



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Public Audit Committee

**Thursday 8 February 2024**

**Session 6**



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Pàrlamaid na h-Alba

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**PUBLIC AUDIT COMMITTEE**

**5<sup>th</sup> Meeting 2024, Session 6**

**CONVENER**

\*Richard Leonard (Central Scotland) (Lab)

**DEPUTY CONVENER**

\*Sharon Dowey (South Scotland) (Con)

**COMMITTEE MEMBERS**

\*Colin Beattie (Midlothian North and Musselburgh) (SNP)

\*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

\*Graham Simpson (Central Scotland) (Con)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Stephen Boyle (Auditor General for Scotland)

Carole Grant (Audit Scotland)

Richard Smith (Audit Scotland)

**CLERK TO THE COMMITTEE**

Lynn Russell

**LOCATION**

The James Clerk Maxwell Room (CR4)



## Scottish Parliament Public Audit Committee

Thursday 8 February 2024

[The Convener opened the meeting at 09:01]

### Decisions on Taking Business in Private

**The Convener (Richard Leonard):** Good morning. I welcome everyone to the fifth meeting in 2024 of the Public Audit Committee.

The first item on our agenda is to agree to take agenda items 4, 5, 6 and 7 in private. Are we agreed?

**Members** *indicated agreement.*

**The Convener:** The second item on the agenda is also a decision to take business in private. Do members agree to consider any future draft report on adult mental health in private?

**Members** *indicated agreement.*

## Section 22 Report: “The 2022/23 audit of the Water Industry Commission for Scotland”

09:01

**The Convener:** Agenda item 3 is consideration of the Auditor General for Scotland’s section 22 report on “The 2022-23 audit of the Water Industry Commission for Scotland”. I welcome to the meeting our three witnesses: Stephen Boyle, Auditor General for Scotland, who is joined this morning by Carole Grant, audit director, and Richard Smith, senior audit manager, from Audit Scotland.

We have quite a number of questions to put to you on the section 22 report, Auditor General, but before we get to them, I invite you to make a short opening statement.

**Stephen Boyle (Auditor General for Scotland):** Many thanks, convener, and good morning, committee.

I have prepared this report on “The 2022-23 audit of the Water Industry Commission for Scotland” under section 22 of the Public Finance and Accountability (Scotland) Act 2000. My report brings to Parliament’s attention significant weaknesses in financial management and governance at the Water Industry Commission for Scotland.

I am concerned that the current culture within the commission does not have sufficient focus on ensuring the achievement of value for money in the use of public funds. The commission incurred two items of expenditure during 2022-23 that required retrospective approval from the Scottish Government sponsor team, following an intervention by the external auditor. That expenditure included more than £77,000 for the chief operating officer to attend a training course at Harvard Business School and buying gift vouchers as Christmas presents for members of staff.

The auditor also found widespread issues with the expenses reimbursement process, including the approval of expense claims without itemised receipts, claims exceeding the approved subsistence rates and reimbursement for the purchase of alcohol. The auditor identified a lack of adequate arrangements to attribute taxable benefits, such as gift vouchers, to individual members of staff, which resulted in the use of public funds to settle personal tax liabilities.

The issues that the auditor identified demonstrate an unacceptable use of public money. The commission has committed to addressing those issues as a matter of urgency,

but the committee will be aware that, following the publication of my report, the chief executive of the commission resigned. The commission, together with the Scottish Government sponsor team, remains in the process of securing an interim chief executive and accountable officer, and that process needs to be concluded quickly so that the commission and the board can make the progress that they have committed to. The auditor will monitor their responses during 2024, and I will report further in public as necessary.

I am joined this morning by Richard Smith, the appointed external auditor, and Carol Grant, who leads our audit of the Scottish Government. Between us, we look forward to answering your questions.

**The Convener:** We will want to go through the report in some detail but, first of all, I note that you mentioned towards the end of your remarks that the recommendations have been accepted and specific actions will be implemented. Can you give us an overview of those actions?

**Stephen Boyle:** Yes, but I will bring in Richard Smith, because both my section 22 report and the recommendations are drawn from the external auditor's annual audit report. With section 22s, those annual audit reports form the basis of my reporting.

