the course of the audit. The total amount of these errors was £56,960. Two of these errors have been adjusted in the audited financial statements with management proposing not to adjust the remaining error.

**23.** WICS is required to include a holiday pay accrual in the financial statements. This accrual represents the amount owed by WICS for untaken staff leave at the year end. This liability, amounting to £10,339, was not reflected in the financial statements presented for audit.

**24.** The second error related to a credit card invoice amounting to £18,621 which was paid in April 2018. The invoice related to expenditure incurred prior to 31 March 2018, however no accrual of spend had been included in the financial statements presented for audit.

**25.** Officers made the necessary amendments to the financial statements to amend the two errors detailed above. As a result of these changes, the net surplus for the year disclosed in the Statement of Comprehensive Net Expenditure reduced by £28,960 to £141,112. Total liabilities shown in the Statement of Financial Position increased by £28,960, resulting in net assets decreasing to £1,142,605.

**26.** One error was identified which has not been adjusted by officers. Bodies who are members of a Local Government Pension Scheme are required to reflect their share of pensions assets and liabilities within their financial statements, based on estimates provided by the actuary. Due to the timing of the actuarial reports, actuaries produce their IAS19 reports using estimated data for the final part of the year. In many cases, estimated cash flows affect both asset and liability values. However, estimated returns on investment assets only impact on the employer assets.

**27.** WICS is a member of the Falkirk Pension Fund. The IAS 19 report provided by the actuary in April 2018 estimated WICS share of pension fund assets at 31 March 2018 as £6.397 million. The actuary subsequently provided the Fund with a more up to date asset valuation as at 31 March 2018. WICS obtained a revised report from the actuary which showed that WICS share of pension fund assets had increased to £6.425 million. This represents an increase of approximately £28,000 from the original estimate, however management do not propose to adjust for the item. This error is above our reporting threshold, however it does not exceed our materiality level.

**28.** If the error had been adjusted, this would have resulted in the net pension liability in the Statement of Financial Position decreasing by £28,000 from £812,000 to £784,000, with a matching increase in the general reserve.

### Significant findings from the audit (ISA 260)

**29.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance.

**30.** The findings include our views about significant qualitative aspects of the board's accounting practices including: significant financial statements disclosures, the impact of any uncertainties, misstatements in the annual report and accounts, accounting estimates and judgements and the effect of any unusual transactions on the financial statements.

**31.** In our view, there are no significant findings to be communicated to those charged with governance, in accordance with ISA260.

### Follow up of prior year recommendations

**32.** We have followed up actions previously reported and assessed progress with implementation, these are reported in [Appendix 1](#) and identified by the prefix b/f (brought forward).

**33.** In total, 2 recommendations and agreed actions were raised in 2016/17. These have been detailed below:

**34. *Travel allowance*** - 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. We noted that there was a risk that travel allowance payments may not comply with the Travel, subsistence and expenses policy.

**35.** WICS agreed to review the financial procedures and travel policies by the end of 2017. Officers have informed us that this review has not yet been completed and is ongoing.

**36. *Performance Management*** - The WICS Performance Report is required to include analysis on how they measure performance. It is not currently clear how WICS monitors and reports performance and progress against delivering WICS's core functions as established in the Corporate Plan.

**37.** WICS agreed to consider the appropriate measures upon which to measure the performance of the organisation. Once agreed these can be reported on as part of the Performance Report of the financial statements. Officers have informed us that WICS is developing performance management indicators as part of an overall review of its governance framework which is in progress. As part of the Strategic Review of Charges, WICS has made progress in developing key performance indicators for the monitoring and reporting, on the revised economic framework for economic regulation.

**38.** WICS have not yet completed the agreed actions detailed in our 2016/17 Annual Audit Report. Revised responses and timescales have been agreed with management in [Appendix 1](#).

# Part 2

## Financial sustainability and governance statement



### Main judgements

**We concluded that adequate financial planning arrangements are in place. However, WICS should continue to monitor delivery of financial plans to ensure that retained cash balances are drawn down and demonstrate compliance with the Financial Memorandum requirements.**

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

### Financial performance in 2017/18

**39.** The main financial objective for 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 2017/18 was £3,570,148 whilst gross expenditure was £3,429,371.

**40.** WICS budgeted for a deficit of £520,010 during the financial year to be funded by utilising existing cash balances. However a lower than expected consultancy usage (Regulation and licencing costs) and changes to the timing of work being carried out resulted in a net operating surplus of £141,112.

### Short term financial planning

**41.** 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.

**42.** The Commission approved the 2018/19 budget in February 2018 with funding from Scottish Water and licensed providers of £3,668,000. Additional income from Hydro Nation of £1,071,000 is also budgeted for 2018/19 to give a total budget of £4,739,000.

**43.** Total expenditure for 2018/19 (including Hydro Nation) is £5,291,000 resulting in a budgeted deficit for the year of £552,000. This deficit is to be funded from existing cash balances.

**44.** Hymans Robertson was commissioned to carry out a full actuarial valuation of the Falkirk Pension Fund as at 31 March 2017. Formal actuarial valuations are carried out every three years; this is where each employer's assets and liabilities are calculated on a detailed basis, using individual member data. A roll forward valuation from the 2017 formal valuation was carried out for the valuation at 31<sup>st</sup> March 2018. As a result of the valuation the net pension liability as accounted for on WICS's Statement of Financial Position decreased by £837,000 from the prior year.

