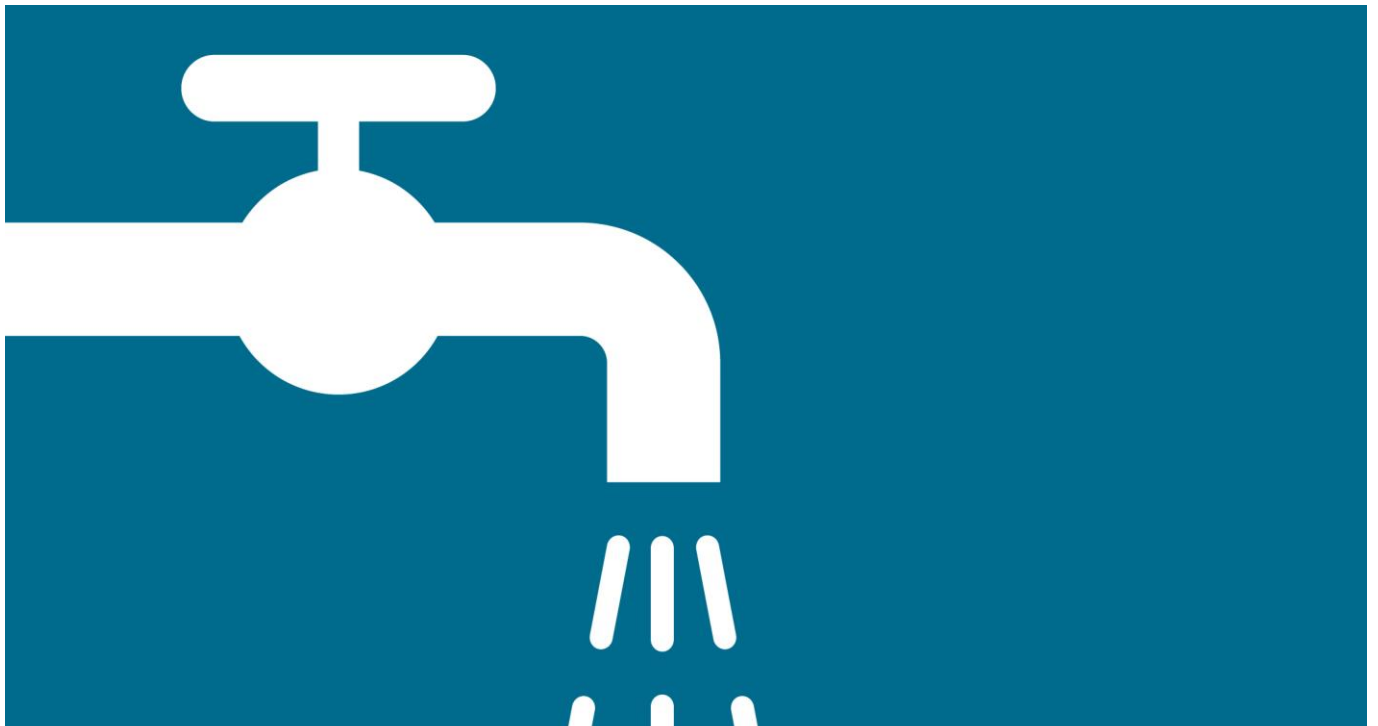


The 2023/24 audit of the Water Industry Commission for Scotland



AUDITOR GENERAL 

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2024

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Key messages

- 1 The appointed auditor issued a qualified regularity opinion on the 2023/24 audit of the Water Industry Commission for Scotland. In his opinion £74,832 of expenditure was not in accordance with applicable enactments and guidance from Scottish ministers. No instances of non-compliant expenditure have been identified by the auditor that occurred since the publication of my previous report.
 - 2 The appointed auditor also reported a further £20,355 of expenditure on business class flights and meals which complied with policies but does not appear to represent value for money.
 - 3 The total cost to the public purse of the departure of the former Chief Executive was £105,488. The Commission should have sought and received clearer guidance from the sponsor team, and taken more time to consider the wider options available, before offering a settlement agreement to the former Chief Executive.
 - 4 Together with its Scottish Government sponsor team, the Commission is taking action to address the financial management and governance weaknesses that I reported last year. It is essential that the board and senior management team, with support from the Scottish Government, provide effective leadership to embed a positive culture of Best Value across the organisation.
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Introduction

