

Water Industry Commission for Scotland

Report on the 2009/10 Audit to the Commission and the Auditor
General for Scotland

October 2010



 AUDIT SCOTLAND

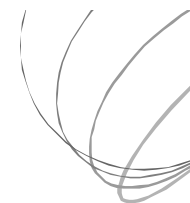


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Key messages

In 2009/10 we looked at the key strategic and financial risks being faced by the Water Industry Commission for Scotland (“the Commission”). We audited the financial statements and we also reviewed the use of resources and aspects of governance and performance management. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of the Commission for 2009/10. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Financial position and use of resources

The Commission net surplus for the year was £0.167 million (2008/09: £0.95 million). Income was £4.963 million (2008/09: £5.169 million), while expenditure was £4.797 million (2008/09: £4.243 million).

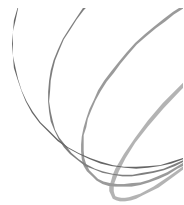
The net assets, excluding pension assets and liabilities, increased by £0.128 million from £1.218 million as at 31 March 2009 to £1.346 million as at 31 March 2010. The net position on pension assets resulted in an increase in the liability by £0.894 million from a break even position in the previous year.

Scotland’s economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight. It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes

Scottish Ministers have agreed a budget for the Commission of £3.96 million for 2010/11, a 6.5% decrease in budget. The Commission will face challenges to meet this reduced budget while absorbing cost pressures.

Governance and accountability

Corporate Governance is concerned with the structures and processes for decision making, accountability, control and behaviour at the upper levels of an organisation. As part of the 2009/10 audit we carried out an overview of the Commission’s corporate governance arrangements, including their management of reputational risk, with satisfactory results. Overall the corporate governance and control arrangements for the Commission operated appropriately during the year, as reflected in the Statement on Internal Control.



Performance

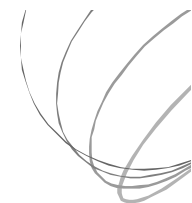
The Commission's Corporate Plan 2006-10 set out 3 broad areas of work in the current regulatory control period, each supported by a set of objectives and targets or milestones. The Commission has met the key milestones relevant to 2009/10, including publishing the final determination for the next control period (2010-2015) in November 2009.

Looking forward

The final part of our report notes some key risk areas and issues for the Commission going forward, including the Commission's pending office move and changes to the Commission membership. We also highlight a number of national issues which affect all public sector bodies.

The assistance and co-operation given to us by Commission members and staff during our audit is gratefully acknowledged.

Audit Scotland
October 2010



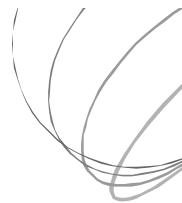
Introduction

1. This report summarises the findings from our 2009/10 audit of the Water Industry Commission for Scotland (“the Commission”). The scope of the audit was set out in our Audit Plan in accordance with the Code of Audit Practice, which was presented to the Audit Committee on 18 March 2010. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. Best value duties apply across the public sector and are a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and this has been further developed during 2009/10 with the completion of its bank of best value toolkits which, although primarily designed for audit use, are available to all public bodies for reference.

Exhibit 1: Framework for a best value audit of a public body

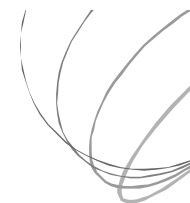


4. A linked development here has been the Scottish Government’s work to refresh its 2006 best value Guidance for Public Bodies. This latter initiative, due for issue later in 2010, will result in clearer



guidance to public bodies, and particularly those in the Central Government and Health sectors, on securing continuous improvement in performance, with due regard to the balance between cost and quality.

5. Throughout this report we comment on aspects of the Commission's arrangements in this area. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not yet have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report represents a further step towards that goal.
6. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. Where these have a bearing on the activities, risks or performance of the Commission, we make reference to these reports in this document. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.
7. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by the Board, directors and staff of the Commission during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.



Financial Statements

8. In this section we summarise key outcomes from our audit of the Commission's financial statements for 2009/10 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

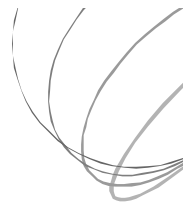
9. We audit the financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of the Commission and its expenditure and income for the period in question
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - the consistency of the information which comprises the Director's Report and Management Commentary within the financial statements
 - the regularity of the expenditure and receipts.
10. 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
 - assessing whether disclosures in the statement are consistent with our knowledge of the Commission.

