



ANNUAL REPORT AND FINANCIAL STATEMENTS
2016-17

■ ■ **We have adopted the principles of Ethical Based Regulation and expect Scottish Water to work continually towards building the full trust of its customers and other stakeholders. ■ ■**

Alan Sutherland, Chief Executive.



“ We seek to create an environment where
Scottish Water can be more innovative and
responsive to customers. ”

Alan Sutherland, Chief Executive.

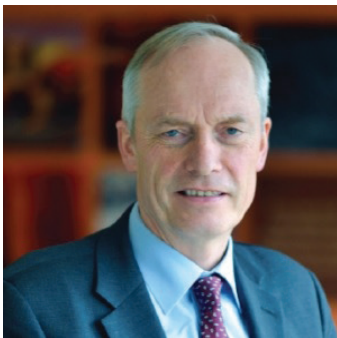
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SG/2017/166 For the period 1 April 2016 to 31 March 2017.

Laid before the Scottish Parliament by the Scottish Ministers under Part 1, section 5(4) of the
Water Industry (Scotland) Act 2002 (as amended). October 2017

Chairman's foreword

The Commission has been working hard to promote the interests of Scottish customers.



This year the Commission has been particularly busy developing its approach for the next regulatory control period which begins in 2021. The Commission's 2021-27 methodology 'Innovation and Collaboration' focuses on those areas which impact most on customers' experience. A key area of focus will be on ensuring good stewardship of water and sewerage assets to protect the levels of service that customers expect both now and into the future.

As an industry, we will adopt the principles of Ethical Based Regulation (EBR) as pioneered by Professor Chris Hodges of Oxford University. This commitment requires, more than ever, that the industry works jointly to deliver the best outcome for customers and for Scotland. The Commission is grateful for the continued support of stakeholders in the development of the 2021-27 Strategic Review of Charges.

It has been a year of change for the competitive retail market. We have seen the incumbent retailer's market share fall below 50% for the first time since market opening and we have welcomed a number of new entrants. The Commission is focusing its efforts on ensuring that the framework for the competitive retail market remains fit for purpose, given the pace of change we are seeing now and expect to see into the future. The Commission particularly welcomes the development of an industry led code of practice which aims to provide higher levels of protection for business customers, particularly small and medium sized enterprises.

The Commission continues to support enthusiastically the Scottish Government's Hydro Nation initiative. We look forward to new opportunities to learn from, and share experience with, other jurisdictions across Europe and beyond.

Commission Members rely greatly upon the efforts and work of the Chief Executive and Commission staff. We are extremely grateful to them for their contribution to the effective discharge of our responsibilities throughout 2016-17.

A handwritten signature in black ink, which appears to read 'Donald MacRae'.

Professor Donald MacRae OBE FRSE
Interim Chairman

November 2017

Ensuring value for money for customers

We have a duty to promote the interests of customers.

We achieve this by limiting the amount that Scottish Water can charge its customers, and we decide what these limits should be 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 lowest reasonable overall cost.

Strategic Review of Charges 2015-2021

Our final determination for water and sewerage charges for the period 2015-21 set out that customers' bills will increase below the rate of inflation throughout the period. The final determination also allowed for an extensive programme of investment of over £3.5 billion. In the second year of the current regulatory control period, we are pleased to note that Scottish Water has performed well and is continuing to deliver benefits to Scottish customers. We will continue to monitor and report on Scottish Water's progress throughout the regulatory control period.

Developing our approach for the Strategic Review of Charges 2021-27

This year, our focus has been on finalising our proposed approach for the regulatory control period that begins in April 2021. Our approach will build on the successes of the 2015-21 price review and place a clear onus on Scottish Water to take full ownership of delivering the very best for its customers and for Scotland. Scottish water industry stakeholders will continue to work together and formally adopt the principles of Ethical Based Regulation (EBR). We believe that EBR will create a supportive and collaborative environment to address appropriately the future challenges and opportunities facing the industry. It is our intention to engage with Scottish Water and other industry stakeholders to align objectives and deliver the best possible outcome for Scottish customers.

Scottish water industry stakeholders have asked the OECD to conduct an independent review of the 2021-27 Strategic Review of Charges process. They will conduct a Peer Review and report on lessons learned towards the end of 2019. The OECD will also provide useful insights on behavioural economics and the development of the industry's approach to capital maintenance.

The Commission will continue to develop its approach for the next regulatory control period and will publish a series of Initial Decision papers for stakeholders on key topics throughout 2017.

Representing customers and communities

We intend to build upon the innovations introduced during the 2015-21 Strategic Review of Charges. For the Strategic Review of Charges 2021-27, a newly appointed Customer Forum will act as a conduit for customers' and communities' views and priorities. This past year we have been working closely with industry stakeholders to agree and develop the Customer Forum's remit. We intend the 2021-27 Strategic Review of Charges to be the most collaborative and customer-centric of our price reviews to date.

More information on the Customer Forum's work on behalf of Scottish customers can be found on their website.

