

Water Industry Commission for Scotland

Annual Audit Plan 2022/23



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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of the Water Industry Commission for Scotland (WICS). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual report and accounts to support our opinions on the financial statements
- an audit of regularity and other statutory information published within the 2022/23 annual report and accounts, including the Performance Report, the Governance Statement and the audited part of the Remuneration and Staff Report
- consideration of arrangements in relation to wider scope areas
- consideration of Best Value arrangements

Audit Appointment

2. We are pleased to be appointed as the external auditor of WICS for the period 2022/23 to 2026/27 inclusive.

3. In the first year of the audit appointment, we invest significant time gaining an understanding of your business and identifying and assessing the risks of material misstatement to the financial statements. While we use our initial assessment of risk to inform our planned audit approach, we keep our assessment of risks under review as the audit progresses. We will inform you of any significant changes in assessed risks and any resulting changes in our planned audit work.

4. The audit team will actively engage with you over the course of the audit to ensure our audit work continues to be focused on risk.

Adding value

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

Respective responsibilities of the auditor and Audited Body

6. The [Code of Audit Practice 2021](#) sets out in detail the respective responsibilities of the auditor and WICS. Key responsibilities are summarised below.

Auditor responsibilities

7. 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.

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

WICS responsibilities

9. WICS is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

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

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

Communication of fraud or suspected fraud

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

Financial statements audit planning

Audit of the financial statements

13. The annual report and accounts are an essential part of demonstrating WICS stewardship of resources and its performance in the use of those resources.

14. Our approach to the audit of the 2022/23 financial statements has been designed to support the appointed auditor's opinion as to whether the annual report and accounts give a true and fair view of WICS finances for the year ended 31 March 2023, and have been properly prepared in accordance with International Financial Reporting Standards and the 2022/23 Government Financial Reporting Manual (FReM).

Materiality

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

Materiality levels for the 2022/23 audit

16. We assess materiality at different levels as detailed in [Exhibit 1](#) on page [6](#), along with the materiality levels set for the 2022/23 audit of WICS.

Exhibit 1

Materiality levels for the 2022/23 audit

Materiality	Amount
<p>Planning materiality: This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It is set based on our assessment of the needs of the users of the financial statements and the nature of WICS operations. For the year ended 31 March 2023 we have set our materiality at 2% of gross expenditure based on the audited financial statements for 2021/22.</p>	£77,000
<p>Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this could indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 75% of planning materiality.</p>	£58,000
<p>Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.</p>	£4,000

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

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

18. Our risk assessment draws on our cumulative knowledge and consideration of WICS major transaction streams, key systems of internal control and risk management processes. It is also informed by our discussions with management, attendance at committees and review of other relevant information.

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

Exhibit 2**Significant and non-significant risks of material misstatement for the 2022/23 financial statements**

Nature of risk	Sources of assurance	Planned audit response
Significant risks of material misstatement		
<p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<ul style="list-style-type: none"> • Detailed testing of transactions and journals with a focus on significant risk areas, including year-end and post-close down entries. • Focussed testing of accruals and prepayments. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Review of significant accounting estimates. • Evaluate significant transactions outside the normal course of business.
Other non-significant risks of material misstatement		
<p>2. Introduction of IFRS 16</p> <p><i>International Financial Reporting Standard 16 – Leases</i> is effective for accounting periods starting from 1 April 2022.</p> <p>Under IFRS 16, lessees are required to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value.</p> <p>The standard is expected to bring right-of-use assets totalling £0.236m onto the Statement of Financial Position, with an associated lease liability of the same amount.</p>	<ul style="list-style-type: none"> • All lease agreements will be reviewed against new IFRS 16 requirements. • Impact of new IFRS 16 accounting requirements will be accurately reflected in the 2022/23 Annual Report and Accounts 	<ul style="list-style-type: none"> • Review list of leases to assess for completeness. • Sample testing of any lease agreements to ensure they have been correctly assessed and accounted for in the 2022/23 financial statements.

Nature of risk	Sources of assurance	Planned audit response
<p>3. Estimation in the valuation of pension assets and liabilities</p> <p>As at 31 March 2022, WICS recognised a net pension liability of £2.201 million.</p> <p>Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy, CPI growth and discounting (based on corporate bond rates).</p> <p>Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations.</p> <p>There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual accounts.</p>	<ul style="list-style-type: none"> • Use of clearly defined methodologies and procedures including experts, as appropriate, when making significant estimations and judgements. 	<ul style="list-style-type: none"> • Assess the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Review the appropriateness of actuarial assumptions and results including comparison with other member bodies and the pension fund as a whole. • Establish officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by WICS.
<p>4. Potential tax implications of international work</p> <p>The Scottish Government's Hydro Nation strategy aims to develop Scotland's water resources to bring the maximum benefit to the Scottish economy. As part of the Hydro Nation International programme WICS are involved in international work in New Zealand. As this project has been extended beyond the original timetable there is a risk that the threshold for having being deemed to have a 'permanent establishment' in New Zealand will be exceeded, which could have tax implications for WICS.</p>	<ul style="list-style-type: none"> • WICS is in ongoing discussions with the UK and New Zealand tax authorities regarding this project. • Management has engaged independent tax experts to provide advice on the potential tax implications of its international work. 	<ul style="list-style-type: none"> • We will review the tax position of this project as part of the financial statements audit to establish whether a contingent liability or provision requires to be recognised under <i>IAS37 – Provisions, Contingent Liabilities and Contingent Assets</i>.

Consideration of the risks of fraud in the recognition of income and expenditure

20. As set out in *International Standard on Auditing (UK) 240: The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements.

