

# Water Industry Commission for Scotland

Annual Audit Plan 2018/19



 AUDIT SCOTLAND

Prepared for Water Industry Commission for Scotland

January 2019

## Who we are

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

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



## About us

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

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

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

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# Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. This plan sets out the work necessary to allow us to provide an independent auditor's report on the financial statements and meet the wider scope requirements of public sector audit.

2. The wider scope of public audit contributes to assessments and conclusions on financial management, financial sustainability, governance and transparency and value for money.

## Adding value

3. We aim to add value to the Water Industry Commission for Scotland (WICS) through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we intend to help promote improved standards of governance, better management and decision making and more effective use of resources.

## Audit risks

4. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for the audit of WICS. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1 2018/19 Key audit risks

 Audit Risk	Source of assurance	Planned audit work
<b>Financial statements issues and risks</b>		
<p>1 <b>Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<ul style="list-style-type: none"> <li>• Detailed testing of journal entries.</li> <li>• Review of accounting estimates.</li> <li>• Focused testing of accruals and prepayments.</li> <li>• Evaluation of significant transactions that are outside the normal course of business.</li> </ul>

 <b>Audit Risk</b>	<b>Source of assurance</b>	<b>Planned audit work</b>
<p><b>2 Risk of fraud over income</b></p> <p>WICS receives the majority of its funding from two sources. These are the statutory contributions from Scottish Water and the levies charged to licensed providers. However, in accordance with ISA 240, the extent of income means there is an inherent risk of fraud.</p>	<p>Financial monitoring reports are produced on a monthly basis and reviewed by management. These are presented to the Board and Audit Committee as a standing agenda item. These arrangements allow for monitoring of income and expenditure, providing explanations on any significant movements.</p>	<ul style="list-style-type: none"> <li>Analytical procedures on income streams.</li> <li>Detailed testing of revenue transactions focusing on the areas of greatest risk.</li> </ul>
<p><b>3 Risk of fraud over expenditure</b></p> <p>The revised version of Practice Note 10, Audit of Public Sector Bodies in the UK, states that there is a risk that misstatements may arise from fraudulent financial reporting where the audited body may manipulate its results to meet externally set targets. Therefore, there is a risk of material misstatement due to fraud related to expenditure.</p>	<p>Detailed annual budgets are prepared and approved by the Board. Financial monitoring reports are produced on a monthly basis, analysing actual expenditure compared to the agreed budget. These are presented to the Board and Audit Committee as a standing agenda item. These arrangements allow for monitoring of income and expenditure, providing explanations on any significant movements.</p>	<ul style="list-style-type: none"> <li>Analytical procedures on expenditure.</li> <li>Detailed testing of expenditure transactions focusing on the areas of greatest risk.</li> </ul>
<p><b>4 New financial system</b></p> <p>WICS introduced a new integrated financial system which includes the general ledger and income and expenditure modules. The system was implemented midway through the 2018/19 financial year.</p> <p>This systems contains the information which is used to prepare the financial statements.</p> <p>There is a risk that information has not been migrated correctly to the new ledger system and this could lead to errors in financial reporting.</p>	<p>The project to migrate the accounting ledger from Sage to Xero was overseen by an external expert. Assurance can be given that all closing ledger balances in Sage are consistent with the opening position on Xero. This has been independently verified by Grant Thornton as part of an internal audit review of the project. This review also provided assurance over the new financial procedures put in place following the migration.</p>	<ul style="list-style-type: none"> <li>Review of internal audit work on the implementation of the new financial system.</li> <li>Documentation and assessment of key controls and processes in the new financial system.</li> </ul>
<b>Wider dimension issues and risks</b>		
<p><b>5 Performance management</b></p> <p>WICS is required to include information on how performance is measured within its annual report.</p> <p>In our 2016/17 and 2017/18 annual audit reports, we noted it was not clear how WICS monitors and reports performance and progress in</p>	<p>The Commission is developing formal KPIs as part of the review of the overall governance framework. These will be agreed by the Board in due course and KPIs could be in place for the financial year beginning 1 April 2019.</p>	<ul style="list-style-type: none"> <li>Consideration of the performance information included within the performance report in the 2018/19 annual report.</li> </ul>

 <b>Audit Risk</b>	<b>Source of assurance</b>	<b>Planned audit work</b>
<p>delivering core functions in the corporate plan.</p> <p>There is a risk that the performance report within the 2018/19 annual report may not fully comply with the FReM requirements.</p>		
<p><b>6 Review of governance framework</b></p> <p>A number of key governance and financial policies have not been reviewed or updated for a number of years. These include the rules of procedure, travel, subsistence and expenses policy and the staff handbook.</p> <p>Officers have informed us that all policies are being reviewed as part of the ongoing review of the governance framework. However this review is still to be completed.</p> <p>There is a risk that existing policies may not be fit for purpose and do not reflect current guidance or requirements in relevant areas.</p>	<p>The Framework Document was agreed between the Office and the Scottish Government in March 2018. Since then, the Commission has been working on reviewing its full suite of policies that, in total, provide a full governance framework that is in line with the Framework Document and any relevant legislation. It is expected that the core documents, such as the terms of reference for the Board and Audit and Risk Committee and a scheme of delegation will be agreed by March 2019. All policies relating to records management have been updated and reviewed independently by Harper Macleod, as have our core employment and procurement contracts. New financial procedures, including the travel and subsistence policy, are drafted and should also be approved and formally in place by April 2019. A review of the staff handbook and relevant policies was carried out in 2016. As a matter of good practice, these are currently under review by Harper Macleod.</p>	<ul style="list-style-type: none"> <li>• Monitor progress of the governance framework review.</li> </ul>
<p>Source: Audit Scotland</p>		

## Reporting arrangements

**5.** Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in [Exhibit 2](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**6.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officer(s) to confirm factual accuracy.

