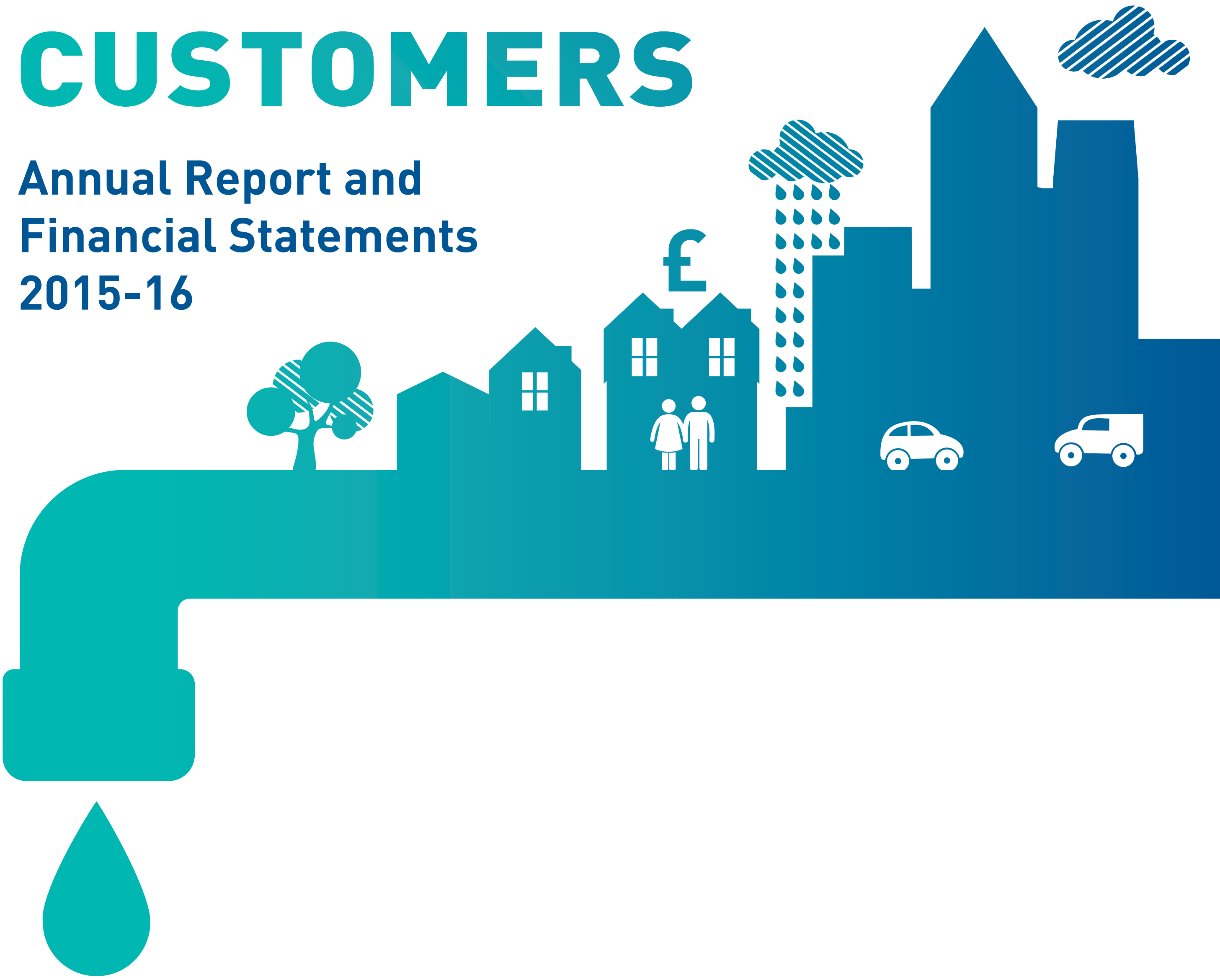
water industry commission FOR SCOTLAND

ACHIEVING BEST VALUE FOR WATER AND SEWERAGE CUSTOMERS

Annual Report and Financial Statements 2015-16



"We are working hard to ensure that our 2021-27 methodology is at the forefront of best regulatory practice. We are testing new and innovative approaches that will further require Scottish Water to challenge itself as to how it can best deliver for its customers."

Alan Sutherland, Chief Executive.

CONTENTS

SG/2016/208 For the period 1 April 2015 to 31 March 2016.

Laid before the Scottish Parliament by the Scottish Ministers under Part 1, section 5(4) of the Water Industry (Scotland) Act 2002 (as amended). November 2016

As economic regulator of the Scottish water and sewerage industry our statutory role is to promote the interests of households and businesses. We do this by incentivising Scottish Water to maintain stable prices, by insisting on better service and by facilitating greater value and choice through the competitive retail framework.

CHAIRMAN'S FOREWORD

The Commission has been working hard to achieve the best value for water and sewerage customers in Scotland.

During 2015-16 the Commission has been developing the methodology that will underpin the Interim Review in 2018 and the Strategic Review of Charges for 2021-27. This will build upon the approach developed for the 2015-21 review with a particular focus on responding to customer experience and safeguarding the long term management of the industry's assets. The Commission is grateful to all of those who have contributed to the Advisory Panel which has been convened to review and challenge our initial ideas.

The retail market continues to grow and evolve. There were 23 Licensed Providers at the end of September 2016, offering a wide range of services and prices to non-residential customers. As measured by the registered connections, nearly 40% of the market has switched from one Licensed Provider to another over the last 3 years so that competition appears to be active and effective. During 2015-16 the Commission focused on preparations for the opening of the retail market in England in April 2017. This has led to amendments to the License and the Governance Code to ensure that the market continues to work well for customers. In addition, a market audit is being undertaken to assess the performance of Licensed Providers in terms of compliance with the Market Code. This will inform a new Code of Practice which is designed to protect non-residential customers.

The Commission has been working to support the Scottish Government's Hydro Nation programme. At the request of the European Commission, the Commission has provided assistance to the Special Secretariat for Water in Greece. It has established strong links with other regulators through its contributions to the European Water Regulators Network (WAREG). This has led to agreements with the regulatory agencies in Albania and Romania under which the Commission will provide support and training.

In all aspects of its work the Commission relies entirely upon the dedication and efforts of its staff. We thank them for their contribution to the successful discharge of our responsibilities.

Finally, I would like to extend our welcome to Jo Armstrong and Donald Macrae who were appointed as Commission Members with effect from July 1st 2016. We look forward to drawing upon their knowledge and experience in future.

G A Hughes

Professor Gordon Hughes
Chairman
October 2016

ENSURING VALUE FOR MONEY FOR CUSTOMERS

We have a duty to ensure that customers in Scotland receive the best possible value for money for their water and wastewater services. We achieve this by limiting the amount that Scottish Water can charge its customers. We decide these limits through a process called the Strategic Review of Charges (or price review). In each review, we set prices that allow Scottish Water to deliver Scottish Ministers' objectives for the water industry at the lowest reasonable overall cost.

We published our final determination for water and sewerage charges for the period 2015-21 in November 2014. Our determination ensures that all household customers' bills will increase below the rate of inflation across the six-year regulatory control period. There will also be no increase in the maximum charges payable by non-household customers, unless there is a substantial increase in inflation.

Following completion of the 2015-21 Strategic Review of Charges, we have begun the process of developing and improving our approach for the regulatory control period that begins in April 2021. We have adopted the following principles in developing our approach:

- legitimacy in the eyes of customers and wider society is of paramount importance;
- customers should consider their water and sewerage bills to be reasonable and the services provided to be appropriate;
- the best value for money solution should always be chosen; and
- the regulatory framework should support the Scottish Government's vision of Scotland as a Hydro Nation.

> **The successful involvement of the Customer Forum in the Strategic Review of Charges has demonstrated the legitimacy and value of adopting the customer's viewpoint to shape the regulatory contract, and more generally to orient the future of water services in Scotland.**

The Customer Forum for water in Scotland – Legacy Report.