Monitoring Scottish Water's performance

Our 2015-21 determination allowed for Scottish Water to build on what it has achieved in previous regulatory control periods. Scottish Water is performing well. We will continue to monitor Scottish Water's progress in delivering improvements for its customers.

We are a member of the Output 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. Together, this group reviews Scottish Water's progress against the ministerial objectives set out in its agreed delivery plan. The Group publishes quarterly reports on the Scottish Government's website.

Our most recent performance report published in November 2016 showed that overall, Scottish Water is performing in line with what they set out to achieve in their delivery plan. We will continue to monitor progress carefully. A full report on Scottish Water's performance for the 2016-17 period will be published later this year.

We are conscious of the need to review and develop the mechanisms by which we measure Scottish Water's performance. Over the course of the year, we have been developing our thinking on how the monitoring regime might be developed for the 2021-27 regulatory control period. We are specifically developing our thinking on the monitoring of investment to maintain the condition and performance of assets.

The Commission will publish its initial views on performance monitoring in October 2017.



Achieving greater value and choice through retail competition

Competition in the non-household market for retail water and sewerage services began in April 2008. Business customers can, as a result, choose a price and service level that reflects their specific needs. Business Customers can now benefit from more tailored services and/or lower prices.

The competitive retail market is evolving. This year, and for the first time since market opening, the incumbent retailer's market share has fallen below 50%. There are now 25 Licensed Providers competing to offer greater choice and value added services to Scotland's 150,000 business customers.

Over the course of the year, we have been working to improve the licence framework and Governance Code to be consistent with the requirements of the changing market. The industry has developed a code of practice to protect further business customers. Deloitte conducted a market audit which showed that overall, Licensed Providers are complying with their regulatory obligations.

We expect the opening of the English retail market in April 2017 to impact on the Scottish market. We intend to keep the regulatory framework under review to make sure that it continues to serve the interests of customers.

Sharing our experience

We are fully supportive of the Scottish Government's 'Hydro Nation' initiative. This year, we have had increasing contact from regulatory colleagues across Europe and internationally who want to learn more about the Scottish water industry's journey and experience.

To promote the success of the public sector regulatory model we have hosted delegations from other jurisdictions and participated in international events and conferences. We have increased our collaboration with international organisations such as the OECD's Network of Economic Regulators. We are also continuing our membership of WAREG, a network of European Regulators focused on sharing knowledge and experience in regulation.

Throughout the year, we have been working to strengthen economic regulation in Romania as part of a capacity building project for the Romanian Public Services Regulatory Authority (ANRSC). The office participated in a scoping mission in Romania to meet with key stakeholders including international investors, Government Ministries and Romanian water companies. Later this year, the office will work on a European Commission sponsored project to build a robust regulatory information framework for Romania.

Managing our office

We are a small office of approximately 20 employees, responsible for regulating an industry of vital importance to the Scottish people and to the Scottish economy.

The Commission is a non-departmental public body with statutory responsibilities, which acts independently of Ministers. We are accountable to customers in Scotland and we achieve this by being transparent in our work. As part of 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 and budget for the regulatory control period. This document is available on our website.

As a public body we are very conscious of our obligations to deliver value for money. We monitor our expenditure with care, and by maintaining robust procurement processes, we ensure maximum efficiency.

Our expenditure for the year saw an increase of £0.48m. Of this increase, £0.22m was incurred on an audit of the Market to allow wider consideration of compliance with the Code of Practice to ensure customer protection. In addition, increased work relating to the Strategic Review of Charges was required during this important stage of the regulatory cycle. Despite the increase in expenditure, the end of year position was 9% ahead of our budget.

Our financial statements for the year to 31 March 2017 sets out our results for the year in full.

FINANCIAL STATEMENTS

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Performance report

1. OVERVIEW

The Water Industry Commission for Scotland (the Commission) presents the financial statements for the year from 1 April 2016 to 31 March 2017. 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.

The purpose of the performance section of the annual report is to provide information on the Commission, its main objectives and strategies and the principal risks that it faces.

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 consumers and business 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 have now completed the second year of the period covered by the 2015-21 Strategic Review of Charges and in line with our principal statutory objectives and through our monitoring procedures, we are pleased to report that, overall, Scottish Water has continued to perform well in 2016-17 and is continuing to deliver improvements for its customers.

During the year, we have completed the development of our approach for the next regulatory control period in 2021-27. A series of Advisory Panel sessions have informed the development of our methodology for the Strategic Review of Charges 2021-27. Work is ongoing and our proposals are being developed in close consultation with Scottish Water and industry stakeholders. Our approach will ensure customers in Scotland continue to receive high-quality services at a reasonable price. Our focus will be on those areas which impact most on the customers' experience both immediately and in the future. In particular, we are looking to ensure the long-term sustainability of service levels and a fair allocation of costs between current and future customers. It is clear from our analysis that the size and composition of the capital programme is a significant factor in ensuring that customers get value for money both now and in the future.

We have also committed to changing the way we regulate through adopting the Principles

of Ethical Business Regulation developed by Professor Christopher Hodges of Oxford University. This will impact on all industry stakeholders and we will work jointly with others to develop the regulatory framework in a way that provides greater transparency, better outcomes for customers and the environment and more innovative approaches.

