

# Water Industry Commission for Scotland

2020/21 Annual Audit Report



 AUDIT SCOTLAND

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

December 2021

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# Key messages

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## Audit of 2020/21 annual report and accounts

- 1 Our audit opinions on the annual accounts of the Water Industry Commission for Scotland (WICS) are unmodified. The accounts give a true and fair view and were properly prepared in accordance with the financial reporting framework. Expenditure and income were incurred in accordance with applicable enactments and guidance.
- 2 The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the annual accounts.
- 3 WICS moved to working remotely at the beginning of the COVID-19 pandemic and have continued to be fully operational. The impact on the accounting timetable for the 2020/21 annual report and accounts was minimal, however, Audit Scotland resourcing priorities have resulted in the audit being carried out later than normal.

## Financial sustainability

- 4 WICS has appropriate financial planning and monitoring arrangements in place.
- 5 The Covid-19 outbreak has not had a significant impact on the short-term finances of WICS, and it is not anticipated that there will be a significant impact on medium to long term financial plans.

## Governance and transparency

- 6 Governance arrangements and controls continued to operate effectively during the move to remote working throughout the Covid 19 pandemic.
- 7 We concluded that the information in the governance statement is consistent with the annual accounts and complies with the guidance issued by Scottish Ministers.

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# Introduction

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1. This report summarises the findings from our 2020/21 audit of the Water Industry Commission for Scotland (WICS).
2. The scope of our audit was set out in our Annual Audit Plan presented to the 11 May 2021 meeting of the Audit and Risk Committee. This report comprises the findings from:
  - an audit of WICS' annual report and accounts
  - our consideration of financial sustainability and the appropriateness of the governance statement.
3. The main elements of our audit work in 2020/21 have been:
  - an audit of WICS' 2020/21 annual report and accounts including the issue of an independent auditor's report setting out our opinions
  - consideration of the appropriateness of the disclosures in the governance statement and of financial sustainability, in accordance with the Code of Audit Practice 2016 (the Code) provisions relating to smaller or less complex audited bodies.

## Adding value through the audit

4. We add value to WICS through the audit by:
  - identifying and providing insight on significant risks, and making clear and relevant recommendations
  - sharing intelligence and good practice through our national reports and good practice guides
  - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Responsibilities and reporting

5. WICS has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers.

**6.** WICS is also responsible for compliance with legislation and for establishing appropriate and effective arrangements 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, the [Code of Audit Practice 2016](#) and supplementary guidance and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**8.** The [Code of Audit Practice 2016](#) (the Code) includes provisions relating to the audit of small bodies. Where the application of the full wider audit scope is judged by auditors not to be appropriate to an audited body, the annual audit work can focus on the appropriateness of the disclosures in the governance statement and the financial sustainability of the body and its services. As highlighted in our 2020/21 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 2020/21 audit.

**9.** This report raises matters from our audit. 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](#). It sets out specific recommendations, the responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## **Auditor Independence**

**11.** Auditors appointed by the Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**12.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2020/21 audit fee of £13,670, as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**13.** This report is addressed to both 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.

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# 1. Audit of 2020/21 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

Our audit opinions on the annual accounts of the Water Industry Commission for Scotland (WICS) are unmodified. The accounts give a true and fair view and were properly prepared in accordance with the financial reporting framework.

Expenditure and income were incurred in accordance with applicable enactments and guidance.

The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the annual accounts.

WICS moved to working remotely at the beginning of the COVID-19 pandemic and have continued to be fully operational. The impact on the accounting timetable for the 2020/21 annual report and accounts was minimal, however, Audit Scotland resourcing priorities have resulted in the audit being carried out later than normal.

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## Our audit opinions on the annual report and accounts are unmodified

**15.** The annual report and accounts for the year ended 31 March 2021 were approved by the Board on 2 December 2021. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were regular and in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## The Covid-19 pandemic had a minimal impact on audit evidence

16. The unaudited annual report and accounts were made available to us in June 2021. The working papers provided to support the accounts were of a good standard and the audit team received support from finance staff which helped ensure the final accounts audit process ran smoothly.