Overall conclusion

11. We have given an unqualified opinion on the financial statements of the Commission for 2009/10.
12. As agreed the unaudited accounts were provided to us on 26 July 2010, supported by a comprehensive working paper package. The quality of the draft accounts and supporting papers coupled with the timely responses received from Commission staff allowed us to conclude our audit within the agreed timetable and provided our opinion to the Audit Committee on 15 September 2010.

Issues arising from the audit

13. As required by auditing standards we reported to the Audit Committee on 15 September 2010 the main issues arising from our audit of the financial statements. In line with our normal practice, we



have also discussed with management the less significant matters arising from the audit, which do not require to be reported here. Overall, the Commission continues to make progress through consolidating the experience gained from the increased in-house financial expertise, including, for example, in the preparation of the accounts and the improved analysis of the Commission's operating expenditure in the annual accounts and within the ledger and management reporting.

Statement on Internal Control

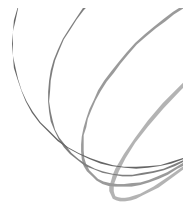
14. We confirm the adequacy of the arrangements put in place by the Accountable Officer to obtain assurances on systems of internal control and that the Statement on Internal Control is consistent with our knowledge of the Commission. Further information is provided with the Governance and Accountability section of this report.

Regularity

15. 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 were 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 material issues were identified for disclosure.

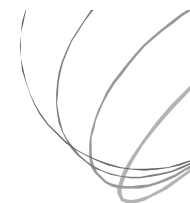
International financial reporting standards (IFRS)

16. UK Government departments and other public sector bodies prepared their accounts in accordance with International Financial Reporting Standards (IFRS) for the first time in financial year 2009/10. The transition arrangements to IFRS required bodies to prepare IFRS shadow accounts for 2008/09, including revised opening balances as at 1 April 2008.
17. During 2009/10 we were required to review the shadow accounts and report on them to the Commission by 28 February 2010. The purpose of this exercise was to consider whether the shadow accounts had been properly prepared and report any matters that might prevent them forming a reliable basis for the first set of IFRS based accounts in 2009/10.
18. The shadow accounts and supporting documentation for the 2008/09 financial year were submitted by the Commission for audit on 23 November 2009. The shadow accounts and supporting working papers were comprehensive, allowing us to conclude our audit within the agreed timetable.



19. We identified two main issues to be considered further by the Commission when preparing their 2009/10 accounts. We followed up on these issues as part of the audit of the 2009/10 accounts with satisfactory results. The main issues were:

- leases – consideration to be given to improving the level of disclosure to reflect the iFReM requirements
- annual leave accrual – while the annual leave accrual is not material by value in 2008/09, the Commission should continue to monitor the value of the accrual on an annual basis.



Use of Resources

20. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of the Commission's financial position.

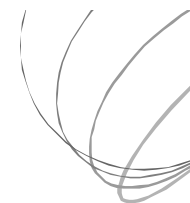
Financial Position

Outturn 2009/10

21. The Commission's net surplus for the year was £0.167 million (2008/09: £0.950 million). Total income was £4.963 million (2008/09: £5.169 million), while expenditure was £4.797 million (2008/09: £4.243 million). Income and expenditure both include £0.72 million funding for WaterWatch Scotland (figure is consistent with prior years).
22. The majority of the Commission's income comes from the statutory contribution by Scottish Water, set by Scottish Ministers at £3.753 million (2008/09: £3.950 million). The reduction reflects a decrease in the associated costs of the licensing framework. Income from the Commission's levy on licensed providers remained constant during 2009/10 at £1.204 million.
23. Operating costs of £4.798 million (2008/09: £4.238 million) show an increase due to the additional work on the final determination. Capital expenditure in the year was £63 thousand (2008/09: £60 thousand), and taxation was nil (2008/09: £5 thousand).
24. The net assets, excluding pension assets and liabilities, increased by £0.128 million from £1.218 million as at 31 March 2009 to £1.346 million as at 31 March 2010. The net position on pension assets resulted in an increase in the liability by £0.894 million from a break even position in the previous year. Reserves decreased by £0.768 million, representing in the main this increase in pension liability.
25. **Year end bank balance** – The Commission's statements of financial position at 31 March 2010 shows bank balances of £1.365 million (2008/09: £1.277 million), which is unusually high for a public sector body with the turnover of the Commission. We note that the reasons for this have been considered and discussed at the Audit Committee and other forums; that it is anticipated that this high cash-holding will be partially utilised by non-recurring costs in 2010/11; and that a mechanism is now available to reduce the statutory levy paid to the Commission by Scottish Water should this be required.