As part of this commitment to improve the way we regulate, we have agreed that the OECD will carry out an independent peer review of the process of the Strategic Review of Charges and publish their findings.

In support of the Scottish Government's 'Hydro Nation' initiative, we have taken further steps to extend activities beyond Scotland and have taken forward opportunities to learn from and share expertise in regulation with other countries. We have supported the Scottish Government in their 'Water for People' project with Malawi and have hosted several delegations on study tours from across Europe and Australia. We have been an active member of the European Water Regulator's Network (WAREG) and continued our participation in the OECD's Network of Economic Regulators (NER).

There are now 25 Licensed Providers in the competitive retail market offering greater choice and value added services to non-household customers. We initiated the development of an industry led Code of Practice to further protect business customers and our Market Audit showed that, overall, Licensed Providers are complying with their various regulatory obligations. With the opening of the retail water market in England, we are continuing to monitor closely the development of the Scottish market to ensure that Licensed Providers can participate on a level playing field and that customers and Scottish Water's core business continue to be protected.

1.4 Risks

A strategic risk register is in place, overseen by the Commission and the Audit and Risk Committee (the Committee), in accordance with the approved risk management strategy. Following an internal audit review in 2016-17, the Commission, along with our internal auditors, reviewed the risk management process. A revised risk strategy is now in place, which clearly outlines the process for identifying, reporting and monitoring risks and the responsibilities held at each level within the organisation. The Commission has identified the following risks as top priorities:

- The risk of failing to deliver benefits to customers through successfully developing and implementing the regulatory framework. The office has committed to developing the regulatory framework in accordance with the principles of ethically based regulation and has adopted a formal project management process ('Prince 2') to help ensure successful delivery of the 2021-27 Strategic Review of Charges.
- The risk from cyber security attacks targeting the Commission's IT systems. The Commission has a range of control measures in place to address this risk, and no incidents have been reported. However, the Commission is aware that this is an issue that it cannot be complacent about and will continue to review the security arrangements in place to ensure the risk is minimised.

1.5 Future developments

We published our methodology for the Strategic Review of Charges 2021-27 in April 2017. It included a detailed timeline for the process. Our approach builds upon the developments initiated at the previous 2015-21 Strategic Review of Charges. In developing the approach, we have worked closely with our industry partners: the Scottish Government, Citizens Advice Scotland (CAS), the Scottish Environment Protection Agency (SEPA), the Drinking Water Quality Regulator (DWQR) and Scottish Water.

As set out in the methodology, the Commission will publish a series of Decision Papers which outline, for customers and other stakeholders, the Commission's views on important matters relating to the Strategic Review. In accordance with the methodology timeline, the Commission will publish Initial, Revised and Final Decision Papers, the last being published in 2019.

The Customer Forum, which proved a highly successful addition to the regulatory process for 2015-21, has been re-established with a broader remit to reach out to communities across Scotland to understand their priorities. The Commission will be again minded to accept a Business Plan that is agreed between Scottish Water and the Customer Forum, and is consistent with Ministers' objectives and the acceptable ranges set by the Commission.

The pace of change in the competitive retail market has increased and is expected to continue at a high level over the course of 2017-18. We are continuing to improve the licence framework and Governance Code to ensure that the competitive retail market continues to work well for customers. We will

be deciding how best to take forward the new Code of Practice which has been developed by industry participants and reviewing the Provider of Last Resort (PoLR) arrangements to ensure customers are appropriately protected if a Licensed Provider were to become insolvent.

We will continue our efforts to support the Scottish Government's Hydro Nation initiative by seeking out appropriate opportunities to share our expertise and support the development of regulation in other jurisdictions.

2. PERFORMANCE ANALYSIS

2.1 Overall financial performance

As set out in the financial statements, there was a retained net deficit for the year of £157,544 (2015-16: surplus of £218,683). Expenditure for the financial year 2016-17 was £3,662,768 (2015-16: £3,178,864). The increase relates to expenditure on an audit of the Market to allow wider consideration of compliance with the Code of Practice to ensure customer protection. The cost during 2016-17 for this work was in the region of £220k. In addition, increased work relating to the Strategic Review of Charges was required during this important stage of the regulatory cycle. Despite the increase in expenditure, the end of year position was under the internal budget by £363k (9%), largely as a result of a lower average headcount and lower consultancy usage than expected. The resulting deficit was anticipated and it is expected that there will be a net deficit each year until the end of this regulatory cycle. This will be funded from the existing cash balance. The cash balance

of £1,613,461 (2015-16: £1,990,308), will be utilised during the rest of this regulatory period for activities such as the OECD review of the Strategic Review of Charges and further audits of the Market. The balance on the General Reserve as at 31 March 2017 was £10,493 (2015-16: £1,226,037). The balance sheet position of the pension liability has deteriorated significantly in the year, resulting in this reduction of the General Reserve.

2.2 Changes in non-current assets

During the year, there was an investment of £18,821 (2015-16: £nil) in information technology assets. There was no other capital expenditure in the year.