1. I have received the audited annual report and accounts including the independent auditor's report for the Water Industry Commission for Scotland (the Commission) for 2023/24. I am submitting these accounts and auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.
2. I have prepared this report to provide an update on the significant issues highlighted in my report, [The 2022/23 audit of the Water Industry Commission for Scotland](#). I recognise that action is being taken to address the financial management and governance weaknesses raised, but I agree with the auditor's view that it is too early to conclude whether this will be successful in embedding a positive culture of Best Value across the organisation.
3. The auditor issued a qualified opinion on the regularity of transactions as expenditure of £74,832 was not in accordance with guidance from the Scottish ministers.

Background

4. The Commission is the economic regulator of Scottish Water. It is a non-departmental public body with a statutory duty to promote the interests of Scottish Water's customers to ensure long-term value and excellent levels of service for customers and communities. Its work in supporting the Scottish Government's **Hydro Nation** ambition is currently paused.

The first **Hydro Nation** strategy was created in February 2012 to fulfil the statutory duty to 'take such reasonable steps as the Scottish Government consider appropriate' for the purpose of ensuring the development of the value of Scotland's water resources.

5. The Commission currently employs 21 staff (full establishment is 30 staff) and incurred expenditure of £3.378 million during 2023/24 (with 70 per cent relating to staff costs). It received income of £4.519 million during the year, including levy income of £4.020 million from Scottish Water and Licensed Providers of retail services in the non-household market. This resulted in the Commission reporting an operating surplus of £1.142 million for the year ended 31 March 2024.

6. As a non-departmental public body, the Commission is supported by a sponsor team in the Water Policy Division of the Scottish Government.

Non-compliant expenditure

The appointed auditor qualified his regularity opinion for 2023/24

7. The independent auditor's report includes a qualified opinion on regularity as £74,832 of expenditure, for the year ended 31 March 2024, was not in accordance with applicable enactments and guidance from the Scottish ministers.

8. Three items of expenditure, totalling £43,604, were identified which did not meet the requirements of the Scottish Public Finance Manual (SPFM) on delegated authority limits, relating to:

- £19,484 with a recruitment consultancy which required Scottish Government approval as the contract was not awarded via a competitive tender exercise and the expected costs of £28,000 exceeded the £20,000 threshold
- a gift bought for a visiting international delegation which cost £120, exceeding the Commission's delegated limit of £75
- £24,000 paid as a retainer for the use of a King's Counsel for 'advanced reservation and commitment of diary time each quarter', which should have been approved by the Scottish Government due to the value and unusual nature of this expenditure.

9. Travel and subsistence expenses of £23,774 were identified which were not incurred in accordance with the requirements set out in Commission's Financial Policies and Guidelines, and did not meet the requirements for authorisation of expenditure set out in the expenditure and payments section of the SPFM.

10. Staff expenses of £7,454 were identified for which no itemised receipts or other proof of purchase were provided. These did not meet the proof of payment requirements set out in the SPFM.

Further expenditure of £20,355 was identified which complied with policies but does not appear to represent value for money

11. As part of the Commission's response to the issues reported on the 2022/23 audit, management conducted a review of financial transactions to identify areas of similar non-compliance. This review considered all

transactions, receipts and invoices submitted, along with purchase orders for transactions over £1,000, up to the end of December 2023.

12. This identified £17,686 for business class flights. This expenditure was in line with the Commission's Financial Policies and Guidelines in place at the time, but the auditor noted that this policy did not set clear criteria for purchasing business class flights, and this expenditure may not have represented value for money.

13. Management's review of expenditure also identified £2,669 incurred on meals which exceeded £50 per head, and the audit team's review identified a further £590 had been spent on two meals with external guests. This expenditure was in line with the Commission's Financial Policies and Guidelines that were in place at the time, as the limit per head for meals was removed from the policy in January 2023. However, I believe this does not represent value for money.