## There were delays in auditing the annual report and accounts due to resourcing priorities

17. Covid-19 had a negligible impact on the preparation of the annual report and accounts by officers. However, as previously reported in our Annual Audit Plan, Audit Scotland are responding to the risks to public services and finances from COVID-19 across the full range of audit work and viewed 2020/21 as a transitional year in moving back to pre Covid-19 audit delivery timetables. Resourcing of the financial statements audit was delayed until October 2021 to accommodate other resourcing priorities. The audit was completed in line with statutory deadlines.

## Overall materiality is £60,000

18. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

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### Exhibit 1 Materiality values

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

Source: Audit Scotland

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## [Appendix 2](#) identifies the main risks of material misstatement and our audit work to address these

19. [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. It also identifies the work we undertook to address these risks and our conclusions from this work.

## **We have no significant findings to report on the annual report and accounts**

**20.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have no issues to report from the audit.

## **There were no identified misstatements**

**21.** There were no misstatements identified that exceeded our reporting threshold.

## **Good progress was made on prior year recommendations**

**22.** WICS has made good progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management. These are set out in [Appendix 1](#) and are identified by a b/f (brought forward) prefix.

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## 2. Financial sustainability

Financial sustainability looks forward to the medium and long term to consider whether a body is planning effectively to continue to deliver its services or the way in which they should be delivered.

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### Main judgements

WICS has appropriate financial planning and monitoring arrangements in place.

The Covid-19 outbreak has not had a significant impact on the short-term finances of WICS, and it is not anticipated that there will be a significant impact on medium to long term financial plans.

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### Financial performance 2020/21

**23.** 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 from activities for the year 2020/21 was £3,423,460, after accrual for agreed refunds of £1m to Scottish Water and £0.300m to licensed providers. Gross operating expenditure was around £322,000 under budget at £4,003,025.

**24.** The net deficit for the year was £577,200, which utilised excess cash reserves as planned. However, significant actuarial adjustments deriving from the triennial valuation increased the year end pensions liability by £3.513m, resulting in a notional net expenditure balance of £4,090,200 being recorded.

**25.** The financial impact of the Covid 19 outbreak was not significant during the year, with savings on travel costs being largely offset by increases in IT and establishment costs associated with the sudden move to remote working across the organisation.

### Short term financial planning

**26.** WICS is funded directly by a statutory contribution paid by Scottish Water, as directed by Scottish Ministers. Licensing activity is funded by a levy charged to licensed providers.

**27.** WICS approved the 2020/21 budget in March 2020 with budgeted income, including funding from Scottish Water and levies on licensed providers, totalling £4,060,997. As part of the update to the Corporate Plan, it was subsequently agreed with SG that refunds would be made for 2020/21 to Scottish Water and licensed providers of £1m and £0.3m

respectively. Revised budgeted income was therefore reduced to £2,760,997.

**28.** Total income from activities per the 2020/21 accounts was £3,423,460. This included international income of £874,718, mainly in relation to the New Zealand international Hydro Nation project, for which only £207,506 had been budgeted for.

**29.** Total operating expenditure for 2020/21 was £4,003,025 compared with the budgeted amount of £4,335,780. Underspends on overheads and travel expenditure resulted in an operating deficit of £579,565 prior to the actuarial loss.

### Medium to long term financial planning

**30.** 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.

**31.** WICS' budget requirements for six years are outlined in the Corporate Plan 2021-2027, which was approved by Scottish Ministers in December 2020. The budget forecasts are based on expected levy income and high-level estimates for expenditure and include cash flow forecasts. A conservative estimate is also included for net contribution from international activities.

**32.** The cash element of the Commissions reserve balance remains high, which continues to be recognised in the medium to long term financial plans. The option remains to fund deficits in future periods from excess cash reserves.

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

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# 3. Governance and transparency

The effectiveness of scrutiny and oversight, and transparent reporting of information

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## Main judgements

Governance arrangements and controls continued to operate effectively during the move to remote working throughout the Covid 19 pandemic.

We concluded that the information in the governance statement is consistent with the annual accounts and complies with the guidance issued by Scottish Ministers.

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## The governance arrangements and controls operating throughout the Covid19 pandemic have been appropriate.

**34.** Our review of the governance statement assessed the assurances 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.