Our methodology will focus on those areas which impact most on the customer experience and will place an emphasis on safeguarding the future of the Scottish water industry.

One of the regulatory innovations introduced in the 2015-21 Strategic Review process was the establishment of the Customer Forum. The Forum's role was to identify customer priorities and to secure the best outcome for customers both in terms of charges and levels of service within a set of acceptable ranges determined by the Commission. The Forum's close involvement in the price setting process resulted in an excellent outcome for customers, with household bills projected to increase by £5 or less each year over the period and more focus placed on service improvements in the areas customers care about most.

The Scotland Act (2016) devolves further powers relating to consumer advocacy and advice to the Scottish Parliament. The Scottish Government has proposed a new consumer protection body, tasked with ensuring that consumers' voices are heard and taken into account. The Scottish Government has made clear its ambition to create a strong interaction between this new body and sector regulators.

We will work with industry stakeholders to ensure that consumer involvement remains at the heart of the price setting process in Scotland.

Household bills projected to
increase by £5 or less
EACH YEAR OVER THE 2015-21 PERIOD

MONITORING SCOTTISH WATER'S PERFORMANCE

Our 2015-21 determination introduced a number of regulatory innovations which allow Scottish Water to build on what it has achieved over the last five years. Scottish Water is performing well under the parameters set within the Strategic Review and we will continue to monitor Scottish Water's performance in delivering improvements for customers.

It is important that Scottish customers can feel confident that their water and sewerage services are being delivered in an efficient way. We monitor Scottish Water's levels of efficiency by considering current operating costs and capital investment expenditure. We then assess what the company should be capable of achieving, both over the regulatory control period and beyond.

We are a member of the Outputs Monitoring Group, alongside the Scottish Government, Scottish Water, the Scottish Environment Protection Agency, the Drinking Water Quality Regulator, the Scottish Public Service Ombudsman and Citizens Advice Scotland. The group reviews progress towards achieving the ministerial objectives set out in Scottish Water's agreed delivery plan. The group meets every three months and publishes quarterly reports on the Scottish Government website.

We publish an annual Performance Report, which describes Scottish Water's performance in delivering key outcomes for customers and the environment over the year. This report covers both the outputs monitored by the Outputs Monitoring Group, and the measures of customer service.

Our most recent Performance Reports, published in October 2016, indicated that the regulatory framework that is in place to regulate Scottish Water has served the public well.

Despite some initial delays in the delivery of the investment programme, customers are continuing to benefit from ever higher standards of drinking water quality, environmental performance and customer service. We will continue to monitor progress in these areas carefully.

As part of our ongoing work to develop the methodology for the next Strategic Review of Charges, we are examining the scope to enhance the performance monitoring regime. We will look to increase transparency and reduce complexity of the monitoring mechanisms, and improve the monitoring of investment in maintaining the condition and performance of assets.

ACHIEVING GREATER VALUE AND CHOICE THROUGH COMPETITION

The introduction of retail competition in April 2008 has empowered business customers to choose a price and service level that reflects their specific needs.

There are around 150,000 non-household customers in Scotland and the competitive market has an annual gross market value of £300 million. The introduction of competition has brought wider choice, more tailored services and lower prices for business customers.

This year we have seen strong and continued growth in activity within the competitive market and increased levels of customer switching. There has also been a marked shift in the structure of the market, with new entrants taking a larger market share.

In the coming year we are working to improve the licensing framework and the Governance Code such that the water and sewerage retail market continues to work well for customers. Water and Sewerage retailers will also help us to develop a new Code of Practice, which will help to further protect customers.

COMPETITION =
wider choice, more tailored service and lower prices
for business customers

SHARING OUR EXPERIENCE

Hydro Nation

Over the past year we have taken the opportunity to support the Scottish Government's 'Hydro Nation' initiative by learning from and sharing expertise in regulation with other countries. The office has also developed a range of international links through its participation in the European Water Regulator's Network (WAREG).

We have begun to collaborate with international organisations such as the OECD. The Commission was recently invited to join the OECD's Water Governance Initiative's working group on 'best practices'.

We are increasingly contacted by a number of international regulators who are interested in learning more about the successful public sector regulatory model in Scotland. There has been particular interest in our approach to consumer involvement and the Customer Forum model. Earlier this year, we hosted delegations from the Italian and Albanian regulators who were keen to better understand our approach to customer involvement and in monitoring Scottish Water's performance.

This year, we were pleased to lead a mission to Greece in response to a call for support from the EU Commission's Structural Support and Reform Service. The key aim of the mission was to conduct a high level diagnostic of some of the key challenges facing the Greek water industry. As part of this mission, we developed an assistance programme for the Hellenic Special Secretariat for Water (SSW) in Greece, identifying the key steps for the development of the SSW's capabilities and of its regulatory functions.

Rural Provisions

As part of the Scottish Government's work to develop a better understanding of the opportunities to support rural communities in water and wastewater provision, we are taking forward work to develop a number of pilots. These pilots will inform the development of governance models that offer tailored solutions for communities as well as providing an impetus for innovative approaches.

> **"The Water Industry Commission for Scotland (WICS) continues to play a key role in promoting the Hydro Nation agenda, bringing energy and commitment to spreading the knowledge and experience from Scotland into other markets."**

Scotland the Hydro Nation' annual report 2015 – Scottish Government

MANAGING OUR OFFICE

With a staff of less than 20 people we are responsible for regulating an industry with an annual turnover of more than £1 billion that provides a vital service to the Scottish people. We carry out our role at a cost of less than 40 pence per person.

The Commission is a non-departmental public body with statutory responsibilities, which acts independently of Ministers. We consider that we are accountable to customers in Scotland; we achieve this by being transparent in our work. As part of our accountability, we must agree a corporate plan with Scottish Ministers as well as submitting an annual report and financial statements. The corporate plan sets out our work plan and budget projections for a six-year period.

To ensure we can fulfill our obligations as outlined in the corporate plan, we monitor our own expenditure with care, and by maintaining robust procurement processes, we aim for maximum efficiency and achievement of value for money.

Expenditure for the financial year 2015-16 was in line with the previous financial year. This financial year, a surplus of £200k was identified and returned to Scottish Water and the Licensed Providers. There remains a surplus from the previous regulatory cycle which has been allocated to a project working with others to deliver a small number of pilot schemes to test innovative approaches to rural water and wastewater provision. In addition, the remainder of this surplus will be used to carry out an audit of the competitive retail market.

Over the past year we have continued to monitor and review contracts and have been working towards updating our procedures in line with the significant changes brought about by new procurement legislation, including the Public Contracts (Scotland) Regulations 2015 the Procurement Reform (Scotland) Act 2014. These changes will help the Commission contribute towards smart, sustainable and inclusive growth while ensuring the efficient use of public funds.

FINANCIAL STATEMENTS

Year ended 31 March 2016

PERFORMANCE REPORT

1. Overview

The Water Industry Commission for Scotland (the Commission) presents the financial statements for the year from 1 April 2015 to 31 March 2016. The financial statements have been prepared in a form directed by the Scottish Ministers in accordance with the Water Industry Act 1999. The Commission is required to make a report to Scottish Ministers at the end of each year on its activities during the year and arrange for the report to be published.

1.1 History and statutory background

The Commission is a non-departmental public body sponsored by the Scottish Government Directorate for Environment and Forestry. The Commission was formed on 1 July 2005. The office of the Water Industry Commissioner for Scotland was dissolved at that time. The Water Services etc. (Scotland) Act 2005 transferred to the Commission the former Commissioner's function of promoting the interests of water customers. It also gave the Commission the functions of:

- determining limits on Scottish Water's charges; and
- creating and managing the UK's first ever regime for licensing the provision of retail water services to the non-household sector.

These functions are subject to scrutiny by the Competition and Markets Authority.