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) – the Fund's actuaries undertook a valuation as at 31 March 2017. This calculation was based on rolling forward valuation data at 31 March 2014 to 31 March 2017, on the basis of a number of financial assumptions. The balance sheet position has significantly worsened over 2016-17 as a result of a decrease in the net discount rate (much lower discount rate net of slightly higher inflation over the period). The effect of this has been partially off-set by much greater than expected asset returns. Details on the pension scheme can be found in the remuneration report on page 19, the accounting policies listed from page 30 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 2016-17, the average length of time taken to pay an invoice was 9 days (2015-16: 9 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 adaptation; 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 travel policy and use of the Scottish Government's travel services framework allow us to ensure only necessary travel is made and in the most economic and efficient manner. During the year, we established an environmental committee, comprised of volunteers in the office, who have implemented several innovative ways to monitor and reduce our carbon usage. The remit of the committee will continue to be developed.

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

Area	2016-17		2015-16	
	Non-financial information	Financial information	Non-financial information	Financial information
Energy	Electricity: 30.7 tonnes CO ₂	Electricity: £6,065 Gas: £1,290	Electricity: 24.1 tonnes CO ₂	Electricity: £6,194 Gas: £1,508
	Gas: 7.5 tonnes CO ₂		Gas: 7.6 tonnes CO ₂	
	Total carbon from energy: 38.1 tonnes CO ₂		Total carbon from energy: 31.7 tonnes CO ₂	
Waste	Waste to landfill: 5.4 tonnes CO ₂	£812	Waste to landfill: 5.4 tonnes CO ₂	£923
	Paper waste recycled: 0.3 tonne CO ₂		Paper waste recycled: 0.9 tonne CO ₂	
	Total carbon from waste: 5.7 tonnes CO ₂		Total carbon from waste: 6.3 tonnes CO ₂	
Water	0.1 tonnes CO ₂	£2,123	0.1 tonnes CO ₂	£2,285
Transport and travel	27 tonnes CO ₂	£75,509	42 tonnes CO ₂	£74,131

All 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. Volume of recycled paper collated from recycling providers service report.

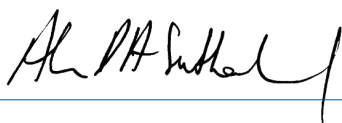
Water: information based on water consumption reports detailing water, sewage and drainage volume and financial charges. This is supplied from our water provider Anglian Water.

Transport and travel: financial and mileage information is based on air and rail usage reports supplied by our approved travel provider. Financial and mileage volume relating to vehicles is based on mileage estimates of journeys taken by employees during the year and estimated expenditure.

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.



25 October 2017

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 Accountable Officer authorised the financial statements for issue on 25 October 2017.
The financial statements were approved by the Commission on 3 August 2017.

The Commission

The Commission meets regularly throughout the year and, as at 31 March 2017, comprises the Chair, four 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.

During the year, two new members were appointed to the Commission – Jo Armstrong and Donald MacRae. In addition, Gordon Hughes resigned as Chair to the Commission on 31 March 2017. Donald MacRae was subsequently appointed as the interim Chair on 30 April 2017. Information on the Commission's non-executive members can be found below.

Name	Position	Initial appointment date	Re-appointment date	Current end date
Professor Gordon Hughes	Chair	01/07/2011	01/07/2016	31/03/2017
Libby Gawith	Member	01/01/2012	01/01/2016	31/12/2019
Ross Finnie	Member	01/07/2012	01/07/2016	30/06/2020
Jo Armstrong	Member	01/07/2016	-	30/06/2020
Donald MacRae	Member	01/07/2016	-	30/06/2020

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. Audit Scotland has been appointed for a five-year period from 2016-17 to 2020-21. Their 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 2017 amounted to £12,710 (2015-16: £11,870)

Data loss

There have been no instances of data loss, including 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 Accounting 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 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 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 2017 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. 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 considering 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 and Risk Committee

The 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 Chair 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 Committee operates independently and reports to the Commission. The Committee presented the annual report of the Committee to the April 2017 Commission meeting, which outlined the work undertaken by the Committee to review the Commission's control systems and financial reporting processes to measure and manage the risk inherent in the delivery of the organisation's objectives. The report did not highlight any concerns or issues.

(iii) Internal audit

The work of the internal auditor is submitted to the organisation's Audit and Risk 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. For the financial year 2016-17, the Commission's internal audit function was carried out by BDO LLP.

During the financial year, internal audit carried out three reviews:

- A review of the Commission's risk management processes resulted in four "medium" recommendations and two "low" recommendations, with an overall assessment that the Commission has a sound system of internal control designed to achieve system objectives with some exceptions. The Commission has taken the review on board, and has made significant changes to the risk management process and associated reporting mechanisms.
- A review of the framework in place to plan, deliver and monitor activities to support environmental sustainability improvements, to comply with environmental regulation and related Scottish Government guidance, resulted in two "medium" and two "low" recommendations, which the Commission will take on board to strengthen our work in this area.
- A review of Record Retention and Data Management within the Commission, resulted in four "medium" recommendations and one "low" recommendation. These recommendations will be incorporated into a larger review of the Commission's records management procedures in 2017-18, to ensure the Commission complies with its statutory requirements under the The Public Records (Scotland) Act 2011.