I was pleased to note that, upon publication of the report, the Scottish Government issued a very clear statement of its intention and its commitment to addressing the actions quickly. As I mentioned in my opening remarks, we will follow up those actions. However, I note with a degree of caution that a gap still exists in the leadership of the Water Industry Commission for Scotland since the resignation of the chief executive.

I will pass over to Richard Smith to set out in a bit of detail the nature of the recommendations and the responses that we have received.

**Richard Smith (Audit Scotland):** Thank you, Auditor General. I am happy to take the committee through the recommendations in the annual audit report, some of which specifically pick up the issues highlighted in the section 22 report.

On the Scottish Government's approval of expenditure, our recommendations come in two parts, the first of which is about ensuring that any expenditure complies with the commission's own finance policies and guidelines, as well as the conditions of the Scottish public finance manual. Linked to that is whether any dubiety exists with regard to Scottish Government approval or board approval being required. We have said that the commission should seek approval for that expenditure proactively rather than, as we reported in the section 22, retrospectively. That element is key to ensuring that, if anything novel

or contentious arises, the commission can think about it and look to get that expenditure in advance.

We also include a specific recommendation about the expense claim issues, which, as you would expect, says that staff will be

"reimbursed at their approved subsistence rates"

and that all those claims should be supported by expense receipts in all instances. That already complies with the policy in the finance policies and guidelines.

We have also picked up on the Auditor General's point about the identification of taxable benefits to staff. Again, we have included a recommendation that management should

"ensure that adequate arrangements are in place to attribute taxable benefits to relevant staff so that they incur the related income tax and national insurance contributions",

so that those fees do not fall on the organisation and, therefore, the taxpayer.

It would be useful to update the committee on the actions that the commission has taken in response, although I should say that that activity has not been audited yet; we have received only a verbal update from the commission. On 30 January, the commission delivered a training course for all staff that covered what appropriate expenditure is, the processes that are in place to get that expenditure approved and how staff should take forward anything that requires board or Scottish Government approval. It also reiterated the need for supporting receipts and other documentation for all expenditure incurred and the fact that staff will not be reimbursed if that documentation is not provided, and it provided guidance to staff on what constitutes taxable benefits, which are more for the finance staff to identify at the time.

We have also reintroduced an approvals panel for all expenditure of more than £10,000. The panel, which is chaired by the head of finance, comprises the four directors as well as the new CEO—when they are appointed—and will ensure that anything over £10,000 is considered before it is approved.

Alongside that, the head of finance has commissioned a review of all financial transactions during financial year 2023-24 to ensure that no issues have occurred since our audit took place that have not yet been identified. I should at this point explain that our audit covered only the financial year 2022-23. Grant Thornton, the commission's internal auditor, has also been asked to review the adequacy of the management actions that have been taken in response to the action plan to ensure that they are addressing the

issues that were reported and are achieving what they are intended to.

**The Convener:** Auditor General, will you comment on the fact that the senior finance person—the head of finance—does not sit at director level? There are four directors, but there is no director of finance. Is that unusual in an organisation such as this?

**Stephen Boyle:** It varies. Even in some large and complex public bodies, there is not always a director of finance as part of the senior leadership structure. In more recent times, there has been an amalgamation of corporate functions, with finance, human resources, information technology and legal services more typically being combined under a director of corporate services or director of resources.

What matters, though, is that the head of finance has unrestricted access to all the activities of the organisation and to the very senior leaders, both executive and non-executive, should they have concerns. I would not say that it is an unusual structure for an organisation of this size; the more fundamental point is that it should not inhibit the organisation from discharging its responsibilities as required.

**The Convener:** This section 22 report is based on a wider-scope audit of the year 2022-23. In paragraph 10, you capture some of the concerns that you have identified as

“widespread issues with expense claims”,

Including lack of “itemised receipts” and the purchase of alcohol “exceeding the approved rates”. Such matters are cultural and behavioural, so the other question that immediately comes to mind is whether they predate this year or whether what would seem to be sensible governance arrangements and expenses regimes were suddenly abandoned at the beginning of April 2022.

**Stephen Boyle:** I will point to a couple of factors. Most fundamentally, when I prepare a section 22 report, I do so on the evidence that is presented to me in the annual audit. Richard Smith and his team identified the issues during the course of the audit and the resultant section 22 report.