1.2 Principal activities

As the economic regulator of the Scottish water and sewerage industry we have a statutory duty to promote the interests of customers. We do this by incentivising Scottish Water to reduce prices, by insisting on better service and by facilitating greater value and choice through the competitive retail framework.

1.3 Performance over the period

We are now in the first year of the period covered by the 2015-21 Strategic Review of Charges. Scottish Water is performing well under the parameters set within the determination and preliminary data suggests that it is on track to deliver improvements for customers and our environment in its £3.5 billion investment programme over the 2015-21 period. We have now begun the process of developing and improving our approach for the regulatory control period that begins in April 2021. We have begun work on our methodology for the 2021-27 Strategic Review of Charges. We have developed our thinking in a series of papers which have been put forward to an Advisory Panel – a group of regulatory, academic and industry experts who will provide comment and challenge on our proposals. Within these Advisory Panel sessions the Commission has put forward its thinking on a long-term vision for the sustainable governance and financing of the Scottish Water Industry.

We monitor Scottish Water's levels of efficiency by considering current operating costs and capital investment costs. We then assess carefully what the company should be capable of achieving, both over the regulatory period and in the future. This is in line with our 'trust but verify' regulatory approach. We are pleased to report that, overall, Scottish Water has continued to perform well in 2015-16 and is continuing to deliver improvements for its customers.

This year we have seen strong and continued growth in activity within the Scottish competitive market (the Market) and welcome increases in levels of customer switching. There has also been a marked shift in the structure of the Market, with new entrants taking a larger market share. There are now 23 retailers, licensed by the Commission, participating in the Market across Scotland. We expect that this number may increase further as companies prepare for the opening of retail competition in England for April 2017.

There has been continued activity south of the border, as the opening of the English retail market approaches. We have continued to monitor developments to ensure Scottish interests are protected.

1.4 Risks

A strategic risk register is in place, overseen by the Commission and the Audit Committee, in accordance with the approved risk management strategy. Risks are managed by the Commission and the strategic risk register identifies the important role that employees have in the achievement of the Commission's objectives. During the year, the following risks were highlighted as part of the regular risk reporting process:

- The approach taken in developing the market framework in England and Wales may adversely impact the Market in Scotland. It is important that the Scottish Ministers' Principles of Charging can be safeguarded. We maintain a dialogue with the Department for Environment, Food and Rural Affairs (Defra) to ensure the implementation of the UK Government's Water Act delivers the aims of the future water and sewerage industry that all stakeholders would wish to see.
- Insufficient borrowing available to Scottish Water leads to a lack of resources to deliver all ministerial objectives, without increasing prices. Analysis is being undertaken on the impact of any proposed reduced borrowing and the wider consideration of the impact of a move to reduce the dependency on borrowing overall.

1.5 Future developments

During 2016-17 we will continue with our Advisory Panel sessions ahead of publishing our price review methodology. In these sessions, we will be exploring ways in which we can incentivise Scottish Water to challenge itself to deliver more for its customers.

One of the regulatory innovations introduced in the 2015-21 Strategic Review process was the establishment of the Customer Forum. We remain committed to ensuring that consumer involvement remains at the heart of the price setting process and will work closely with Citizens Advice, the Scottish Government and Scottish Water to decide how customers' views can best be represented in the 2021-27 Strategic Review of Charges process.

We are reviewing and developing the mechanisms by which we measure and report on Scottish Water's performance. In our work for the 2021-27 price review methodology we are exploring ways in which we might enhance the monitoring regime put in place for the 2015-21 Strategic Review of Charges.

This year, we are working to improve the licence framework and the Governance Code such that the water and sewerage retail market continues to work well for customers. Water and Sewerage retailers will also help us to develop a new Code of Practice which will help to further protect customers. We will also conduct a Market Audit which will review Licensed Provider's compliance with market codes. This will identify whether there are any areas where the code should be strengthened.

We expect that market opening will encourage further growth and activity in the Scottish retail market and benefit Scottish business customers by creating greater choice and lowering bills.

2. Performance analysis

2.1 Overall financial performance

As set out in the financial statements, there was a retained net surplus for the year of £218,683 (2014-15: £516,303). Expenditure for the financial year 2015-16 was largely in line with the previous financial year. The surplus retained last year, and for the full regulatory period 2010-15, will be utilised as part of the on-going project to deliver a small number of pilot schemes to test innovative approaches to rural and waste water provision. Of the cash balance of £1,990,308 (2014-15: £1,220,671), approximately £1m may be allocated to this project. Up to a further £500k may be spent on audits of the Market to allow wider consideration of Code compliance to ensure customer protection. This financial year, a further surplus of £200k was identified and returned to Scottish Water and the Licensed Providers.

The balance on the General Reserve as at 31 March 2016 was £1,226,037 (2014-15: £152,354). The balance sheet position of the pension liability has improved significantly in the year. Liabilities decreased by £492k as a result of an increase in the net discount rate, with improvements also being seen in asset returns, an increase of £269k.

2.2 Changes in non-current assets

During the year there was an investment of £7,983 in information technology assets. There was no other capital expenditure in the year. (2014-15: £nil).

2.3 Pensions

Some employees and former employees of the Commission's office are members of the Local Government Superannuation Scheme administered by Falkirk Council. This scheme is a defined benefit scheme. In accordance with IAS 19 (Revised) – Employee Benefits (IAS 19), the Commission commissioned the Fund's actuaries to undertake a valuation as at 31 March 2016. This calculation was based on rolling forward valuation data at 31 March 2014 to 31 March 2016, on the basis of a number of financial assumptions. Good asset returns in the year, as well as a decrease in liabilities resulting from an increase in the net discount rate, has resulted in a significant improvement in the balance sheet position of the pension. Details on the pension scheme can be found in the remuneration report on page 19, the accounting policies listed from page 28 and in note 12 to the financial statements.

2.4 Supplier payment performance

It is the Commission's policy to pay all invoices not in dispute within 30 days from receipt of the invoice or the agreed contractual terms if otherwise specified. However, the Commission aims to pay suppliers as soon as possible following receipt of an invoice. During 2015-16, the average length of time taken to pay an invoice was 9 days (2014-15: 6 days), which is in line with the Scottish Government's 10 day payment pledge.

2.5 Sustainability

Public Bodies in Scotland are bound by the Climate Change Public Bodies Duties set out in Part 4 of the Climate Change (Scotland) Act 2009. These duties require that public bodies covered by the duties must, in exercising their functions,

- contribute to carbon emissions reduction (climate change mitigation);
- contribute to climate change adaption; and
- act sustainably.

The Commission endeavours to behave in a carbon aware manner, with the location of our office allowing employees and visitors to have better access to sustainable forms of transport. We have maintained our recycling policy during this financial year, and our energy usage remains in line with the previous year. The Commission's support of the Scottish Government's Hydro Nation initiative has involved increased travel to European countries, increasing our carbon footprint from transport and travel.

Details of the carbon footprint of the office of the Commission can be found in the table below.

	2015-16		2014-15	
Area	**Non-financial information**	**Financial information**	**Non-financial information**	**Financial information**
Energy	**Electricity:** 24.1 tonnes CO2 **Gas:** 7.6 tonnes CO2 **Total carbon from energy:** 31.7 tonnes CO2	**Electricity:** £6,194 **Gas:** £1,508	**Electricity:** 24.1 tonnes CO2 **Gas:** 8.2 tonnes CO2 **Total carbon from energy:** 32.3 tonnes CO2	**Electricity:** £5,825 **Gas:** £1,916
Waste	**Waste to landfill:** 5 tonnes CO2 **Paper waste recycled:** 1 tonne CO2 **Total carbon from waste:** 6 tonnes CO2	£923	**Waste to landfill:** 5 tonnes CO2 **Paper waste recycled:** 1 tonne CO2 **Total carbon from waste:** 6 tonnes CO2	£900
Water	0.1 tonnes CO2	£2,285	Note 1	£2,974
Transport and travel	42 tonnes CO2	£74,131	28 tonnes CO2	£81,935

Note 1: Due to a leak elsewhere in the building, we do not have an accurate reading of the water consumption of the office for the financial year 2014-15.