(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 Committee on a quarterly basis. The Accountable Officer, also reviews the register prior to its submission to the 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.

In May 2017, the interim Chair commissioned an external review of the effectiveness of the Commission's Board. This review will provide the Commission with areas of focus for improving the way in which the Board operates.

2. REMUNERATION AND STAFF REPORT

2.1 Background

The Chair 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 Chair of the Commission. The parameters for the remuneration of the Chief Executive, the Chair 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.

The sections below (2.2 – 2.4) are subject to audit.

2.2 Directors' salary and pension entitlements

The total remuneration of the Chief Executive in the year was £153,357 (2015-16: £149,642).

The total remuneration of the Directors was as follows:

	2016-17			2015-16		
	Gross Salary £(000)	Pension benefits £(000)	Total £(000)	Gross Salary £(000)	Pension benefits £(000)	Total £(000)
Directors						
Alan Sutherland, Chief Executive	150 - 155	45 - 50	200 - 205	145 - 150	50 - 55	200 - 205
Katherine Russell, Director of Corporate Affairs & Strategy	125-130	30 - 35	160 - 165	125-130	35 - 40	165 - 170
Ian Tait, Director of Investment	105 - 110	40 - 45	150 - 155	100 - 105	40 - 45	145 - 150

The Directors' normal retirement age is 67, 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 2016-17 (2015-16: £nil). The total remuneration of the Chief Executive and other Directors was £390k-£395k (2015-16: £380k-£385k). The Chief Executive and the Directors are also ordinary members of the Falkirk Council Pension Scheme.

Directors	Accrued pension as at 31/03/17 £(000)	Lump sum as at 31/03/17 £(000)	Real increase in pension £(000)	Real increase/ (decrease) in lump sum £(000)	Value of increase (excluding Director's own contribution) £(000)
Alan Sutherland	30 - 35	25 - 30	2.5 - 5	0 - 2.5	45 - 50
Katherine Russell	20 - 25	10 - 15	2.5 - 5	(0 - 2.5)	30 - 35
Ian Tait	20 - 25	25 - 30	2.5 - 5	0 - 2.5	40 - 45

Directors	CETV* at 31/03/17 £(000)	CETV at 31/03/16 £(000)	Increase in CETV (excl director's own contributions and inflation) £(000)
Alan Sutherland	440	380	47
Katherine Russell	309	255	34
Ian Tait	384	312	43

*cash equivalent transfer value

2.3 Commission remuneration

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:

	2016-17	2015-16
	Total £(000)	Total £(000)
Professor Gordon Hughes	36 - 40	36 - 40
Ross Finnie	11 - 15	11 - 15
Libby Gawith	11 - 15	11 - 15
Jo Armstrong	11 - 15	-
Donald MacRae	11 - 15	-

Commission Members are not members of the pension scheme. The Commission also paid £3,251 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: £3,154). No benefits in kind were paid in the year.

2.4 Staff report

Fair pay disclosure

The range of staff remuneration within the Commission is £15-20k to £150-£155k (2015-16: £15-20k to £145-£150k). 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 remuneration of the highest paid Director of the Commission for the year to 31 March 2017 was £153,357 (2015-16: £149,642). This was 5 times the annualised median remuneration of the workforce, which was £27,755 (2015-16: £28,796). The highest paid Director of the Commission is the Chief Executive.

	2016-17	2015-16
Highest paid Director's total remuneration (£000)	153.4	149.6
Median total remuneration (£)	27,755	28,796
Ratio	5.5	5.2

Average number of persons employed

The average number of whole-time equivalent persons employed during the year was 20 (2015-16: 18), including the Chief Executive. These were employed in the following areas:

	Year ended 31 March 2017	Year ended 31 March 2016
Chief Executive and Directors	3	3
Corporate Affairs	8	7
Analysis	9	8

All employees are employed on permanent contracts.

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	10	11	21

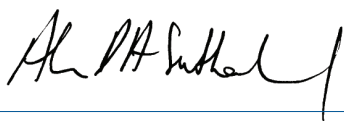
Staff costs are disclosed in more detail in note 4.

Employment of disabled persons

Although the Commission does not employ any person with a disability, the organisation is committed to valuing and promoting equal opportunities in all areas of recruitment, employment, training, managing people and providing benefits to employees.

Sickness absence

The average length of time that each employee was absent due to sickness was 5 days (2015-16: 5 days).



25 October 2017

Alan D A Sutherland, Accountable Officer

Independent auditor's report

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

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 120 of the Code of Audit Practice approved by the Auditor General for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion on financial statements

I have audited the financial statements in the annual report and accounts of the Water Industry Commission for Scotland for the year ended 31 March 2017 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 Net Income/ (Expenditure), the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Equity and notes to the financial statements, including a summary of significant accounting policies. 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 2016/17 Government Financial Reporting Manual (the 2016/17 FReM).

In my opinion the accompanying 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 2017 and of its net expenditure 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 2016/17 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.