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

22. In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this risk for WICS because many of its expenditure transaction streams are low risk, for example staff costs and pensions IAS 19 charges, or are largely driven by the supply of services which are controlled by the provider. This limits the opportunities to manipulate the way expenditure is recognised.

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

Revisions to ISA (UK) 315 on auditor's responsibility to identify and assess the risks of material misstatement

24. The reviewed *International Standard on Auditing (UK) 315* includes a revised requirement for auditors to understand a body's use of IT, as part of our understanding of the wider control environment, and to consider the related risks.

25. As part of our 2022/23 audit planning work, we will undertake an assessment of WICS IT systems to obtain an understanding of the use of IT in financial reporting. This will consider the nature and characteristics of the audited body's IT applications and IT infrastructure. It will include considerations of any risks related to external IT systems, and assurances over the operation and reliability of these systems during the year.

26. Any risks of material misstatement identified from our assessment of the IT systems and infrastructure will be communicated to management and reflected in our approach to the audit of the 2022/23 financial statements.

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

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

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

29. Based on our knowledge of the audit, and the established procedures in place to produce these statements, we have not identified any specific risks to be communicated to those charged with governance.

Wider Scope and Best Value

30. The [Code of Audit Practice](#) sets out the four areas that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the wider scope areas in audited bodies.

31. In summary, the four wider scope areas cover the following:

- **Financial management** means having sound financial control processes. We will consider these arrangements and comment on financial management in our Annual Audit Report.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit and comment on the 2022/23 financial position and sustainability in our Annual Audit Report.
- **Vision, leadership and governance** – we will conclude on the arrangements in place to deliver the vision, strategy and priorities of WICS. We also consider the effectiveness of the governance arrangements.
- **Use of resources to improve outcomes** – [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will be carrying out a high-level review to confirm that such arrangements are in place within WICS.

32. The Code of Audit Practice includes provisions relating to the audit of less complex 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, concluding on the financial sustainability of the body and its services and the arrangements for securing Best Value. In light of the low volume and lack of complexity of the financial transactions, we plan to apply the less complex body provisions of the Code to the 2022/23 audit of WICS.

Wider scope risks

33. Our planned work on our wider scope responsibilities is risk based and proportionate. We have not identified any additional local wider scope risks for the 2022/23 audit of WICS.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

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

35. 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 officers to confirm factual accuracy, prior to issue and publication of the final reports.

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

37. [Exhibit 3](#) outlines the target dates for our audit outputs, and reflects our aim to issue the independent auditor's report by 8 December 2023.

Exhibit 3 2022/23 Audit outputs

Audit Output	Target date	Audit and Risk Committee
Annual Audit Plan	31 March 2023	30 May 2023
Independent Auditor's Report	14 November 2023	21 November 2023
Annual Audit Report	14 November 2023	21 November 2023 (Board meeting on 7 December)



Source: Audit Scotland

Timetable

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

Exhibit 4

Proposed annual report and accounts timetable

 Key stage	 Provisional Date
Latest submission date of unaudited annual report and accounts with complete working papers package	30 June 2023
Latest date for final clearance meeting with the Head of Finance	7 November 2023
Agreement of audited annual report and accounts for consideration by the Audit and Risk Committee	14 November 2023
Issue of Proposed Annual Audit Report to those charged with governance (along with template letter of representation and proposed independent auditor's report)	14 November 2023
Audit and Risk Committee meeting to consider Proposed Annual Audit Report and audited annual report and accounts	21 November 2023
Board meeting to approve and sign audited annual report and accounts	7 December 2023
Independent auditor's report certified by appointed auditor and Annual Audit Report finalised and issued	8 December 2023

Source: Audit Scotland

39. Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. We are identifying ways to work more efficiently to expedite the 2022/23 audits whilst at the same time maintaining high standards of quality.

40. We will continue to work closely with management to identify the most efficient approach as appropriate and will keep timeframes and logistics for the completion of the audit under review. Progress will be discussed with management and finance officers over the course of the audit.

Audit fee

41. In determining the audit fee, we have taken account of the risk exposure of WICS and the planned management assurances in place. The proposed fee for the 2022/23 audit is £18,200 (£13,940 in 2021/22), an increase of 31 per cent.

42. Fees have increased in 2022/23 and this reflects the current audit market and the rising costs in delivering high quality audit work. These include increased regulatory expectations and a widening in the scope of audit work.

43. In setting the fee we have assumed that WICS has effective governance arrangements and will prepare comprehensive and accurate accounts for audit in line with the agreed timetable for the audit. The audit fee assumes there will be no major change in respect of the scope of the audit during the year. Where our audit cannot proceed as planned, a supplementary fee may be levied.

Other matters

Internal audit

44. It is the responsibility of WICS to establish adequate internal audit arrangements. WICS internal audit function is provided by Grant Thornton.

45. While we are not planning to place formal reliance on the work of internal audit in 2022/23, we will review internal audit reports and assess the impact of the findings on our financial statements and wider scope audit responsibilities.

Independence and objectivity

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

47. 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 Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

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

Audit Quality

49. Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. High quality audits provide assurance, add value and can support public bodies to achieve their objectives.

50. Until 2021/22, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC (UK) 1). This set out an audit practice's responsibilities for its system of quality control for audits.

51. ISQC(UK) 1 has been replaced by two new audit quality standards: Internal Standards on Quality Management (ISQM (UK) 1) applicable from 15 December 2022 and (ISQM(UK) 2) effective for the 2023/24 audits. Work is underway at Audit Scotland to meet the requirements of these quality standards.

52. Audit Scotland is committed to delivering high quality audits. 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 supplementary 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 England and Wales (ICAEW) have been commissioned to carry out external quality reviews.

53. 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

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

www.audit-scotland.gov.uk/accessibility

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