All of the information in the table is based on our best estimates. We used the following sources for the information:

Energy: all information based on actual usage as reported on gas and electricity invoices.

Waste: financial information taken from actual invoices received in relation to waste collection and shredding services; volume based on estimated average weekly volume of waste, multiplied by number of collections in year.

Water: financial information taken directly from invoices received by Business Stream. Due to a water leak elsewhere in the building, no accurate consumptions figures are available for 2014-15.

Transport and travel: financial information based on estimated expenditure in the year; volume based on mileage estimates of journeys taken by employees during the year which have been booked through the travel agent.

All conversions to carbon consumption are calculated using data available from Defra.

2.6 The Public Services Reform (Scotland) Act 2010

The Public Services Reform (Scotland) Act 2010 imposed new duties on the Scottish Government and on public bodies such as the Commission to publish specific information on their expenditure. The Act also requires us to publish two statements outlining the steps we have taken to promote and increase sustainable growth and to improve efficiency, effectiveness and economy. The duties to publish this information are intended to promote greater openness and transparency. We publish a document with our response to the requirements of the Act each year on our website.

26 October 2016

Alan D A Sutherland, Accountable Officer

Water Industry Commission for Scotland
Moray House, Forthside Way, Stirling FK8 1QZ

ACCOUNTABILITY REPORT

1. Corporate Governance report

1.1 Directors' report

The Commission

The Commission meets regularly throughout the year and currently comprises the Chairman, Gordon Hughes, two further non-executive members, and the Chief Executive, Alan Sutherland. Members of the Commission are appointed by Scottish Ministers. The length of appointments may vary to ensure continuity of Commission membership, but are usually three or four years.

Directors

The Directors during the year were Alan Sutherland, Katherine Russell and Ian Tait. As well as being the Chief Executive and Accountable Officer, Alan Sutherland is also the executive member of the board of the Commission.

Interests held by the Commission

Neither the Commission, nor its members or directors, held interests in other bodies with which the Commission has dealings. The Commission has a register of interests which is available for inspection on our website.

Auditor

Audit appointments are made by the Auditor General, either to Audit Scotland or private firms for a five year term. For the financial year 2015-16, the auditor for the Commission is KPMG LLP. Its appointment is undertaken in accordance with the Code of Audit Practice approved by the Auditor General. The cost of these services for the year to 31 March 2016 amounted to £11,870 (2014-15: £13,365). In addition, KPMG provided non-audit services to the value of £6,180 (2014-15: £8,760).

Data loss

There have been no instances of personal data loss in the year.

Significant events since the end of the financial year

There have been no significant events since the end of the financial year that require adjustment or disclosure under the terms of IAS 10: events after the reporting period. In accordance with the requirements of IAS 10, events are reviewed and considered up to the date on which the financial statements are authorised for issue. This is interpreted as the date on which the Independent Auditor's report is signed.

1.2 Statement of Accountable Officer's Responsibilities

Under the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, the Scottish Ministers have directed the Water Industry Commission for Scotland to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The financial statements are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Water Industry Commission for Scotland and its income and expenditure, changes in equity and cash flows for the financial year.

In preparing the financial statements, the Accountable Officer is required to comply with the requirements of the Government Financial

Reporting Manual (FReM), and in particular to:-

- Observe the Accounts Direction issued by Scottish Ministers, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis.
- Make judgements and estimates on a reasonable basis.
- State whether applicable accounting standards, as set out in FReM, have been followed, and disclose and explain any material departures in the financial statements.
- Prepare the financial statements on a going concern basis.

The Permanent Secretary has appointed the Chief Executive as Accountable Officer of the Water Industry Commission for Scotland. The responsibilities of an Accountable Officer, including responsibility for the propriety and regularity of the public finances for which the Accountable Officer is answerable, for keeping proper records and for safeguarding the Water Industry Commission for Scotland's assets, are set out in the Scottish Public Finance Manual (SPFM) published by the Scottish Ministers.

The Accountable Officer confirms that the annual report and accounts as a whole is fair, balanced and understandable and that he takes personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable.

Disclosure of information to auditor

So far as the Accountable Officer is aware, there is no relevant audit information of which the Commission's auditor is unaware. The Accountable Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the Commission's auditor is aware of that information.

1.3 Governance statement

Scope of responsibility

The SPFM is issued by the Scottish Ministers to provide guidance to the Scottish Government and other relevant bodies on the proper handling and reporting of public funds. It sets out the relevant statutory, parliamentary and administrative requirements, emphasises the need for economy, efficiency and effectiveness, and promotes good practice and high standards of propriety.

The Accountable Officer has responsibility for maintaining a sound governance framework that supports the achievement of the organisation's policies, aims and objectives set by Scottish Ministers, whilst safeguarding the public funds and assets for which he is personally responsible, in accordance with the responsibilities assigned to him.

The purpose of the governance framework

The governance framework comprises the systems and processes, and culture and values, by which the Commission is directed and controlled. It enables the Commission to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an on-going process designed to identify and prioritise the risks to the achievement of the Commission's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place at the Commission for the year ended 31 March 2016 and up to the date of approval of the annual report and financial statements.

The Commission's governance framework and review of effectiveness

The Commission aims for the highest standards in corporate governance and details of the processes, significant developments and issues identified during the period are outlined below.

(i) The Commission

The Commission members have corporate responsibility for ensuring that the Commission fulfils its statutory duties, any targets agreed with Scottish Ministers and for promoting the efficient and effective use of staff and other resources by the Commission in accordance with the principles of Best Value. There were no changes to the membership of the Commission during the year.

The Commission reviews our strategy and its implementation regularly. This includes assessing changing external economic, political, environmental and social factors and our capacity to deliver in light of any such changes. The Commission meets regularly and at least quarterly for general business, including a review of the risk register. At each meeting the Commission discusses strategic issues relating to the monitoring of Scottish Water's performance, Strategic Review of Charges and developments in the Market.

(ii) Audit Committee

The Audit Committee meets four times a year and monitors and reviews risk, control and corporate governance. During the year the Committee was chaired by Ross Finnie. In addition, membership of the Committee includes two non-executive members who are not Commission members. The non-executive members are appointed internally by the Chief Executive and Chairman of the Committee based on the breadth of skill, knowledge and experience they can bring to the Committee. The external and internal auditors are invited to attend all meetings and are given the opportunity to speak confidentially to the Committee members. The Audit Committee operates independently and reports to the Commission. The Committee presented the annual report of the Audit Committee to the April 2016 Commission meeting, which concluded that the Committee was satisfied that the Commission has acted diligently to set in place effective control systems and financial reporting processes to measure and manage the risk inherent in the delivery of the organisation's objectives.

(iii) Internal audit

The work of the internal auditor is submitted to the organisation's Audit Committee and includes regular reports and the Head of Internal Audit's independent and objective opinion on the adequacy and effectiveness of the organisation's systems of internal control together with recommendations for improvement.

The work of internal audit only identified one 'medium' and 'eleven' low rated findings during the financial year 2015-16, most of which have been closed or are in the process of being implemented. Based on the internal audit work performed during the year, the Internal Audit Annual Report confirmed that there are "adequate and effective governance, risk management and control processes to enable the related risks to be managed and objectives to be met".

(iv) Risk management

All bodies to which the SPFM is directly applicable must operate a risk management strategy in accordance with relevant guidance issued by the Scottish Ministers. The general principles for a successful risk management strategy are set out in the SPFM and the Commission has used this to derive its own risk management strategy.