Basis of opinion

I conducted my audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I am independent of the body in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the Accountable Officer for the financial statements

As explained more fully in the Statement of the Accountable Officer Responsibilities, the Accountable Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Accountable Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require me to comply with the Financial Reporting Council's Ethical Standards for Auditors. 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 body's circumstances 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.

My objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material

misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the annual report and accounts

The Accountable Officer is responsible for the other information in the annual report and accounts. The other information comprises the information other than the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on matters prescribed by the Auditor General for Scotland to the extent explicitly stated later in this report.

In connection with my audit of the financial statements in accordance with ISAs (UK&I), my responsibility is to read all the financial and non-financial information in the annual report and accounts 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 me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

REPORT ON REGULARITY OF EXPENDITURE AND INCOME

Opinion on regularity

In my 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.

Responsibilities for regularity

The Accountable Officer is responsible for ensuring the regularity of expenditure and income. I am responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

REPORT ON OTHER REQUIREMENTS

Opinions on other prescribed matters

I am required by the Auditor General for Scotland to express an opinion on the following matters.

In my opinion, the auditable part of the Remuneration and Staff Report has been properly prepared 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.

In my opinion, based on the work undertaken in the course of the audit:

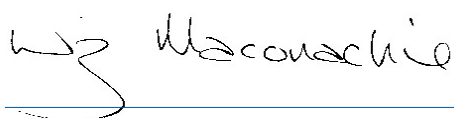
- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers; and
- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared 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.

Matters on which I am required to report by exception

I am required by the Auditor General for Scotland to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the auditable part of the Remuneration and Staff Report are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.



Liz Maconachie

October 2017

Audit Scotland, 4th Floor, South Suite, The Athenaeum Building,
8 Nelson Mandela Place, Glasgow G2 1BT

Statement of comprehensive net income/(expenditure)

For the year ended 31 March 2017

	Note	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Income			
Income from activities	2	3,501,467	3,393,564
Expenditure			
Staff costs	4	1,410,890	1,350,585
Depreciation	6	31,380	31,107
Other expenditures	5	2,220,498	1,797,172
		3,662,768	3,178,864
Operating (deficit)/surplus		(161,301)	214,700
Interest receivable		3,757	3,983
Retained net (deficit)/surplus for the year		(157,544)	218,683
Other comprehensive net income			
Actuarial (loss)/gain	12	(1,058,000)	855,000
Total comprehensive net expenditure)/income for the year		(1,215,544)	1,073,683

All income and expenditure relates to continuing activities.

The notes on pages 30 - 44 form part of these financial statements.

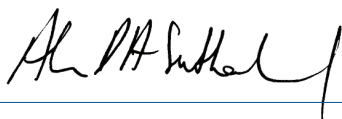
Statement of financial position

As at 31 March 2017

	Note	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Non-current assets			
Property plant and equipment	6	84,027	96,586
Total non-current assets		84,027	96,586
Current assets			
Other receivables	7	146,929	45,553
Cash and cash equivalent		1,613,461	1,990,308
Total current assets		1,760,390	2,035,861
Total assets		1,844,417	2,132,447
Current liabilities			
Trade payables and other current liabilities	8	(143,104)	(299,560)
Total current liabilities		(143,104)	(299,560)
Non-current liabilities			
Provisions	9	(41,820)	(34,850)
Total net assets, excluding pension liabilities		1,659,493	1,798,037
Pension scheme liability	12	(1,649,000)	(572,000)
Net Assets		10,493	1,226,037
Equity			
General Reserve		10,493	1,226,037

The notes on pages 30 - 44 form part of these financial statements.

The Accountable Officer authorised these financial statements for issue on:



25 October 2017

Alan D A Sutherland, Accountable Officer

Statement of cash flows

For the year ended 31 March 2017

	Note	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Cash flows from operating activities			
Operating surplus		(161,301)	214,700
<i>Adjustments for non-cash items</i>			
Difference in pension costs compared to contributions	12	(1,000)	49,000
Depreciation on tangible non-current assets	6	31,380	31,107
Finance costs		20,000	45,000
Increase in provision	9	6,970	6,970
<i>Movements in working capital</i>			
Decrease/(Increase) in trade and other receivables	7	(101,376)	443,463
(Decrease)/Increase in trade payables	8	(156,456)	(16,603)
Net cash inflow from operating activities		(361,783)	773,637
Cash flows from investing activities			
Purchase of property, plant and equipment	6	(18,821)	7,983
Net cash outflow from investing activities		(18,821)	7,983
Cash flows from financing activities			
Interest received		3,757	3,983
Net inflow from financing activities		3,757	3,983
Net (decrease)/increase in cash and cash equivalents		(376,847)	769,637
Cash as at 1 April		1,990,308	1,220,671
Cash as at 31 March		1,613,461	1,990,308
Net (decrease)/increase in cash and cash equivalents		(376,847)	769,637

The notes on pages 30 - 44 form part of these financial statements.