Action plan point 1

26. **Movement in the net surplus / (deficit) in the Falkirk Pension Fund** – there have been significant changes in the net position on the pension assets and liabilities over recent years. It is noted that most of the volatility is through the calculation of actuarial gains and losses, which are reflected in the



Statement of Changes in Reserves, rather than the Income Statement. The net liability at 31 March 2010 of £0.894 million is significant in relation to the Commission's assets and liabilities. Contribution rates increase in 2010/11, which will help increase the pension assets. However, in the short term it appears there will be continue to be some volatility associated with changes in interest rates, market valuations and actuarial assumptions.

| | 2005/06 £k | 2006/07 £k | 2007/08 £k | 2008/09 £k | 2009/10 £k |
|----------------------------|------------|------------|------------|------------|------------|
| Pension assets | 863 | 1,045 | 1,206 | 1,464 | 2,081 |
| Pension liabilities | (858) | (1,240) | (1,089) | (1,462) | (2,975) |
| Net | 5 | (195) | 117 | 2 | (894) |

Scotland's public finances

27. The Auditor General's report on *Scotland's public finances, published in November 2009*, contained an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The aim of this report was to help to inform the debate on the future of public finances in Scotland. The key messages from this report were:

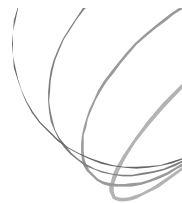
Extract from Auditor General's report *Scotland's public finances*

The public sector is coming under the greatest financial pressure since devolution.

- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.

The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available.

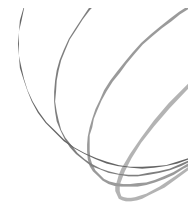


In the current economic climate difficult decisions will have to be made about priority spending programmes.

- The Scottish Government's annual budget is largely developed on an incremental basis which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities, based on robust information about activity, costs and performance.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.

Financial sustainability and the 2010/11 budget

28. The Commission's budget for 2010/11 is £3.96 million, as per the Commission's corporate plan for 2010 – 2015, which has been approved by Scottish Ministers. The budget will remain static throughout this regulatory period. The £3.96 will be raised through the statutory levy to be paid by Scottish Water of £2.74 million, with the balance of £1.22 million being raised from the fee scheme for retail licensing. The Commission's overall budget for 2010/11 of £3.96 million highlights a reduction of £0.278 million or 6.5% from the £4.23 million available in 2009/10.



Governance and Accountability

29. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of the Commission's arrangements.
30. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

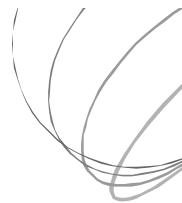
31. This year we reviewed:
 - key systems of internal control and the statement on internal control
 - overall corporate governance, including arrangements for managing risks to reputation
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.

Systems of internal control

32. 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 2009/10 PricewaterhouseCoopers, the internal auditors, provided their opinion that based on the internal audit work undertaken during the year. The work of internal audit concluded that it did not identify any significant control weaknesses that we consider to be pervasive in their effects on the system of internal control.

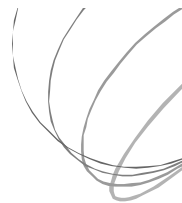
Statement on Internal Control

33. The Statement on Internal Control provided by the Commission's Accountable Officer reflected the main findings from both external and internal audit work. It recorded management's responsibility for maintaining a sound system of internal control and set out the Commission's approach to this.