The Commission has established a robust and effective framework for the management of risk, one that is proactive in understanding risk, builds upon existing good practice and is integral to all our decision making, planning, performance reporting and delivery processes. Our risk strategy makes clear the roles and responsibilities for achieving an effective control framework. The focus of our strategy is a risk register which identifies potential or actual risks to the achievement of the objectives set out in our Corporate Plan. It also documents the controls in place to manage these risks and any action being taken to reduce the risk rating and is regularly reviewed as described below.

The Commission actively champions the risk management process and is responsible for defining the organisation's risk appetite. The risk register is populated by contributions from the Commission and all staff, and each risk is scored and set a realistic target to reduce the level of the risk. The action plans in place to reduce risk ratings are subject to continual review. They are monitored by staff internally and reviewed by the Commission's Audit Committee on a quarterly basis. The Accountable Officer, also reviews the register prior to its submission to the Audit Committee. The Commission is informed of significant changes to the register or new risks.

Significant governance issues

The review of effectiveness of the Commission's governance framework, as detailed above, provides good assurance of the effectiveness of the Commission's system of internal control. There have been no governance issues identified during the year that are significant in relation to the Commission's overall governance framework. Specific, but not significant, opportunities for improvement in governance and internal controls identified as part of the assurance processes detailed above have been addressed.

2. Remuneration and staff report

2.1 Background

The Chairman and Commission members are appointed by Scottish Ministers in line with the Code of Practice issued by the Scottish Commissioner for Public Appointments. The Chief Executive is appointed by the Chairman of the Commission. The parameters for the remuneration of the Chief Executive, the Chairman and the members of the Commission are set by the Scottish Government's Public Sector Pay Policy for Senior Appointments, which is updated annually.

There is no separate Remuneration Committee and remuneration related issues are brought to the attention of the Commission as they arise. Performance pay of all employees is in line with the Public Sector Pay Policy as defined by the Scottish Government on an annual basis.

2.2 Directors' salary and pension entitlements

This section of the remuneration report is subject to audit.

The total remuneration of the Chief Executive in the year was £149,642 (2014-15: £144,320). The total remuneration of the Directors was as follows:

	2015-16			2014-15		
Directors	Gross Salary £(000)	Pension benefits £(000)	Total £(000)	Gross Salary £(000)	Pension benefits £(000)	Total £(000)
Alan Sutherland, Chief Executive	145 - 150	50 - 55	200 - 205	140 -145	35 - 40	180–185
Katherine Russell, Director of Corporate Affairs & Strategy	125-130	35 - 40	165 - 170	125-130	25 – 30	150–155
Ian Tait, Director of Investment	100-105	40 - 45	145 - 150	95-100	50 – 55	145-150

The Directors' normal retirement age is 65, which is the earliest date at which the member can take full benefits without consent and without reduction. There are no additional benefits to which the Directors would become entitled on early retirement.

No bonus payments or benefits in kind were paid to the Chief Executive or Directors during 2015-16 (2014-15: £nil). The total remuneration of the Chief Executive and other Directors was £380k-£385k (2014-15: £365k-£370k). The Chief Executive and the Directors are also ordinary members of the Falkirk Council Pension Scheme.

Directors	Accrued pension as at 31/03/16 £(000)	Lump sum as at 31/03/16 £(000)	Real increase in pension £(000)	Real increase/ (decrease) in lump sum £(000)	Value of increase (excluding Director's own contribution) £(000)	Director's own contribution £(000)
Alan Sutherland	25 – 30	25 – 30	2.5 – 5	0 – 2.5	50 - 55	15 – 20
Katherine Russell	15 – 20	10 – 15	2.5 – 5	(0 – 2.5)	35 - 40	10 – 15
Ian Tait	20 – 25	25 - 30	2.5 – 5	0 – 2.5	40 - 45	10 – 15

Directors	CETV* at 31/03/16 £(000)	CETV at 31/03/15 £(000)	Increase in CETV (excl director's own contributions and inflation) £(000)
Alan Sutherland	380	323	37
Katherine Russell	255	215	24
Ian Tait	312	266	32

*cash equivalent transfer value

2.3 Commission remuneration

This section of the remuneration report is subject to audit.

The remuneration of the Commission Members, other than the Chief Executive, is determined by Scottish Ministers and subject to the Scottish Government's Public Sector Pay Policy for Senior Appointments. The remuneration of the Commission members, other than the Chief Executive, was as follows:

	2015-16	2014-15
	Total £(000)	Total £(000)
Professor Gordon Hughes	36 - 40	36 - 40
Ross Finnie	11 - 15	11 - 15
Libby Gawith	11 - 15	11 - 15

Commission Members are not members of the pension scheme. The Commission also paid £3,154 on behalf of Commission Members in the year in respect of PAYE and National Insurance contributions due on travel to work expenses in 2015-16 (2014-15: £2,270). No benefits in kind were paid in the year.

2.4 Staff report

Fair pay disclosure

Reporting bodies are required to disclose the relationship between the remuneration of the highest paid director in their organisation and the median remuneration of the organisation's workforce. The average banded remuneration of the highest paid Director of the Commission for the year to 31 March 2016 was £149,642 (2014-15: £144,320). This was 5 times (2014-15: 5 times) the annualised median remuneration of the workforce, which was £28,796 (2014-15: £28,000). The highest paid Director of the Commission is the Chief Executive.

	2015-16	2014-15
Highest paid Director's total remuneration (£000)	149.6	144.3
Median total remuneration (£)	28,796	28,000
Ratio	5.2	5.2

Staff composition

The Commission recognises the commitment of all employees in carrying out the functions of its Office, and seeks to be an equal opportunity employer in the recruitment, training and development of all staff. The Commission seeks to consult fully with employees on all matters that impact upon their employment within the office. At the end of the financial year, the number of employees of each sex was as follows:

	Male	Female	Total
Directors	2	1	3
Other employees	8	7	15

Sickness absence

The average length of time that each employee was absent due to sickness was 5 days (2014-15: 8 days).

26 October 2016

Alan D A Sutherland, Accountable Officer

Independent auditor’s report to the members of Water Industry Commission for Scotland, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Water Industry Commission for Scotland for the year ended 31 March 2016 under the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005. The financial statements comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows and the Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the 2015-16 Government Financial Reporting Manual (the 2015-16 FReM).

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of Accountable Officer and auditor

As explained more fully in the Statement of Accountable Officer’s Responsibilities, the Accountable Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and is also responsible for ensuring the regularity of expenditure and income. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors. We are also responsible for giving an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the body and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accountable Officer; and the overall presentation of the financial statements. It also involves obtaining evidence about the regularity of expenditure and income. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements, irregularities, or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view in accordance with the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers of the state of the body's affairs as at 31 March 2016 and of its retained net surplus for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015-16 FReM; and
- have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers.

Opinion on regularity

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Opinion on other matters prescribed matters

In our opinion:

- the part of the Remuneration and Staff Report to be audited has been properly prepared in accordance Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, and directions made thereunder by the Scottish Ministers; and
- the information given in the Performance Report and the Accountability Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration and Staff Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Governance Statement does not comply with guidance from the Scottish Ministers.

We have nothing to report in respect of these matters.

Andrew Shaw

28 October 2016

Andrew Shaw (for and on behalf of KPMG LLP)

20 Castle Terrace
Edinburgh EH1 2EG

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2016

	Note	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Income			
Income from activities	2	3,393,564	3,589,514
Expenditure			
Staff costs	4	1,350,585	1,346,955
Depreciation	6	31,107	29,666
Other expenditures	5	1,797,172	1,698,621
		3,178,864	3,075,242
Operating surplus		214,700	514,272
Interest receivable		3,983	2,031
Retained net surplus for the year		**218,683**	**516,303**
Other comprehensive income			
Actuarial gain/(loss)	12	855,000	(596,000)
Total comprehensive income for the year		**1,073,683**	**(79,697)**

All income and expenditure relates to continuing activities.

The notes on pages 28 - 43 form part of these financial statements.