This is the first year of the rotation of the current round of external audit appointments for public bodies in Scotland, and it is not untypical that that will result in the auditor and finance team building a new relationship and exploring practices and transactions. This year, a fundamental step change is taking place in the commission's arrangements relating to the volume of expenditure. As we say in the report, that volume is connected to part of the commission's wider

strategy and its role in the Scottish Government's hydro nation initiative. The volume of expenditure through expenses increased significantly; part of that would have predated Covid, which was an interrupting factor in the organisation's expenses.

None of that detracts from the point that you have made, convener. There are cultural issues in the Water Industry Commission for Scotland and there needs to be more rigour in their internal control arrangements. It needs to have appropriate controls, checks and balances and, as it spends public money and reimburses expenditure, it has to get some of the basics right. Receipts have to be in place and properly authorised, and the commission has to spend on appropriate factors.

I will pause there for a moment. It would be useful for the committee to hear directly from the auditor.

**Richard Smith:** Just to allude to what Stephen Boyle has said, I would point out that, as part of the hydro nation work, the commission does a lot of work in New Zealand and other jurisdictions, including Romania. In 2021-22, the travel and subsistence expenditure was only £16,572, but that increased in 2022-23 to £372,480. Because our audit approach is risk based, we tend to focus on the areas of highest expenditure, and it is fair to say that our focus on travel and subsistence was a lot greater this year than it would have been under the previous auditor, which is why we started looking at expenses.

As part of the testing, we identified in one of the samples that we picked a claim by the chief executive that included two claims that did not have receipts to support them. At that point, we expanded our testing to see what other claims had gone through that were not supported by receipts. That explains how we identified those issues this year.

**The Convener:** Was the issue one of a lack of “itemised receipts” and the purchase of alcohol “exceeding the approval rates” in claims made by the former chief executive, or was this sort of thing more widespread through the organisation?

**Stephen Boyle:** Your first suggestion is absolutely the case. The section 22 report refers to examples of the former chief executive's use of the expenses system such as, as Richard Smith has mentioned, his claims for expensive meals and reclaiming the purchase of alcohol. There were other instances of claims that were not supported by receipts.

However, the issue goes wider than that, and I will let Richard set that out. There were a range of deficiencies in internal control. The culture lacked the rigour to require someone claiming back expenses to have receipts, and claims were processed without those being in place.

09:15

**Richard Smith:** We identified a total of 84 items in the 19-month period from 1 April 2022 to 18 October 2023. The latter was the date when we carried out the audit, so the period extended beyond the financial year. Claims for those 84 items totalled £9,660, 47 of which related to claims made by the chief executive totalling £4,351. The majority therefore related to the chief executive but, to pick up your point, some were made by other people.

For clarity, the only good aspect was that staff had been encouraged to use corporate credit cards. From the point of view of reimbursement, that money had already been spent. However, we would have expected that, for claims that were not valid, the commission would have looked to recover the money from the individuals concerned.

**The Convener:** The wider-scope audit report suggests that the lack of itemised receipts related to “business entertaining costs”. What constitutes such costs?

**Stephen Boyle:** Richard Smith might want to give a broader definition of our understanding. I have already referred to one instance in which, as part of the hydro nation strategy, the chief executive, together with a representative of the New Zealand water industry—one of the main sources of additional income for the commission—spent £200 per head for a two-person meal. That would fall under that bracket.

Before Richard comes in, I should stress that that is unusual activity and expenditure for a Scottish public body. We do not routinely see business entertaining in the context of our external audit activity. For that reason it jumped out and—reasonably, I would argue—caught the attention of the auditors as part of their review of wider expenses issues within the organisation.

Richard Smith might want to say more about what falls within that category.

**Richard Smith:** Before I explain that, I should say that “business entertaining costs” was the commission’s term. In our annual audit report, we highlighted that the commission does not have a separate budget for such expenditure, its finance policy and guidelines do not cover such costs, and there is certainly no special dispensation for staff to exceed the approved subsistence rates when engaged in such activity.

The costs mainly related to meetings with foreign delegations that were visiting Scotland or meetings with partners working on the hydro nation initiative. As the Auditor General said, that generally involved food and drink, including meals that exceeded the subsistence rates.