All inappropriate payments occurred in the first nine months of the year and predated my previous report

14. While it is disappointing that further inappropriate expenditure has been identified, it is reassuring that this occurred prior to my December 2023 report. The auditor has confirmed that the action taken by management to address the financial management weaknesses identified has improved compliance. The auditor's testing did not identify any instances of non-compliant expenditure between January and March 2024.

Financial settlement for former Chief Executive

The total cost to the public purse of the departure of the former Chief Executive was £105,488

15. The former Chief Executive and Accountable Officer tendered his resignation with effect from 31 December 2023. As part of the agreement for his departure he received a payment of £86,268 covering payment of salary in lieu of the six months' notice period (£84,800) and 2.25 days of accrued but untaken annual leave (£1,468).

16. The Commission also paid £840 to the former Chief Executive's legal representatives and incurred a further £6,580 for their own legal advice and services. A payment of £11,800 was paid to HMRC for the employer national insurance contributions due on the payment in lieu of notice. The total cost to the Commission of the former Chief Executive's departure was £105,488.

17. I note that the Director General Net Zero provided approval for this payment on 11 March 2024. The auditor therefore concluded that this payment did not impact on his regularity opinion.

The Commission should have taken more time to consider the wider options available, before offering a settlement agreement to the former Chief Executive. The use of a settlement agreement removed the possibility for disciplinary procedures to be taken.

A **settlement agreement** is a legally binding contract between an employer and an employee whereby the employee agrees to waive their rights to bring any claims against the employer, and vice versa, often in exchange for compensation.

18. The former Chief Executive was appointed as Water Industry Commissioner for Scotland from November 1999, before serving as the Chief Executive of the Commission from July 2005. The auditor identified that a subsequent contract was issued to the former Chief Executive in February 2007, however this was never signed. It is not clear why another contract was issued at that time.

19. The auditor has identified that the Commission applied the conditions in the former Chief Executive's initial contract of employment when preparing the value-for-money assessment. The assessment considered financial costs, non-financial costs and non-financial benefits of the following options:

- accepting the offer from the former Chief Executive to work until November 2024
- suspending the former Chief Executive to allow an investigation/hearing to take place
- dismissing the former Chief Executive (and incurring 12 months contractual severance)
- allowing the former Chief Executive to work his six-month notice period, or
- making a payment in lieu of the six-month contractual notice period.

20. As the initial contract included a notice period on termination of 12 months, the conclusion was that the lowest financial cost options were either to allow the former Chief Executive to work his six-month notice period or to make a payment in lieu of this.

21. However, had the more recent contract, from February 2007, been used this would have reduced the notice period required on termination from 12 months to three months. This would then have been the lowest financial cost option.

22. The auditor discussed this issue with the former Chair of the Board who advised that, based on the legal advice received, the Board was uncertain about the Commission's ability to enforce the terms of the former Chief Executive's later contract as he had not signed it.

23. Given the significant difference in the potential costs of terminating the former Chief Executive's contract under the terms in the two different contracts, further consideration should have been given to the enforceability of the terms of the 2007 contract. The Commission's legal advice did not give a clear view on its enforceability.

24. The auditor confirmed that the Commission's legal advisers provided guidance, including highlighting the potential financial risk to the Commission of commencing a disciplinary process against the former Chief Executive. Given the importance of these issues, more time should have been taken to assess wider options prior to the settlement agreement being prepared on 19 December 2023. The use of a settlement agreement removed the possibility for any disciplinary procedures against the former Chief Executive.

The Commission should have sought and received clearer guidance from the sponsor team before offering a settlement agreement to the former Chief Executive

25. As also reported in evidence to the Scottish Parliament's Public Audit Committee, the former Chair of the Board advised the auditor of telephone conversations held with the former Deputy Director of the Scottish Government Water Policy Division on 19 December 2023 and 20 December 2023. The former chair then emailed the former Deputy Director on 22 December 2023 to notify him of the Board's decision regarding the departure of the former Chief Executive. This email made no reference to the use of a settlement agreement in relation to the former Chief Executive's departure.