STATEMENT OF FINANCIAL POSITION

As at 31 March 2016

	Note	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Non-current assets			
Property plant and equipment	6	96,586	119,710
Total non-current assets		**96,586**	**119,710**
Current assets			
Other receivables	7	45,553	489,016
Cash and cash equivalent		1,990,308	1,220,671
Total current assets		**2,035,861**	**1,709,687**
Total assets		**2,132,447**	**1,829,397**
Current liabilities			
Trade payables and other current liabilities	8	(299,560)	(316,163)
Total current liabilities		**(299,560)**	**(316,163)**
Total net assets, excluding pension liabilities		**1,832,887**	**1,513,234**
Pension scheme liability	12	(572,000)	(1,333,000)
Total net assets, including pension liabilities		**1,260,887**	**180,234**
Non-current liabilities			
Provisions	9	(34,850)	(27,880)
Net Assets		**1,226,037**	**152,354**
Equity			
General Reserve		1,226,037	152,354

The notes on pages 28 - 43 form part of these financial statements.

26 October 2016

Alan D A Sutherland, Accountable Officer

STATEMENT OF CASH FLOWS

For the year ended 31 March 2016

	Note	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Cash flows from operating activities			
Operating surplus		214,700	514,272
Adjustments for non-cash items			
Difference in pension costs compared to contributions	12	49,000	43,000
Depreciation on tangible non-current assets	6	31,107	29,666
Finance costs		45,000	29,000
Increase in provision	9	6,970	6,970
Movements in working capital			
Decrease/(Increase) in trade and other receivables	7	443,463	(358,117)
(Decrease)/Increase in trade payables	8	(16,603)	132,159
Net cash inflow from operating activities		**773,637**	**396,950**
Cash flows from investing activities			
Purchase of property, plant and equipment	6	7,983	-
Net cash outflow from investing activities		**7,983**	**-**
Cash flows from financing activities			
Interest received		3,983	2,031
Net inflow from financing activities		**3,983**	**2,031**
Net increase in cash and cash equivalents		**769,637**	**398,981**
Cash as at 1 April		1,220,671	821,690
Cash as at 31 March		1,990,308	1,220,671
Net increase in cash and cash equivalents		**769,637**	**398,981**

The notes on pages 28 - 43 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY (SCE)

For the year ended 31 March 2016

	£
Balance at 1 April 2014	232,051
Total comprehensive income for the year 2014-15	(79,697)
Balance as at 31 March 2015	152,354
Total comprehensive income for the year 2015-16	1,073,683
Balance as at 31 March 2016	**1,226,037**

The general reserve is analysed in note 10.

The notes on pages 28 - 43 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting policies

The financial statements are prepared in a form determined by the Scottish Ministers, in accordance with the Water Industry Act 1999, as amended by the Water Industry (Scotland) Act 2002 and the Water Services etc. (Scotland) Act 2005.

The financial statements are prepared as required by the Accounts Direction issued by the Scottish Ministers and prepared in accordance with the FReM issued by HM Treasury.

The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of the Commission for the purpose of giving a true and fair view has been selected. The policies adopted are described below. They have been applied consistently in dealing with items that are considered material in relation to the financial statements.

The preparation of the financial statements in conformity with the FReM requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed below in "Critical accounting estimates and key judgements".

The Commission and Accountable Officer have considered the budget for 2016-17, comprising the statutory contribution from Scottish Water and licensed provider levies, and consider that the Commission has adequate resources to continue in operational existence for the foreseeable future. The financial statements are therefore prepared on a going concern basis.

1.1 Accounting Convention

These financial statements have been prepared under the historical cost convention modified to account for the revaluation of property, plant and equipment and intangible assets.

1.2 Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Commission makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost/ (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

The Commission determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Commission considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in note 12.

1.3 Newly Adopted IFRS

In these financial statements, there are no adopted IFRSs which are effective for the first time which have had a material effect on the financial statements therefore there has been no restatement of comparatives.

Adopted IFRS not yet applied

The following Adopted IFRS has been issued but has not been applied in these financial statements. Its adoption is not expected to have a material effect on the financial statements unless otherwise indicated:

IFRS 13 "Fair Value Measurement"

1.4 Furniture and fittings and information technology

Furniture and fittings and information technology are recorded in the financial statements at depreciated replacement cost because their fair market value is not readily available.

Depreciation is charged on cost less estimated residual value on a straight line basis over the expected useful lives of up to a maximum of:

- furniture and fittings: 10 years, which is not more than the lease term of the building in which the furniture and fittings are located; and
- information technology: 4 years.

The Commission considers that all of the assets in these categories have short useful lives and the depreciation rates provide a realistic reflection of consumption and reduction in carrying value. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

A full year's depreciation is provided in the year of acquisition and none in the year of disposal.

1.5 Financial assets

Classification

The Commission classifies its financial assets as 'loans and receivables'. The Commission does not hold any financial assets that would be classified as 'available for sale' or 'held-to-maturity'. The classification depends on the purpose for which the financial assets were acquired and is determined at initial recognition.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets. Loans and receivables comprise other receivables and cash and cash equivalents.

Recognition and measurement

Financial assets are recognised when the Commission becomes party to the contractual provisions of the financial instrument. Financial assets are no longer recognised when the rights to receive cash flows from the asset have expired or the Commission has transferred substantially all risks and rewards of ownership.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Commission will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the loan and receivable is impaired. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the comprehensive statement of income and expenditure. When a loan or receivable is uncollectible it is written off against the provision account. Subsequent recoveries of amounts previously written off are credited in the comprehensive statement of income and expenditure.

1.6 Financial liabilities

Classification

The Commission classifies its financial liabilities on initial recognition as other financial liabilities. Other financial liabilities are included in current liabilities, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current liabilities. The Commission's other financial liabilities comprise trade and other payables in the balance sheet.

Recognition and measurement

Financial liabilities are recognised when the Commission becomes party to the contractual provisions of the financial instrument. A financial liability is removed from the balance sheet when it is extinguished, that is when the obligation is discharged, cancelled or expired. Other financial liabilities are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.7 Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks.

1.8 Provisions

Provisions are recognised when: the Commission has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax interest rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as an interest expense.

1.9 Income

Funding is by way of the statutory contribution paid by Scottish Water, as directed by Scottish Ministers. Licensing activity is funded by a levy charged to licensed providers. All income is recognised in the statement of comprehensive income in the period to which it relates.

1.10 Value added tax

Most of the activities of the Commission are outside the scope of Value Added Tax (VAT) and, in general, the Commission is not required to declare output tax to HMRC on the income that it receives. Correspondingly, the Commission is not entitled to recover VAT that it incurs on costs (input tax) in relation to these activities that fall outside the scope of VAT. Such irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets. The Commission became VAT registered from 1 January 2015 to recognise the provision of services being carried out in relation to the opening of the retail market in England, which are subject to VAT. Input tax is recovered on all costs directly associated with this work and these activities also permit the Commission to recover a percentage of the VAT incurred on other applicable overhead costs.

1.11 Operating Leases

Leases where most of the risks and rewards of ownership of the asset remain with the lessor are classified as operating leases. Operating lease payments are recognised in the comprehensive statement of income and expenditure on a straight line basis over the lease term. The benefit of any lease incentive is recognised as a reduction in rental expense on a straight line basis over the life of the lease.

1.12 Employee benefits

Employees of the Commission are members of the Local Government Pension Scheme (the Scheme) administered by Falkirk Council. The Scheme is a tax approved, defined benefit occupational pension scheme and the scheme regulations are made under the Public Service Pension Schemes Act 2013 and, in the case of the LGPS (Transitional Provisions and Savings) (Scotland) Regulations 2014, under the Superannuation Act 1972. The Scheme is contracted out of the State Second Pension scheme and meets the government's standards under the automatic enrolment provisions of the Pensions Act 2008.