**The Convener:** The framework document, which was last reviewed in April 2022—in other words, at the start of the period—contains a section on gifts and hospitality, although I think that that relates to the board of directors rather than to staff. It covers the circumstances under which people need to record accepting or receiving gifts and so on; it does not cover giving gifts and hospitality. What is the policy on giving those versus receiving them? Were some of those expenses incurred by board members, or did the chief executive incur almost half of them, or more than that, while the rest were incurred by other members of staff?

**Stephen Boyle:** Richard Smith can say more about the analysis if we have that detail.

The position on giving hospitality is clear not only in the framework document; the Scottish public finance manual covers it in a fair degree of detail, too. The expectation—and the assumption—is that it will be very rare and unusual for a public body to offer hospitality. There are also clear boundaries about public officials receiving hospitality, out of concern that it might influence their judgment or other activities.

If we have the detail of who was taking part in that, we can share it with the committee. However, our focus has been on the connection with the hydro nation strategy that has been driven primarily by the former chief executive and the board of directors.

**Richard Smith:** Gifts and hospitality are covered in the Scottish public finance manual, which sets a limit of £75 for them. Anything above that would require Scottish Government approval. As the Auditor General has said, it is incredibly rare for us to see public sector bodies giving gifts. We usually look more at the other side of such situations, where people have received gifts, to ensure that they have been declared appropriately.

It was difficult to ascertain exactly who was in attendance for the meals, because they were not covered by receipts. We worked with finance staff to look at the calendars of individuals who had put in claims, to try to ascertain whom they had met previously and who was likely to have been there. That process related not only to the chief executive but to other members of the senior management team. As we say in our report, external attendees were at some of those meals, including people who were involved in the hydro nation work.

I should also say that there is probably a limit on how far we can guarantee that people definitely attended meals: the fact that they were at a meeting that preceded the provision of food and drink does not necessarily mean that they stayed



for them. Also, it is hard to know whether they expected that the cost would be reclaimed. It had been paid by credit card and the individual who paid had not asked for a receipt. It might be fair for a person to assume that if they are out with someone who does not ask for a receipt, they are not expecting to claim that money back from their organisation.

I would add those caveats to what we can say about the attendees and whether they knew that those amounts were being reclaimed from the commission.

**The Convener:** That is helpful. I think that Graham Simpson wants to come in on that point.

**Graham Simpson (Central Scotland) (Con):** Yes, I do. I am concerned about what I have heard already. There was a corporate credit card—or was there more than one?

**Richard Smith:** I believe that all members of the senior management team have corporate credit cards.

**Graham Simpson:** How many are there?

**Richard Smith:** That would be five, including the chief executive and four directors.

**Graham Simpson:** Five. Is there a limit on what can be put on those credit cards?

**Richard Smith:** I am not aware of what the limit is.

**Stephen Boyle:** Finding that detail would require a bit of further exploration. As the Government and the commission are reviewing the wider arrangements for the use of corporate credit cards as part of the action plan, we anticipate that such expectations will be made clear.

It might be important for the committee to be aware of this point. We have mentioned the purchase of alcohol a couple of times in our discussion. The commission's policy did not preclude that, which is quite unusual for a public body. Normally, arrangements will clearly state that alcohol will not be provided or received as part of gifts and hospitality, but that was not the case for the Water Industry Commission for Scotland.

**Graham Simpson:** So we have five of those corporate credit cards, with no apparent limit on what can be spent on them. You mentioned that one particular meal cost £200 per person. Was that for the former chief executive and a guest?

**Stephen Boyle:** Yes, that is correct. The former chief executive and a representative from the New Zealand water industry were the two attendees at that meal.

**Graham Simpson:** Given the cost, I am imagining that it was at a Michelin-starred restaurant. Do we know where that meal took place?

**Richard Smith:** Yes. The meal took place on Sunday 9 October 2022, at the Champany Inn, in Linlithgow. The total cost was £402.41. One issue that we identified was that we do not have a receipt for that, so we do not know the split between the costs for food and drinks. However, that was the total cost for the two individuals.