26. After the settlement agreement confirming the terms and date of the former Chief Executive's departure was signed by the Chief Executive and the Chair of the Board, the Commission's finance team emailed the Deputy Director of the Scottish Government Water Policy Division to inform him of the value of the payment and seek confirmation for the payment. This email, on 12 January 2024, noted that they held a copy of the related settlement agreement.

27. At this point, the Water Policy Division emailed to advise that the settlement payment could not be approved until the Commission completed a business case for the settlement agreement in accordance with the requirements of the SPFM. On 11 March 2024, the financial settlement payment to the former Chief Executive was approved by the Director General Net Zero. The payment was made on 27 March 2024.

28. On 15 March 2024 the Cabinet Secretary for Wellbeing Economy, Net Zero and Energy wrote to the former Chair of the Board stating: 'I note that in choosing a settlement agreement to conclude the departure of the former CEO, the Board failed to follow due process. This is extremely concerning given the nature of the failings identified by the Auditor General. Furthermore, it did not offer an opportunity to the SG to offer a wider steer on the use of settlement agreements and in particular the concerns that the PAC has expressed in respect of the use of such agreements. While I am advised that the payment reflects contractual terms, this recurrent breach of process is unacceptable.'

29. A complete timeline for the financial settlement paid to the former Chief Executive, including the process relating to the use of the settlement agreement, is detailed in [Appendix 1 \(page 16\)](#).

30. At January 2024, when the settlement agreement was signed, the Settlement agreements, severance, early retirement and redundancy terms section of the SPFM was written based on the final decision to enter into a settlement agreement resting with the Accountable Officer for the public body.

31. Given that the departure related to the Accountable Officer of the Commission, the specifications of the SPFM, as written at the time, could not be fully followed. I agree with the auditor that the Commission's sponsor division should have been more proactive in providing clear guidance and support. I note that the relevant section of the SPFM was revised in March 2024 and now includes an additional clause to provide clarity on the approach to be taken where the Accountable Officer is the subject of a settlement agreement.

32. Further, I note the report published by the Scottish Government on 7 November 2024, [Water Industry Commission for Scotland – independent review: sponsorship oversight and governance](#), which acknowledges weaknesses in the sponsorship arrangements at that time. Steps have been taken to strengthen the sponsorship oversight for the Commission and I have asked the Scottish Government auditor to monitor the implementation of the recommendations.

Leadership and culture

There have been changes to the Board and senior management team

33. Following the departure of the former Chief Executive and Accountable Officer on 31 December 2023, the Commission operated without a Chief Executive or Accountable Officer until the Director of Strategy and Governance was appointed interim Chief Executive and Accountable Officer on 20 March 2024. The Commission plan to commence the recruitment of a permanent Chief Executive early in 2025.

34. In July 2024, the Acting Cabinet Secretary for Net Zero and Energy announced the appointment of two new interim members of the Board. The Chair of the Board then resigned with effect from 21 October 2024. One of the newly appointed non-executive board members has been appointed by the Cabinet Secretary as interim Chair, while a permanent Chair is recruited.

35. I note that the auditor is satisfied that improvements have been made in the level of reporting to, and scrutiny at, the Board and Audit and Risk Committee since January 2024.

The Commission is taking action to address the financial management and governance issues reported last year

36. Following the publication of my section 22 report on the 2022/23 audit, management agreed a twenty-one-point workplan to respond to the reported issues. The range of actions included an overhaul of the Commission's governance and controls, including revising the expenses policy; reinstating an approval panel to scrutinise expenditure; and strengthening the internal reporting processes. It also included training to ensure all staff were aware of the requirements of the Commission's Finance Policies and Guidelines and the SPFM, and their role in ensuring that all expenditure incurred is compliant. Staff were also provided with specific VFM training.

37. The Commission also asked their internal auditors at the time, Grant Thornton, to undertake a detailed review of governance and financial management arrangements. This report was considered by the Audit and Risk Committee in June 2024 with a further action plan agreed to address the recommendations. All actions are due to be implemented by the end of the 2024/25 financial year.

38. The Commission has acted quickly to address the findings, with the auditor advising that the original twenty-one actions has been implemented.