The Scheme is accounted for on a defined benefit basis under IAS 19. Assets and liabilities of the Scheme are held separately from those of the Commission. The Scheme's assets are measured using market values and the Scheme's liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Contributions to the Scheme are calculated so as to spread the cost of pensions over employees' working lives. The contributions are determined by an actuary on the basis of triennial valuations using the Age Attained Method. The actuaries also review the progress of the Scheme in each of the intervening years. Variations from regular cost are spread over the expected average remaining working lifetime of members of the Scheme after making allowances for future withdrawals.

The expected cost of providing staff pensions to employees contributing to the Scheme is recognised in the statement of comprehensive income and expenditure on a systematic basis over the expected average remaining lives of members of the funds in accordance with IAS 19 and recognises retirement benefits as the benefits are earned and not when they are due to be paid. The statement of comprehensive income and expenditure also includes the net impact of returns on the Scheme's assets and interest on the Scheme's liabilities, which is disclosed (net) as other finance income or interest payable. A pension scheme asset is recognised on the balance sheet only to the extent the surplus may be recovered by reduced further contributions or to the extent that the trustees have agreed a refund from the scheme at the balance sheet date. A pension scheme liability is recognised to the extent that the Commission has a legal or constructive obligation to settle the liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income and expenditure, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

1.13 Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Commission recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

1.14 Segmental reporting

Operating segments are identified on the basis of internal reports about components of the Commission that are regularly reviewed by the chief operating decision makers (the Chief Executive and Commission) in order to allocate resources to the segments and assess their performance.

2. Income

	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Scottish Water statutory contribution	1,900,004	2,080,008
Levy on licensed providers	1,352,858	1,158,618
Other income	140,702	350,888
	3,393,564	3,589,514

Other income relates to the reimbursement of costs associated with the work done by the Commission in relation to the development of the retail market in England. The Commission had a memorandum of understanding in place with Open Water Market Limited (OWML), the body charged by Government to coordinate the development of the market rules, framework and systems required for an effective non-household retail market in England. From 8 September 2014 the Commission recharged costs incurred directly in relation to this work and time spent by Commission employees, on a cost recovery basis. This arrangement ended in May 2015.

3. Analysis of net expenditure by segment

The purpose of activity reporting is to analyse the Commission's costs and income by team and by the key work streams of the organisation. This allows the Commission to have a better understanding of how (and against which activities) resources are being deployed. A summary of the full year report is detailed below.

		ACTIVITY			
		Determination of prices and monitoring of performance	**Managing and developing the competitive framework**	**Office administration and other corporate costs**	**TOTAL**
Income received (£)	2015-16	1,900,004	1,493,560	-	3,393,564
	2014-15	*2,080,008*	*1,508,856*	-	*3,588,864*
Expenditure (£)	2015-16	1,137,600	663,841	698,421	2,499,862
	2014-15	*900,663*	*1,048,332*	*856,449*	*2,805,444*
Reallocation of office administration and corporate costs (£)	2015-16	441,049	257,372	(698,421)	-
	2014-15	*547,923*	*308,526*	*(856,449)*	-
Surplus (£)	2015-16	321,355	572,347	-	893,702
	2014-15	*631,422*	*151,998*	-	*783,420*

Reconciliation to statement of comprehensive income:

	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Net surplus for the year per statement of comprehensive income	218,683	516,303
Cost of secondments and Hydro Nation	581,019	195,767
Staff costs: IAS 19 adjustment	49,000	43,000
Other income	-	(650)
Finance income: IAS 19 adjustment	45,000	29,000
Retained net surplus for the year as above	**893,702**	**783,420**

4. Staff numbers and related costs

Staff costs comprise:

	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Wages and salaries	1,015,474	1,010,162
Social security costs	100,111	99,793
Pension costs	235,000	237,000
Staff costs per statement of comprehensive income	1,350,585	1,346,955

The cash contributions made to the pension scheme are disclosed in note 12.1.

Average number of persons employed

The average number of whole-time equivalent persons employed during the year was 18 (2014-15: 17), including the Chief Executive. These were employed in the following areas:

	Year ended 31 March 2016	Year ended 31 March 2015
Chief Executive and Directors	3	3
Corporate Affairs	7	7
Analysis	8	7

All employees are employed on permanent contracts.

5. Other expenditure

	Year ended 31 March 2016 £	Year ended 31 March 2015 £
Travel and subsistence	210,730	196,168
Office accommodation	118,713	122,572
General operating costs	212,796	203,766
Regulation and licensing costs	1,029,976	989,299
Customer consultation costs	51,316	58,192
Recruitment	72,282	56,923
Information technology	53,620	40,506
Finance charges	47,739	31,196
	1,797,172	**1,698,621**

The operating costs for the year are stated after charging the external audit fee of £11,870 (2014-15: £13,365), non-audit fees of £6,180 (2014-15: £8,760) and, within office accommodation, an operating lease rental of £49,176 (2014-15: £49,176).

6. Property, plant and equipment

	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2015	172,302	277,656	449,958
Additions	7,983	-	7,983
At 31 March 2016	**180,285**	**277,656**	**457,941**
Depreciation			
At 31 March 2015	165,717	164,531	330,248
Charge for the year	7,466	23,641	31,107
At 31 March 2016	**173,183**	**188,172**	**361,355**
Net book value at 31 March 2016	**7,102**	**89,484**	**96,586**
Net book value at 31 March 2015	**6,585**	**113,125**	**119,710**

	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2014	174,895	277,656	452,551
Disposals	(2,593)	-	(2,593)
At 31 March 2015	**172,302**	**277,656**	**449,958**
Depreciation			
At 31 March 2014	162,840	140,335	303,175
Charge for the year	5,470	24,196	29,666
Eliminated on disposals	(2,593)	-	(2,593)
At 31 March 2015	**165,717**	**164,531**	**330,248**
Net book value at 31 March 2015	**6,585**	**113,125**	**119,710**
Net book value at 31 March 2014	**12,055**	**137,321**	**149,376**

7. Other receivables

	As at 31 March 2016 £	As at 31 March 2015 £
Current receivables		
Prepayments	45,503	227,125
Other receivables	50	261,891
Total other receivables	**45,553**	**489,016**

	As at 31 March 2016 £	As at 31 March 2015 £
Intra-government receivables		
Central Government	-	151,808
Bodies external to government	45,553	337,208
Total other receivables	**45,553**	**489,016**

8. Current liabilities

	As at 31 March 2016 £	As at 31 March 2015 £
Trade payables	11,848	44,485
Taxation and Social Security	31,612	94,749
Accruals	256,100	176,929
Total current liabilities	**299,560**	**316,163**

	As at 31 March 2016 £	As at 31 March 2015 £
Intra-government payables		
Local Authorities	2,200	2,110
Central Government	42,678	104,479
Bodies external to government	254,682	209,574
Total current liabilities	**299,560**	**316,163**

9. Provisions for liabilities and charges

	As at 31 March 2016 £	As at 31 March 2015 £
Balance at 1 April 2015	27,880	20,910
Provided in the year	6,970	6,970
Balance at 31 March 2016	**34,850**	**27,880**

The provision for dilapidation costs relates to the Commission's contractual duty to repair leasehold property on termination of the lease. Provision is made for the estimated costs of fully repairing leasehold properties at the balance sheet date.

10. Note to the statement of changes in equity

The general reserve is analysed below to highlight that element which relates to pensions.

	Note	Operations £	Pension £	General Reserve £
Balance at 1 April 2014		897,051	(665,000)	232,051
Changes in reserves 2014-15				
Actuarial gains		-	109,000	109,000
Change in assumptions underlying the present value of the scheme liabilities		-	(705,000)	(705,000)
Net surplus for the year		581,303	(65,000)	516,303
Balance as at 31 March 2015		**1,478,354**	**(1,326,000)**	**152,354**
Changes in reserves 2015-16				
Actuarial gains	12	-	(88,000)	(88,000)
Change in assumptions underlying the present value of the scheme liabilities	12	-	943,000	943,000
Net retained surplus for the year		84,683	134,000	218,683
Balance as at 31 March 2016		**1,563,037**	**(337,000)**	**1,226,037**

11. Commitments and contingent liabilities

11.1 Capital commitments

There were no capital commitments at 31 March 2016 (2014-15: £nil).