Statement of changes in equity (SCE)

For the year ended 31 March 2017

	£
Balance at 1 April 2015	152,354
Total comprehensive income for the year 2015-16	1,073,683
Balance as at 31 March 2016	1,226,037
Total comprehensive income for the year 2016-17	(1,215,544)
Balance as at 31 March 2017	10,493

The general reserve is analysed in note 10.

The notes on pages 30 - 44 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 2017-18, 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. Consideration of applying this IFRS will be given before the effective date of 1 April 2019.

IFRS 16 "Leases"

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 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 using 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 net income/(expenditure) 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 to spread the cost of pensions over employees' working lives. The contributions are determined by an actuary based on 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 / (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/ (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 net income/ (expenditure) 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 (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 based on 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 2017 £	Year ended 31 March 2016 £
Scottish Water statutory contribution	2,032,000	1,900,004
Levy on licensed providers	1,469,467	1,352,858
Other income	-	140,702
	3,501,467	3,393,564

The Commission's main source of income is the statutory contribution received from the Scottish Government, as agreed in the Corporate Plan 2015-21. Fees are payable by Licensed Providers on a cost recoverable basis, sufficient to meet the costs incurred by the Commission in exercising its functions relating to water services and sewerage services licences. Other income in 2015-16 related 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			Total £
		Determination of prices and monitoring of performance	Managing and developing the competitive framework	Office administration and other corporate costs	
Income received (£)	2016-17	2,032,000	1,469,467	-	3,501,467
	2015-16	1,900,004	1,493,560	-	3,393,564
Expenditure (£)	2016-17	1,597,739	674,873	876,341	3,148,953
	2015-16	1,137,600	663,841	698,421	2,499,862
Reallocation of office administration and corporate costs (£)	2016-17	616,103	260,238	(876,341)	-
	2015-16	441,049	257,372	(698,421)	-
(Deficit)/surplus (£)	2016-17	(181,842)	534,356	-	352,514
	2015-16	321,355	572,347	-	893,702

Reconciliation to statement of comprehensive net income/ (expenditure):

	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Net surplus per statement of comprehensive net income/(expenditure)	(157,544)	218,683
Cost of secondments and Hydro Nation	510,058	581,019
Staff costs: IAS 19 adjustment (note 1)	-	49,000
Finance income: IAS 19 adjustment (note 1)	-	45,000
Retained net surplus for the year as above	352,514	893,702

Note 1: costs have been included in analysis above in 2016-17.

4. STAFF RELATED COSTS

Staff costs comprise:

	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Wages and salaries	1,092,896	1,015,474
Social security costs	115,689	100,111
Pension costs	202,305	235,000
Staff costs per statement of comprehensive net income/ (expenditure)	1,410,890	1,350,585

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

5. OTHER EXPENDITURE

	Year ended 31 March 2017 £	Year ended 31 March 2016 £
Travel and subsistence	274,013	210,730
Office accommodation	134,899	118,713
General operating costs	244,493	212,796
Regulation and licensing costs	1,450,321	1,029,976
Customer consultation costs	12,976	51,316
Recruitment	43,378	72,282
Information technology	38,211	53,620
Finance charges	22,207	47,739
	2,220,498	1,797,172

The operating costs for the year are stated after charging the external audit fee of £12,710 (2015-16: £11,870), non-audit fees of £nil (2015-16: £6,180) and, within office accommodation, an operating lease rental of £49,175 (2015-16: £49,176).

6. PROPERTY, PLANT AND EQUIPMENT

	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2016	180,285	277,656	457,941
Additions	18,821	-	18,821
Disposals	(7,001)		(7,001)
At 31 March 2017	192,105	277,656	469,761
Depreciation			
At 31 March 2016	173,183	188,172	361,355
Charge for the year	7,819	23,561	31,380
Eliminated on disposals	(7,001)	-	(7,001)
At 31 March 2017	174,001	211,733	385,734
Net book value at 31 March 2017	18,104	65,923	84,027
Net book value at 31 March 2016	7,102	89,484	96,586
	Information technology £	Furniture and fittings £	Total £
Cost			
At 31 March 2015	172,302	277,656	449,958
Disposals	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

7. OTHER RECEIVABLES

	As at 31 March 2017 £	As at 31 March 2016 £
Current receivables		
Prepayments	137,882	45,503
Other receivables	9,047	50
Total other receivables	146,929	45,553

	As at 31 March 2017 £	As at 31 March 2016 £
Intra-government receivables		
Central Government	1,382	-
Bodies external to government	145,547	45,553
Total other receivables	146,929	45,553

8. CURRENT LIABILITIES

	As at 31 March 2017 £	As at 31 March 2016 £
Trade payables	14,987	11,848
Taxation and Social Security	3,251	31,612
Accruals	124,866	256,100
Total current liabilities	143,104	299,560

	As at 31 March 2017 £	As at 31 March 2016 £
Intra-government payables		
Local Authorities	2,700	2,200
Central Government	11,724	42,678
Bodies external to government	128,680	254,682
Total current liabilities	143,104	299,560

9. PROVISIONS FOR LIABILITIES AND CHARGES

	As at 31 March 2017 £	As at 31 March 2016 £
Balance at 1 April 2015	34,850	27,880
Provided in the year	6,970	6,970
Balance at 31 March 2016	41,820	34,850

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. An error in the split between the operations and pension reserves from previous two financial years was identified. The effect of this error resulted in a movement of £235k between the reserves accounts as at 31/03/16 and £7k as at 31/03/15. However, the overall general reserve balance has not been affected. The figures below reflect the restated, prior year balances and current year adjustments.