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

## Performance management and reporting

**36.** Within the Corporate Plan 2021-27, published in December 2020, the Commission has identified a suite of 11 Key Performance Indicators (KPIs) to be used in measuring performance against a set of 9 outcomes supporting the 3 Strategic Objectives;

- To support the sector to achieve its long-term vision and the Scottish Ministers' Objectives for the regulatory control period.
- To challenge Scottish Water to achieve best in class levels of service for its customers and communities.
- To become an international leader in the field of economic regulation.

**37.** We have reported in prior year annual audit reports that the lack of KPIs aligned to corporate objectives resulted in a lack of clarity in performance reporting. Following the approval of the corporate plan, work has been progressing on performance reporting arrangements to allow WICS to report against KPIs for the current financial year.

**38.** Per FReM requirements, the performance analysis included within the Annual Report and Accounts should include:

- trend information
- details of objectives and progress made against them, using unbiased indicators, incorporating qualitative, quantitative and prior year information.

**39.** In addition, the FReM requires the performance overview to include a summary performance appraisal, providing a synopsis of the performance analysis section.

**40.** The specific KPIs in the new Corporate Plan should allow WICS to meet these reporting requirements for the 2021/22 financial year.

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## **Recommendation 1**

WICS should put in place the supporting performance management and reporting framework to ensure that future annual performance reporting complies with FReM requirements.

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# Appendix 1. Action plan 2020/21

## 2020/21 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Performance management and reporting</b></p> <p>We have previously commented on a lack of clarity in the reporting of performance against corporate plan objectives. KPIs have now been developed to measure performance for outcomes supporting delivery of strategic objectives, however, work is still progressing on the arrangements for reporting performance against those KPIs.</p> <p><b>Risk – Performance management and reporting arrangements do not support and demonstrate delivery of Corporate Plan objectives, and do not enable annual performance reporting to comply with statutory requirements.</b></p>	<p>WICS should put in place the supporting performance management and reporting framework to ensure that future annual performance reporting complies with FReM requirements.</p> <p><a href="#">Paragraph 40</a></p>	<p>The Operational Board, which meets weekly, has responsibility for overseeing that KPI progress is on track, through regular check-ins on progress. Central Office will provide commentary on KPI progress in a report presented by the Chief Executive at every formal Board meeting, based on discussions at the Operational Board.</p> <p><b>Responsible Officer:</b> Chief Executive Officer</p> <p><b>Agreed date:</b> Process has been implemented from 1 April 2021, and a summary of the reporting for the year will be included in the annual report 2021-22.</p>

## Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>2. b/f Performance management</b></p> <p>The Financial Reporting Manual (FReM) requires bodies to include a performance analysis within their annual report and accounts, including details of how they measure performance.</p> <p>In prior annual audit reports, we noted it was not clear how WICS monitors and reports on their performance and progress in delivering the core functions of their Corporate Plan.</p> <p>In the 2019/20 annual report and accounts, the Commission has made progress with the inclusion of the 2015-21 Corporate Plan objectives and the work undertaken throughout the year in achieving these objectives, however it is difficult to measure if these objectives have been achieved or not due to the nature of the KPIs</p> <p><b>Risk – WICS is not complying with the reporting requirements of the FReM.</b></p>	<p>WICS are currently preparing the 2021-2027 Corporate Plan.</p> <p>WICS should identify key performance indicators to facilitate performance monitoring and reporting of progress against objectives in the new corporate plan.</p>	<p>KPIs are in the process of being defined for each key outcome identified in the Corporate Plan for the period 2021-27. It is anticipated that the performance analysis for the accounts to 31 March 2021 will be similar to the format presented in these accounts. However, for the next regulatory period we will be able to report our performance against specific KPIs every year of the next review period.</p> <p><b>Responsible Officer:</b> Chief Executive Officer</p> <p><b>Agreed date:</b> The Corporate Plan for 2021-27, including relevant KPIs, will be submitted to the SG for approval by the end of 2020.</p> <p><b>Corporate Plan 2021-27 published December 2020 with appropriate KPIs.</b></p> <p><b>Reporting planned to commence March 2022.</b></p> <p><b>This issue has been superseded by issue 1 in this appendix.</b></p>
<p><b>3. b/f Documentation of the authorisation of manual journals</b></p> <p>A number of manual journals are posted to the general ledger. These are prepared by the finance team and authorised as part of the</p>	<p>WICS should ensure appropriate controls are in place in relation to processing of manual journals, due to the risk of manipulation. The authorisation and review of these journals should be evidenced to mitigate this risk</p>	<p>Manual adjustments are reviewed as part of the monthly management reporting process. However, WICS management agree that it is difficult to evidence this specific review. Given the size of the Finance team and</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>monthly finance pack, however this authorisation is not documented on the system.</p> <p><b>Risk – Manual journals create a risk of manipulation due to their nature.</b></p>	<p>and improve the control environment.</p>	<p>the automated facilities of the accountancy software, it is sometimes difficult to evidence the segregation of some duties. However, WICS management understands the level of risk associated with manual journals and will develop a method to evidence the review of each journal.</p> <p><b>Responsible Officer:</b> Head of Finance</p> <p><b>Agreed date:</b> With immediate effect.</p> <p><b>Completed and this issue is now closed.</b></p>
<p><b>4. b/f Documentation of exceptional expenditure and employee contracts</b></p> <p>As part of the work undertaken throughout our audit, as well as the work undertaken by Internal Audit on financial controls, there were instances of supporting documentation being incomplete in relation to exceptional items of expenditure.</p> <p>It was also highlighted from our review that a number of employee contracts may not reflect the current terms and conditions applicable.</p> <p>There is scope for improved governance within WICS processes in terms of documentation of exceptional items of expenditure and employee contracts</p> <p><b>Risk – Exceptional items of expenditure within public</b></p>	<p>WICS should ensure that a process is put in place to confirm all required documentation and authorisation is obtained and documented in relation to exceptional expenditure.</p> <p>WICS should also look to review employee contracts to ensure these reflect current terms and conditions</p>	<p>This recommendation related to documentation not being signed appropriately. WICS management will ensure there is clear documentation of the approval for any future exceptional expenditure. WICS management are in the process of considering a full review of employee contracts.</p> <p><b>Responsible Officer:</b> Head of Finance</p> <p><b>Agreed date:</b> 31 December 2020 (for employee contracts); immediately for authorisation of exceptional expenditure.</p> <p><b>Completed and this issue is now closed.</b></p>

Issue/risk	Recommendation	Agreed management action/timing
<b>bodies can be subject to heightened public interest, which could present a reputational risk if the audit trail is not fully complete.</b>		

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# Appendix 2. Significant audit risks

The table below sets out the audit risks we identified on the 2020/21 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 financial statements and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

## Risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</p>	<p>Detailed testing of journal entries.</p> <p>Assessment of estimation methodology applied and the reasonableness of accounting estimates contained within the financial statements.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>We did not identify any issues relating to management override of controls from our audit testing of journal entries, accounting estimates, accruals and prepayments.</p> <p>No significant transactions outside the normal course of business were identified.</p>

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

Audit risk	Assurance procedure	Results and conclusions
<p><b>2. Performance management</b></p> <p>Per the recently published Corporate Plan 2021-27, the Commission has identified a suite of key performance indicators (KPIs) to be used</p>	<p>Review of progress reports to Commission Members.</p> <p>Ongoing dialogue with officers.</p> <p>Review of related disclosures.</p>	<p>The key performance indicators developed should provide a satisfactory framework for measuring performance against required outcomes.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>in measuring performance against a set of outcomes which support the Strategic Objectives. These are effective from 1 April 2021, with reporting of performance against the KPIs being developed during the year and planned to commence from March 2022.</p> <p>There is a risk that measurement and reporting of achievement of strategic outcomes is not sufficiently focussed and robust in the interim period up to full implementation of the reporting framework, which could have an adverse impact on effective scrutiny of performance.</p>	<p>Commentary and, where appropriate, recommendations in 2020/21 Annual Audit Report.</p>	<p>As noted in our action plan at Appendix 1, the Board should continue to closely monitor progress in the development of reporting mechanisms so that full implementation of the reporting framework is delivered from March 2022.</p>

# Water Industry Commission for Scotland

## 2020/21 Annual Audit Report

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[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)



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