11.2 Commitments under operating leases

Total future minimum lease payments under operating leases are given in the table below for each of the stated periods. The amounts relate entirely to the Commission's office accommodation.

	2015-16 £	2014-15 £
Later than 5 years:	245,880	295,056

11.3 Contingent liabilities

The Commission had no contingent liabilities at 31 March 2016 (2014-15: £nil).

12. Pension

12.1 Background

Some employees and former employees of the Commission's office are members of the Local Government Superannuation Scheme administered by Falkirk Council. This scheme is a defined benefit scheme. In the period the Commission paid contributions totalling £186,000 (2014-15: £194,000) into the Fund. Under the Superannuation Regulations, contributions are set to meet 100% of the overall liabilities of the Fund. We have been advised that specific (minimum) rates for employer contributions in 2016-17 will be 19.1%, plus a fixed amount of £23,500.

In accordance with IAS 19 the Commission commissioned the Fund's actuaries to undertake a valuation as at 31 March 2016. This calculation was based on rolling forward valuation data at 31 March 2015 (the last formal valuation) to 31 March 2016 on the basis of a number of financial assumptions. The main financial assumptions used included:

12.2 Financial Assumptions

	Year Ended 31 March 2016 %	Year Ended 31 March 2015 %
Pension Increase Rate	2.2	2.5
Salary Increase Rate	3.7	3.9
Discount rate	3.6	3.3

Life expectancy is based on the Fund's VitaCurves assuming the current rate of improvements has peaked and will converge to a long term rate of 1.25% pa. Based on these assumptions, the average future life expectancies at age 65 are summarised below.

	Males	Females
Current pensioners	22.1 years	23.8 years
Future pensioners	24.3 years	26.3 years

12.3 Change in the fair value of plan assets, defined benefit obligation and net liability for the year end 31 March 2016

	Assets £(000)	Obligations £(000)	Net (liability)/ asset £(000)
Fair value of employer assets	4,659	-	4,659
Present value of funded liabilities	-	5,946	(5,946)
Present value of unfunded liabilities	-	46	(46)
Opening position as at 31 March 2015	**4,659**	**5,992**	**(1,333)**
Service cost			
Current service cost	-	235	(235)
Past service cost (including curtailments)	-	-	-
Total service cost	**-**	**235**	**(235)**
Net interest			
Interest income on plan assets	157	-	157
Interest cost on defined benefit obligation	-	202	(202)
Total net interest	**157**	**202**	**(45)**
Total defined benefit cost recognised in deficit	**157**	**437**	**(280)**
Cashflows			
Plan participants' contributions	72	72	-
Employer contributions	184	-	184
Contributions in respect of unfunded benefits	2	-	2
Benefits paid	(56)	(56)	-
Unfunded benefits paid	(2)	(2)	-
Expected closing position	**5,016**	**6,443**	**(1,427)**
Re-measurements			
Change in financial assumptions	-	(865)	865
Other experience	-	(78)	78
Return on assets excluding amounts included in net interest	(88)	-	(88)
Total re-measurements recognised in Other Comprehensive Income (OCI)	**(88)**	**(943)**	**855**
Fair value of employer assets	4,928	-	4,928
Present value of funded liabilities	-	5,458	(5,458)
Present value of unfunded liabilities	-	42	(42)
Closing position as at 31 March 2016	**4,928**	**5,500**	**(572)**

12.4 Change in the fair value of plan assets, defined benefit obligation and net liability for the year end 31 March 2015

	Assets £(000)	Obligations £(000)	Net (liability)/ asset £(000)
Fair value of employer assets	4,153	-	4,153
Present value of funded liabilities	-	4,772	(4,772)
Present value of unfunded liabilities	-	46	(46)
Opening position as at 31 March 2015	**4,153**	**4,818**	**(665)**
Service cost			
Current service cost	-	230	(230)
Past service cost (including curtailments)	-	7	(7)
Total service cost	**-**	**237**	**(237)**
Net interest			
Interest income on plan assets	183	-	183
Interest cost on defined benefit obligation	-	212	(212)
Total net interest	**183**	**212**	**(29)**
Total defined benefit cost recognised in deficit	**183**	**449**	**(266)**
Cashflows			
Plan participants' contributions	68	68	-
Employer contributions	192	-	192
Contributions in respect of unfunded benefits	2	-	2
Benefits paid	(46)	(46)	-
Unfunded benefits paid	(2)	(2)	-
Expected closing position	**4,550**	**5,287**	**(737)**
Re-measurements			
Changes in demographic assumptions	-	(47)	47
Change in financial assumptions	-	532	(532)
Other experience	-	220	(220)
Return on assets excluding amounts included in net interest	109	-	109
Total re-measurements recognised in Other Comprehensive Income (OCI)	**109**	**705**	**(596)**
Fair value of employer assets	4,659	-	4,659
Present value of funded liabilities	-	5,946	(5,946)
Present value of unfunded liabilities	-	46	(46)
Closing position as at 31 March 2016	**4,659**	**5,992**	**(1,333)**

12.5 Projected defined benefit cost for the period to 31 March 2017

	Assets £(000)	Obligations £(000)	Net (liability)/ asset £(000)	% of pay
Current service cost	-	185	(185)	(21.8%)
Total service cost	**-**	**185**	**(185)**	**(21.8%)**
Interest income on plan assets	179	-	179	21.1%
Interest cost on defined benefit obligation	-	200	(200)	(23.6%)
Total net interest cost	**179**	**200**	**(21)**	**(2.5%)**
Total included in income statement	**179**	**385**	**(206)**	**(24.3%)**

Employer's contributions for the period to 31 March 2017 will be approximately £185,000.

12.6 Sensitivity analysis

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

Change in assumptions at 31 March 2016	Approximate % increase to Employer	Approximate monetary amount £(000)
0.5% decrease in Real Discount Rate	14%	752
1 year increase in member life expectancy	3%	165
0.5% increase in the Salary Increase Rate	5%	250
0.5% increase in the Pension Increase Rate	9%	491

13. Related party transactions

The Commission is a non-departmental public body sponsored by the Scottish Government Directorate for Environment and Forestry. The Directorate is regarded as a related party, as is Scottish Water, which is required by Scottish Ministers to provide a funding contribution. In addition, the licensed provider, Business Stream (a Scottish Water company), is also considered as a related party. During the year, the Commission has had material transactions with Scottish Water and Business Stream.

Below is a breakdown of all related party transactions in the year.

Related party	Income (£)	Expenditure (£)	Year-end receivable (£)	Year-end payable (£)
Scottish Water	1,900,004	-	-	-
Business Stream	986,421	1,458	-	-

All Commission members and Directors complete and update a register of interests on an annual basis. During the year 2015-16, no Commission Member, Director or other related party has undertaken any material transactions with the Commission.

14. Losses and special payments

There were no losses or special payments made during this period (2014-15: £nil).

WATER INDUSTRY COMMISSION FOR SCOTLAND

DIRECTION BY THE SCOTTISH MINISTERS

1. The Scottish Ministers, in pursuance of The Water Industry Act 1999, hereby give the following direction.

2. The statement of accounts for the financial year ended 31 March 2006, and subsequent years, shall comply with the accounting principles and disclosure requirements of the edition of the Government Financial Reporting Manual (FReM) which is in force for the year for which the statement of accounts are prepared.

3. The accounts shall be prepared so as to give a true and fair view of the income and expenditure and cash flows for the financial year, and of the state of affairs as at the end of the financial year.

4. This direction shall be reproduced as an appendix to the statement of accounts.

Signed by the authority of the Scottish Ministers

Dated 03 October 2006

November 2016

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