Overview of corporate governance, including reputational risk

34. Corporate governance is the system by which organisations direct and control their functions and relate to their stakeholders. This incorporates the way in which an organisation manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles of corporate governance apply equally to all public sector bodies: openness, integrity and accountability.
35. Audit Scotland conducted an overview and evaluation of the corporate governance arrangements of the Commission as at April 2010. We considered:
- the overall framework within which the Commission operates
 - the Commission's own corporate governance arrangements
 - issues relating to risks to reputation.
36. In relation to the overall framework we noted that:
- all the components of the overall governance framework that we would expect have been put in place and appear to be operating well
 - there has been significant change within elements of the overall governance framework over recent years that has been implemented successfully
 - the relationship between the Commission and the Scottish Ministers/ the Scottish Government remains a key feature. Each party has their own responsibility, creating the potential for differences in priorities or emphasis. It is important for success in this area that, following discussion and liaison, their respective objectives are aligned as far as is practical.
37. In relation to its own corporate governance arrangements, we noted that the Commission has many of the features of sound corporate governance arrangements and over recent years has continued to enhance systems, procedures and controls. We support this and think there is scope for the Commission to continue developing aspects of governance, such as completing the imminent roll out of updated HR guidance to staff; and enhancing the presentation of their organisational values in outward facing communications and documentation, explaining the Commission's approach to stakeholders.
38. In March 2010 there was media coverage of aspects of the Commission's expenditure in the areas of travel & subsistence, hospitality and corporate events. The coverage suggested the examples quoted were extravagant in the context of a public sector body. Following on from this media coverage there



was formal correspondence between the Cabinet Secretary for Finance and Sustainable Growth and the Chairman of the Commission, with the Commission providing further information on the items covered in the media. Subsequently the Chairman of the Commission met with the Cabinet Secretary to discuss the position.

39. The issues arising have been considered by the board and the audit committee. Part of the Commission's response was to ask their internal auditors to carry out an audit exercise on the Management of Reputational Risk. Internal audit undertook an audit of the expenditure in question, which confirmed that the expenditure was not out with the Commission's powers and was, in most regards, in line with the extant procedures at the time it was incurred. Internal audit also provided the Commission with recommendations as to how the controls over the propriety and probity of expenditure in these areas could be improved in order to minimise any negative impact to the reputation of the organisation. These recommendations have been accepted by management.
40. From our own work in this and previous audits and our review of internal audit work we agree with the findings, conclusions and recommendations of internal audit. It is management's view that certain elements of the expenditure that has been the subject of media attention would not now be incurred because it would not pass the public perception test, or other control procedures introduced. Also, following on from this work, decisions on expenditure in areas of hospitality, corporate and staff events have a clearer documented record of the Commission's consideration of Value for Money.

Internal Audit

41. 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 2009/10 audit we assessed whether we could place reliance on the Commission's internal audit function. We concluded that PricewaterhouseCoopers operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2009/10, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.
42. We are placing formal reliance on the following reviews for financial statements purposes:
 - review of the financial control environment
 - staff travel and subsistence
 - management of reputational risk.



43. These reviews also contributed to our assurance on our broader responsibilities under the Code of Audit Practice. In addition, in this regard we also reviewed the internal audits reviews of:

- appointment and evaluation of consultants
- risk management arrangements.

Prevention and detection of fraud and irregularities

44. We have discharged our responsibilities as they relate to the prevention and detection of fraud and irregularity, standards of conduct and the Commission's financial position. Overall, we have concluded that arrangements within the Commission are satisfactory.

National Studies

45. In late 2010, Audit Scotland will be publishing a national study on the role of boards which will be relevant to the governance of the Commission.

46. Boards play a crucial role in ensuring that governance standards are maintained in public sector organisations. There are recent examples of the failure of public sector organisations to establish an adequate board. We will assess how board members are selected and whether the membership of the board is appropriate. In this study we will also review how the performance of boards is measured and the arrangements for induction and training for non-executive members.

47. Feedback relevant to the Commission will be provided in due course.

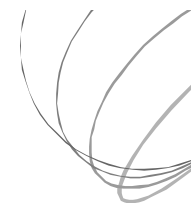


Performance

48. 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. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
49. In this section we comment on:
- the Commission's corporate plan
 - performance against targets
 - arrangements for risk management.