Further work is required to embed a positive culture of Best Value

39. The Commission has started engaging more formally with staff and, in February 2024, completed a Health and Safety Executive Stress Survey. This survey is designed to help organisations identify and manage work-related stress among employees and includes questions across six key areas: Demands, Control, Support, Relationships, Role and Change.

40. The results of the survey were reported in March 2024 and indicated staff who had experienced bullying and harassment within the workplace. Management engaged HR consultants to provide Bullying and Harassment training and a Diversity, Equality, and Inclusion workshop for staff in June 2024. Staff will be given the opportunity to complete the survey again during 2025 to enable the Commission to assess how their response is addressing the issues identified. In addition, the Commission also plans to conduct its own staff survey and pulse surveys to monitor the wellbeing of staff on an ongoing basis.

41. Following the Covid-19 pandemic, the former Chief Executive decided that the Commission did not need a physical office as all staff could work from home. While this decision has saved the Commission around £200,000 a year, management believe it had a detrimental impact on the organisation in terms of collaboration and cohesiveness within and between teams, and communication across the organisation.

42. The hybrid working arrangements are being reviewed and an essential aspect of this is re-establishing a physical office presence to provide staff with greater opportunities for in-person interaction.

43. In June 2024, the Board approved an organisational change programme which is looking to clarify roles and responsibilities, effectively align budgets, and strengthen the Commission's risk and assurance functions, communication strategies, and hybrid working practices. Although the work has commenced it is expected to continue into 2025/26.

44. As noted at [paragraph 4](#), the Commissions international work is currently paused. Given that this remains one of the Commission's strategic objectives for the current control period, management need to engage with the Scottish Government to discuss the expectations of activity in this area in the future. It is critical that appropriate governance arrangements and financial policies are in place to provide clarity on what is permissible activity and expenditure as part of this work.

45. The Scottish Government recently published the [Water Industry Commission for Scotland - independent review: governance arrangements](#). The report notes that the Commission remains in a state of reset and highlights how important it is to foster a culture where it is safe to challenge, staff views are heard, and issues of non-compliance are identified and acted upon.

46. This has been a challenging year for the Commission. Significant work is under way to improve the leadership, governance and culture of the Commission. It is critical that all parties, Board members, senior management, staff and the sponsor team, work together to move the Commission into a stronger place in delivering its regulatory role while ensuring Best Value in the use of its resources.

Conclusion

47. Actions are being taken to address the financial management and governance weaknesses raised. Effective leadership from the Board and senior management team, with support from the Scottish Government sponsor team, is essential to embed a positive culture of Best Value and provide clear strategic direction during this period of organisational change.

Appendix 1

Timeline for the financial settlement paid to the former Chief Executive

Date	Event
6 November 2023	Draft 2022/23 Annual Audit Report issued by appointed auditor to the former Chief Executive.
21 November 2023	Appointed auditor presented 2022/23 Annual Audit Report to the Audit and Risk Committee and notified them that the Auditor General for Scotland would be preparing a Section 22 Report on the Commission's 2022/23 audit. This was confirmed via email on 22 November 2023, which provided the Section 22 report timetable and requested that this information was shared with the Commission's sponsor division.
6 December 2023	Appointed auditor issued draft Section 22 report to the former Chief Executive, former Chair of the Board and Chair of the ARC. The covering email requested that the report was also shared with the sponsor division to ensure they were aware of the issues being reported by the Auditor General for Scotland within the report.
7 December 2023	The Commission's Senior Management Team presented a draft action plan to the Board setting out actions to address the points being reported in the Section 22 report on the 2022/23 audit.
10 December 2023	The former Chair of the Board received a letter from the former Chief Executive setting out his intention to retire in October 2024.
12 December 2023	The Board discussed the former Chief Executive's letter and agreed as a Board that they would accept his resignation but wished for him to leave the organisation as soon as possible.
19 December 2023	<p>The former Chair of the Board and another board member met with the former Chief Executive to discuss the timing of his departure. The Board also held separate discussions with its legal advisers and the former Deputy Director of the Scottish Government Water Policy Division during the day.</p> <p>Later that day the former Chief Executive advised the former Chair that he would resign and confirmed via email that evening that he was giving six months' notice, from 31 December 2023, as required under his contract.</p>