**7.** We will provide an independent auditor's report to WICS, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual accounts. We will provide the Accountable Officer and Auditor General for Scotland

with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

**8.** Under the Public Finance and Accountability (Scotland) Act 2000 there is a requirement for the resource account of the Scottish Government to be presented to Parliament within nine months of the financial year – end, i.e. 31 December.

## Exhibit 2

### 2018/19 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Report	August 2019	Audit and Risk Committee – 23 July 2019  Board – August 2019 (TBC)
Independent Auditor's Report	August 2019	Board – August 2019 (TBC)

Source: Audit Scotland

### Audit fee

**9.** The proposed audit fee for the 2018/19 audit of WICS is £13,160 (Prior year fee £12,910). In determining the audit fee we have taken account of the risk exposure of WICS, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited annual accounts, with a complete working papers package on 3 June 2019.

**10.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual accounts or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises out with our planned audit activity.

### Responsibilities

#### Audit and Risk Committee and the Accountable Officer

**11.** Audited bodies have the primary 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 successfully deliver their objectives.

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

#### Appointed auditor

**13.** 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.

**14.** Auditors in the public sector give an independent opinion on the financial statements and other information within the annual accounts. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

# Audit scope and timing

## Annual accounts

**15.** The annual report, which includes the financial statements, will be the foundation and source for most of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of WICS and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how WICS will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

**16.** We will give an opinion on whether the financial statements:

- give a true and fair view of the of the state of affairs of WICS at 31 March 2019 and of their income and expenditure
- have been properly prepared in accordance with the financial reporting framework.

## Other information in the annual report and accounts

**17.** We also review and report on other information published within the annual report including the performance report, annual governance statement and the remuneration and staff report. We give an opinion on whether these have been compiled in accordance with the appropriate regulations and frameworks in our independent auditor's report.

**18.** We also read and consider any information in the annual accounts other than the financial statements and audited part of the remuneration report and report any uncorrected material misstatements.

## Materiality

**19.** We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinions in the independent auditor's report.

**20.** We calculate materiality at different levels as described below. The calculated materiality values for WICS are set out in [Exhibit 3](#).



characteristics



responsibilities



principal activities



risks



governance arrangements

## Exhibit 3

### Materiality values

Materiality	Amount
<b>Planning materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 1.5% of gross expenditure for the year ended 31 March 2019 based on the latest audited financial statements for 2017/18.	£51,000
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement, we have calculated performance materiality at 75% of planning materiality.	£39,000
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 5% of planning materiality.	£2,500

Source: Audit Scotland

## Timetable

**21.** To support the efficient use of resources it is critical that the annual accounts timetable is agreed with us to produce the unaudited accounts. We have included an agreed timetable at [Exhibit 4](#).

## Exhibit 4

### Annual accounts timetable

 Key stage	 Date
Latest submission date of unaudited annual accounts with complete working papers package	3 June 2019
Latest date for final clearance meeting	By end of June 2019
Issue of Letter of Representation and proposed independent auditor's report	July 2019
Agreement of audited unsigned annual accounts	July 2019
Issue of Annual Audit Report to those charged with governance	By end of August 2019
Independent auditor's report signed	By end of August 2019

## Internal audit

**22.** Internal audit is provided by Grant Thornton. As part of our planning process we carry out an annual assessment of the internal audit function to ensure that it operates in accordance with Public Sector Internal Audit Standards (PSIAS). We will report any significant findings to management on a timely basis.

### Using the work of internal audit

**23.** Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible to avoid duplication. We plan to consider the findings of the work of internal audit as part of our planning process to minimise duplication of effort and to ensure the total resource is used efficiently or effectively.

**24.** From our initial review of internal audit plans we plan to place formal reliance on internal audit work for the the review of finance which includes a review of the implementation of the new finance system.

### Audit dimensions

**25.** 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 accountability and value for money.

**26.** The Code of Audit Practice 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. In the light of the volume and lack of complexity of the financial transactions, we plan to apply the small body provisions of the Code to the 2018/19 audit of the WICS.

### Independence and objectivity

**27.** Auditors appointed by the Accounts Commission or Auditor General 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. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland’s Ethics Partner.

**28.** The engagement lead (i.e. appointed auditor) for WICS is Stephen O’Hagan, (Senior Audit Manager). Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of WICS.

### Quality control

**29.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor’s report or opinion is appropriate in the circumstances.

**30.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice (and supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

**31.** 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 engagement lead.

# Water Industry Commission for Scotland

## Annual Audit Plan 2018/19

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)

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