Vision and strategic direction

50. The Commission published its corporate plan for the regulatory control period 2006 – 2010, which was agreed with Scottish Ministers, sets out the Commission's three main functions, which are as follows:
- to determine water and sewerage service charge caps
 - to monitor Scottish Water's performance
 - to establish and manage a framework that will allow potential competitors to access the markets for retail water services.
51. The Corporate Plan also sets out the following strategic aims for the Commission, encompassing its roles as water and sewerage industry regulator and in relation to the framework for competition in the retail water and sewerage markets:
- to promote the interests of customers of Scottish Water in relation to service provision in the exercise of its key functions
 - to encourage Scottish Water to become more efficient and sustainable through a clearer understanding of its costs
 - to adhere to the Better Regulation Task Force principles for transparency, accountability, proportionality, consistency and targeting



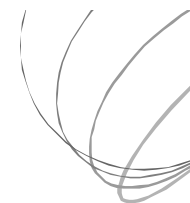
- to act transparently, fairly and proportionately in its role establishing and managing a framework for competition in the retail water and sewerage markets
- to exercise its licensing functions in a way that safeguards the interests of all customers who are served by the public networks
- to ensure that the markets develop in an orderly way.

52. The Corporate Plan sets out how each of the Commission's three main functions will be performed successfully during the current regulatory control period, in terms of key deliveries or actions along with timescales.

Performance overview

53. The Commission's Corporate Plan 2006 – 2010 sets out key deliveries or actions along with timescales in order to fulfil its three main functions. Those deliveries or actions relevant to 2009/10 are set out in the table below, together with information on related performance. The table illustrates that the Commission has substantially met the key milestones relevant to 2009/10.

| Activity | Provisional date | Date achieved |
|---|---|---------------|
| <i>Function: the determination of charges</i> | | |
| Draft determination published | June 2009 | June 2009 |
| Final determination published | November 2009 | November 2009 |
| <i>Function: monitoring Scottish Water's performance</i> | | |
| Publication of annual Costs and Performance Report | November/ December 2009 | October 2009 |
| Publication of annual Investment and Asset Management Report | November/ December 2009 | November 2009 |
| Publication of annual Customer Service Report | November/ December 2009 | October 2009 |
| <i>Function: establishing and managing a licensing framework</i> | | |
| The Corporate Plan specified granting of a license to operate in the retail markets and this was achieved early, being completed before 2009/10 | | |
| Regulation of retail charges throughout the 2006-10 regulatory control period through a license condition | Confirmed as Standard License Condition A8 (January 2008) | |

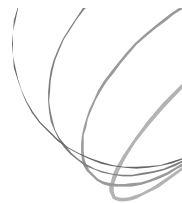


Risk management

54. The Commission has continued to develop and consolidate a robust risk management framework. This is based upon a risk strategy which makes clear the roles and responsibilities for achieving an effective control framework, with each risk assigned to an individual risk owner. The Commission's risk register and related action plans identify potential or actual risks to the achievement of the objectives set out in the Corporate Plan; and record the controls in place to manage these risks and any action being taken to reduce the risk rating. The risk register is subject to continual review. It is monitored by staff internally and reviewed by the Chief Executive and the Audit Committee on a quarterly basis. The Commission members are informed of significant changes to the register or new risks every quarter.
55. We will continue to monitor the Commission's risk management arrangements over the course of the 2010/11 audit year.

Improving public sector efficiency

56. The Audit Scotland report *Improving public sector efficiency* was published on 25 February 2010. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in the 2006 report about the previous efficiency programme.
57. The report found that Scottish public bodies reported more efficiency savings than the Government's two per cent target. But there are serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult.
58. The report recommended that to deal with reduced future funding and increase savings public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working.
59. The drive to improve efficiency and productivity is not just an exercise for managers and service providers. It requires strong leadership and engagement from the very top of public bodies. Leaders and senior decision-makers within an organisation have a responsibility to check, challenge, monitor and support their organisations in delivering efficiency and productivity improvements. The report's recommendations highlighted areas that public bodies' key decision makers should look at to assess their organisation's development and to challenge existing arrangements (see below).