Date	Event
	<p>Following further consideration, the Board agreed that it would accept the former Chief Executive's resignation but would require him to step down with effect from the end of December rather than working his notice period.</p> <p>The Board instructed its legal advisers to prepare a settlement agreement to cover the payment the Commission were required to make for the period of his notice and for any accrued leave up to and including the 31 December 2023.</p>
20 December 2023	<p>Section 22 report on the 2022/23 audit published and the Scottish Government released a media statement stating that: 'The Water Industry Commission for Scotland's Chief Executive is stepping down with immediate effect and has tendered his resignation.'</p>
22 December 2023	<p>The former Chair of the Board contacted the former Deputy Director of the Scottish Government Water Policy Division to formally notify him of the Board's decision regarding the departure of the former Chief Executive. This email made reference to the previous discussions held between him and the Board and also stated that: 'Under his contract he had to provide six-months' notice and as confirmed by the Scottish Government Public Pay Policy Unit to you he is entitled to his salary for the period of his notice; in paying this WICS is meeting its contractual obligation and not making any change to his contract. WICS had received legal advice confirming our contractual obligation in respect to Alan's notice period.' However, the email made no reference to the use of a settlement agreement in relation to the former Chief Executive's departure.</p>
4 and 5 January 2024	<p>A settlement agreement confirming the terms and date of the former Chief Executive's departure was signed by the former Chief Executive (4 January 2024) and the former Chair of the Board (5 January 2024).</p>
12 January 2024	<p>The Commission's finance team emailed the former Deputy Director of the Scottish Government Water Policy Division to inform him of the value of the payment due to the former Chief Executive and to seek confirmation they could make the payment. This email also noted that the Commission held a copy of the related settlement agreement.</p>
15 January 2024	<p>The Water Policy Division emailed the Commission's finance team to advise that the settlement payment could not be approved until the Commission completed a business case for the settlement agreement in accordance with the requirements set out in the Scottish Public Finance Manual.</p>
19 January 2024	<p>The Commission's Director of Strategy and Governance (now interim Chief Executive) submitted a voluntary severance</p>

Date	Event
	business case to the Water Policy Division in relation to the former Chief Executive's financial settlement on the basis that the payment made was a contractual entitlement (ie, payment in lieu of notice). The Water Policy Division advised that a settlement agreement business case would be required as the Commission had used a settlement agreement for the financial settlement.
23 January 2024	The Commission's Director of Strategy and Governance (now interim Chief Executive) submitted a settlement agreement business case to the Water Policy Division.
29 February 2024	The Water Policy Division requested additional documentation, including a copy of the settlement agreement value for money assessment, to be submitted in support of the settlement agreement business case.
4 March 2024	The Commission's Director of Strategy and Governance (now interim Chief Executive) resubmitted the business case for the settlement agreement, along with the related value for money assessment and employee information schedule, to the Water Policy Division.
11 March 2024	Financial settlement to be paid to the former Chief Executive approved by Director General Net Zero.
15 March 2024	<p>Letter sent by Cabinet Secretary for Wellbeing Economy, Net Zero and Energy to the former Chair of the Board noting:</p> <p>'That the manner in which the removal [of the Chief Executive] was achieved was not in accordance with Scottish Government requirements as set out in the Scottish Public Finance Manual.'</p> <p>The letter also stated that: 'I note that in choosing a Settlement Agreement to conclude the departure of the former CEO, the Board failed to follow due process. This is extremely concerning given the nature of the failings identified by the Auditor General. Furthermore, it did not offer an opportunity to the SG to offer a wider steer on the use of Settlement Agreements and in particular the concerns that the PAC has expressed in respect of the use of such agreements. While I am advised that the payment reflects contractual terms, this recurrent breach of process is unacceptable.'</p>
27 March 2024	Payment to former Chief Executive made in accordance with the settlement agreement and business case.

The 2023/24 audit of the Water Industry Commission for Scotland



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