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.

## Medium to long term financial planning

**45.** 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.

**46.** 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.

**47.** WICS's Rules of Procedure include a Financial Memorandum which requires the organisation to avoid building up cash balances or net assets in excess of what is required for operational purposes. WICS planned for a deficit of £520,010 in 2017/18 however they underspent by £651,000 against budget. At 31 March 2018, WICS held cash balances of £2,421,458, including £423,000 of income from a European Funded project that officially began in April 2018. Cash balances at 31st March 2018 represent 70% of WICS's gross annual expenditure.

**48.** Following the triennial valuation of Falkirk Pension Fund at 31 March 2017, the employer pension contribution rate for WICS increased from 19.1% to 28.3% from 1 April 2018 onwards. This is forecasted to increase annual staff costs by over £100,000 per year. The budget outlined in the 2018-2024 Corporate Plan includes an increase in levy to cover these costs.

**49.** WICS have budgeted to increase the Scottish Water levy and the Licensed Provider's levy by 3% in the first year (2018-19) followed by 2.5% each year for the remainder of the regulatory period.

**50.** WICS have considered the significant level of cash balances 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. The Corporate Plan 2018-24 details budgeted deficits for each of the next 6 years which details the utilisation of the cash balance.

**51.** We have concluded that WICS has adequate medium term financial planning arrangements in place. However they should continue to monitor delivery of financial plans to ensure retained cash balances are drawn down and demonstrate compliance with the Financial Memorandum requirements.

## Governance statement

**52.** 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.

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

## Other matters

**54.** WICS continue to work with their Sponsor team and partner bodies to assess the impact of EU withdrawal. Although WICS are involved European project work for which funding could be potentially affected, this is not within the core remit of the Commission. Therefore no direct impact is anticipated at this stage.

**55.** During the year WICS have made significant progress in preparation towards compliance for the introduction of the General Data Protection Regulation (GDPR) which was introduced in the UK on 25 May 2018. This included carrying out staff training and an information audit.

**56.** WICS have also achieved Cyber Essentials Plus accreditation following a pre assessment and independent audit. This provided assurance that WICS's systems meet the required security standards.

# Appendix 1

## Action plan 2017/18

### Recommendations for improvement



No.	Issue/risk	Recommendation	Agreed management action/timing
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### 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></p> <p>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><b>Updated response</b></p> <p>We are in the process of reviewing our travel, subsistence and expenses policy and this will be considered as part of that work.</p> <p><b>Revised action</b></p> <p>New travel, subsistence and expense policy to be issued to staff.</p> <p><b>Responsible officer</b></p> <p>Head of Finance, Governance and Risk</p> <p><b>Revised date</b></p> <p>31 December 2018</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 be 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><b>Updated response</b></p> <p>During 2017-18, the Commission has been developing and reporting against KPIs relating to the Strategic Review of Charges. In addition, we have been developing performance management indicators as part of an overall review of our formal governance arrangements. We hope for these to be agreed by the end of 2018-19.</p> <p><b>Revised action</b></p>



No.	Issue/risk	Recommendation	Agreed management action/timing
			Develop KPIs to monitor the Commission's performance.
			<b>Responsible officer</b>
			Chief Executive
			<b>Revised date</b>
			31 March 2019

# 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 in order 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 control 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 income 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 Financial Statements 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 expenditure.</p> <p>Detailed testing of expenditure 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>

Audit risk	Assurance procedure	Results and conclusions
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p><b>4 Financial sustainability</b></p> <p>WICS is a member of the Falkirk Council Local Government Pension Scheme (LGPS). Following the triennial valuation of the scheme, indications are that the employer pension contributions will increase from 19.1% to 28.3% from 1 April 2018.</p> <p>Management estimate these additional contributions will equate to over £100,000 per annum.</p> <p>WICS may be able to fund the additional contributions from existing cash balances in the short term. However there is a risk that this is not sustainable in the longer term.</p>	<p>Review of financial monitoring reports and WICS' year-end financial position.</p>	<p>WICS has prepared a revised Corporate Plan for the 6-year period 2018-24. Annual budgets have been included for the 6 year period which includes the plan to increase levy to cover the increase in pension costs.</p> <p>We are satisfied that the increase in pension costs have been included in future financial plans.</p>
<p><b>5 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 be may not be able to sufficiently monitor performance and identify areas for improvement.</p>	<p>Consideration of the performance information included within the performance report in the 2017/18 financial statements.</p>	<p>Officers have informed us that WICS is developing performance management indicators as part of an overall review of its governance framework which is in progress. As part of the Strategic Review of Charges, WICS has made progress in developing key performance indicators for the monitoring, and reporting, on the revised economic framework for economic regulation.</p> <p>We will continue to monitor progress in this area and report as necessary.</p>

# Appendix 3

## Summary of national performance reports 2017/18



		Apr	
		May	
Common Agricultural Policy Futures programme: further update		Jun	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		Aug	
Equal pay in Scottish councils		Sept	
Transport Scotland's ferry services		Oct	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov	
		Dec	
		Jan	
Early learning and childcare		Feb	
Managing the implementation of the Scotland Acts		Mar	

# Water Industry Commission for Scotland

## 2017/18 Annual Audit Report

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