Extract from Audit Scotland report Improving public sector efficiency

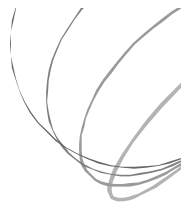
In order to improve the delivery of efficiency savings public bodies should:

- ensure they have a priority-based approach to budgeting and spending
- continue to improve collaboration and joint working, overcoming traditional service boundaries
- consider using alternative providers of services, if these providers can improve the efficiency, productivity or quality of services
- improve information on costs, activity, productivity and outcomes, including setting baselines to measure performance against
- give greater urgency to developing benchmarking programmes
- maintain the momentum of activities and initiatives to improve purchasing and asset management and extend shared services
- ensure there is a joined-up approach to efficiency savings across the public sector, avoiding duplication
- ensure that plans are in place to deliver savings, clearly setting out what action will be taken, the level of savings to be delivered and how these will be measured
- strengthen the involvement of front-line staff, service providers and users in redesigning public services
- reduce reliance on non-recurring savings to meet financial targets and generally use these as part of a wider and longer term strategy
- report efficiency savings consistently.

60. To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work should consider assessing themselves against each question, and recording the results.

61. Through the Corporate Plan for the regulatory control period 2010 – 2015, the Commission will reduce its operating costs by more than 10% in real terms in 2010/11 from its budgeted expenditure in 2009/10. It will then not increase its expenditure in nominal terms before 2015/16. The amount charged to licensed providers will increase by less than inflation in 2010/11 and remain static each year thereafter.

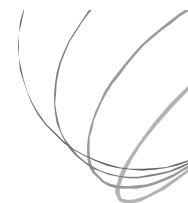
62. We will continue to monitor the financial position and the actions taken by the Commission in order to achieve these savings.



Looking Forward

63. The Commission faces a number of challenges in 2010/11, which include:

- **Efficiencies and future funding** - Scottish public bodies reported more efficiency savings than the Government's target of two per cent annually that was set in 2008/09, but there are serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult. To deal with reduced future funding and increase savings fresh approaches to improving efficiency and productivity must be considered, taking a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working. The Commission have identified a series of measures which cumulate to a real terms reduction of 10% in operating costs for 2010/11. The Commission, with agreement from Scottish Ministers, will not increase their expenditure in nominal terms before 2015/16.
- **Best Value** - The concept of best value is seen as a key driver of modernisation and improvement in public services. Audit Scotland has continued its commitment to extending the best value audit regime across the whole public sector and significant development work has taken place over the last year including the finalisation of its best value toolkits. This has been matched by the Scottish Government's commitment to refreshing its Best Value Guidance for Public Bodies. The Commission should continue to respond to this important initiative as it develops.
- **Accommodation changes** - During 2009/10 the Commission opted to exercise the break clause in the lease agreement for their current office accommodation which allows the lease to be terminated as at 22 March 2011. The Commission are currently negotiating a new arrangement for another property, which it is anticipated will generate savings. The change in office accommodation will lead to a range of challenges in 2010/11 and the Commission should ensure all aspects of this move are fully considered.
- **Membership of the Commission** - The appointments of the Chairman and two Commission members will end in July 2011. The Commission have considered succession planning arrangements. They have commissioned an independent review of the Commission's performance against its statutory objectives, chaired by Sir Christopher Bolt, which includes coverage of aspects of performance and the desired contributions from Commission members. This will inform the succession processes. The Commission are also reviewing induction material for new members of the Commission to ensure that any training needs will be met. These developments are key to the future success of the Commission.



Appendix A: Action Plan

Key Risk Areas and Planned Management Action

| Action Point | Risk Identified | Planned Action | Responsible Officer | Target Date |
|--------------|---|---|-------------------------------------|-------------|
| 1 | Year end bank balance The Commission's statement of financial position as at 31 March 2010 shows balance balances of £1.365 million (2008/09: £1.277 million), which is unusually high for a public sector body with the turnover of the Commission. We note that the reasons for this have been considered and discussed; and recommend that arrangements are put in place to reduce the balance over 2010/11. | The Commission will continue to monitor its bank and cash position over 2010/11. It is anticipated that the high cash-holding at 31 March 2010 will be partially utilised by non-recurring costs in 2010/11; and that a mechanism is now available to reduce the statutory levy paid to the Commission by Scottish Water should this be required. | Alan Sutherland, Chief Executive | May 2011 |