	Note	Operations £	Pension £	General £
Balance at 1 April 2015		1,485,354	(1,333,000)	152,354
Changes in reserves 2015-16				
Actuarial losses		-	(88,000)	(88,000)
Change in assumptions underlying the present value of the scheme liabilities		-	943,000	943,000
Net surplus/(deficit) for the year		312,683	(94,000)	218,683
Balance as at 31 March 2016		1,798,037	(572,000)	1,226,037
Changes in reserves 2016-17				
Actuarial gains	12	-	874,000	874,000
Change in assumptions underlying the present value of the scheme liabilities	12	-	(1,932,000)	(1,932,000)
Net retained deficit for the year		(138,544)	(19,000)	(157,544)
Balance as at 31 March 2017		1,659,493	(1,649,000)	10,493

11. COMMITMENTS AND CONTINGENT LIABILITIES

11.1 Capital commitments

There were no capital commitments at 31 March 2017 (2015-16: £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.

	2016-17 £	2015-16 £
Not later than one year	49,176	49,176
Later than one year and not later than 5	147,528	196,704

11.3 Contingent liabilities

The Commission had no contingent liabilities at 31 March 2017 (2015-16: £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 £202,000 (2015-16: £186,000) 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 2017-18 will be 19.1%, plus a fixed amount of £24,500.

In accordance with IAS 19 the Commission commissioned the Fund's actuaries to undertake a valuation as at 31 March 2017. This calculation was based on rolling forward valuation data at 31 March 2016 (the last formal valuation) to 31 March 2017 based on a number of financial assumptions. The main financial assumptions used included:

12.2 Financial Assumptions

	Year Ended 31 March 2017 %	Year Ended 31 March 2016 %
Pension Increase Rate	2.4	2.2
Salary Increase Rate	3.9	3.7
Discount rate	2.7	3.6

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 2017

	Assets £(000)	Obligations £(000)	Net (liability)/ asset £(000)
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)
Opening position as at 31 March 2016	4,928	5,500	(572)
Service cost			
Current service cost	-	201	(201)
Past service cost (including curtailments)	-	-	-
Total service cost	-	201	(201)
Net interest			
Interest income on plan assets	180	-	180
Interest cost on defined benefit obligation	-	200	(200)
Total net interest	180	200	(20)
Total defined benefit cost recognised in deficit	180	401	(221)
Cashflows			
Plan participants' contributions	78	78	-
Employer contributions	200	-	200
Contributions in respect of unfunded benefits	2	-	2
Benefits paid	(146)	(146)	-
Unfunded benefits paid	(2)	(2)	-
Expected closing position	5,240	5,831	(591)
Re-measurements			
Change in financial assumptions	-	1,930	(1,930)
Other experience	-	2	(2)
Return on assets excluding amounts included in net interest	874	-	874
Total re-measurements recognised in Other Comprehensive Income (OCI)	874	1,932	(1,058)
Fair value of employer assets	6,114	-	6,114
Present value of funded liabilities	-	7,716	(7,716)
Present value of unfunded liabilities	-	47	(47)
Closing position as at 31 March 2017	6,114	7,763	(1,649)

12.4 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			
Changes in demographic assumptions	-	-	-
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)

12.5 Projected defined benefit cost for the period to 31 March 2018

	Assets £(000)	Obligations £(000)	Net (liability)/ asset £(000)	% of pay
Current service cost	-	309	(309)	(33.5%)
Total service cost	-	309	(309)	(33.5%)
Interest income on plan assets	168	-	168	18.2%
Interest cost on defined benefit obligation	-	214	(214)	(23.2%)
Total net interest cost	168	214	(46)	(5.0%)
Total included in income statement	168	523	(355)	(38.5%)

Employer's contributions for the period to 31 March 2018 will be approximately £201,000.

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 2017	Approximate % increase to Employer	Approximate monetary amount £(000)
0.5% decrease in Real Discount Rate	14%	1,092
0.5% increase in the Salary Increase Rate	5%	355
0.5% increase in the Pension Increase Rate	9%	710

13. RELATED PARTY TRANSACTIONS

A levy is received from each licensed provider to fund any licensing activity carried out by the Commission. Anglian Water is a licensed provider. Through a Scottish Government framework agreement, Anglian Water provides the Commission with water and waste water services and is therefore considered a related party.

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

Related party	Income (£)	Expenditure (£)	Year-end receivable (£)	Year-end payable (£)
Anglian Water	315,490	2,089	2,056	-

All Commission members and Directors complete and update a register of interests on an annual basis. During the year 2016-17, 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 (2015-16: £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.

A handwritten signature in black ink, appearing to be 'D. Smith', followed by a vertical line.

Signed by the authority of the Scottish Ministers

Dated 03 October 2006

November 2017

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