**Graham Simpson:** Sorry, what was the total cost?

**Richard Smith:** It was £402.41.

**Graham Simpson:** £402. Wow! That is quite extraordinary. I like to treat Mrs Simpson occasionally, but to arrive at that kind of bill would be quite staggering, frankly. It is also staggering that there is no upper limit. Presumably the former chief executive felt that they could just get away with spending that amount and not repaying it.

**Stephen Boyle:** That is the essence of our section 22 report. That example is one of a number that challenge the extent to which public money was being well used within the organisation. Although, in the greater scheme of things, it does not involve a significant amount of public money, it perhaps illustrates some aspects of the organisation's culture and the lack of focus on what it was actually spending.

**Graham Simpson:** Convener, may I ask about another point that has already come up? Mr Smith, I think that you said that £300,000 had been spent on foreign travel in one year. To the best of your knowledge, is that situation continuing?

**Richard Smith:** That is travel and subsistence expenditure, so the majority of it probably relates to travel. There will still be some foreign travel, because the commission is still doing work that requires employees to go over and work in New Zealand. That work breaks even, because the commission is reimbursed for it by the New Zealand Department for Internal Affairs. Although that expenditure has increased significantly, we also highlight in the annual report that the relative income has increased significantly. A lot will be spent on travel for the foreseeable future while the commission is doing that work in New Zealand.

**Graham Simpson:** Okay. I read the Government's report on the hydro nation project, which I think is best explained by saying that it is Scottish Water—is it just the commission, or is it Scottish Water?—working with other countries, presumably to help them to improve the way they run their water industry. Is that fair?

**Stephen Boyle:** That is a fair summation. The strategy goes back to February 2012 and aims to

apply the expertise and skills in the Scottish water industry internationally to help regulators in other jurisdictions. As Richard Smith mentioned, there is an income stream associated with that and, looking at some of the more recent activity, it more than breaks even. It is generating income for Scottish public services. That aside, although it is consistent with the Government's strategy and ambition in exploring revenue-generating activities, from our perspective it is about querying the appropriateness of some of the expenditure that supports that.

**Graham Simpson:** If I was doing that job in New Zealand, I might be querying why we were having to take advice from the other side of the world on how to run our water industry.

**Stephen Boyle:** Just for absolute clarity, convener, we have not audited the Scottish Government's hydro nation strategy. That has not been part of the scope of our work, which is focused specifically on the audit of the finances of the Water Industry Commission for Scotland.

**The Convener:** Thanks. Willie Coffey has some questions.

**Willie Coffey (Kilmarnock and Irvine Valley) (SNP):** My questions are about the impact of all this on the commission's ability to carry out its functions properly, and a little bit on the reserves and surpluses that you mentioned a wee minute ago. First, what is your assessment of the impact of the situation on the commission's ability to carry out its duties and functions since the section 22 report revealed it?

**Stephen Boyle:** There is no doubt that it is a disruption. The Water Industry Commission for Scotland's purpose is to regulate Scottish Water so that it can deliver its services successfully and cost effectively. As I mentioned in my introductory remarks, the chief executive of the commission resigned on the day of publication of the section 22 report, towards the end of December. I will bring in Carole Grant to set out for the committee what the Scottish Government's intention is for backfilling that post, whether on a permanent or interim basis, to have clear leadership within the commission.

This will undoubtedly be a challenging period for the organisation. We have not yet seen whether the situation has had a direct bearing on the functions and performance of the Water Industry Commission for Scotland, which will absolutely be part of Richard Smith's audit during 2023-24. We do not know the answer to that yet, six or seven weeks after the publication of the report. For any organisation to be successful, it has to have clear leadership in place. Operating in an environment where that is not the case must, tangentially, have an impact on the organisation. We do not have the

evidence for that yet, but we want to see the situation resolved as quickly as possible. Carole Grant can set out where the Government has got to in that process.

**Carole Grant (Audit Scotland):** It is still in the middle of the process; it is working hard to find individuals with suitable expertise who can go in on an interim basis and enable a full recruitment process to take place.

09:30

On the back of the earlier conversation, I want to mention that part of the public service reform focus in one of the early sprints was about revenue raising and seeing the value of bringing that income into the Scottish public sector. The Scottish Government is now reflecting on whether it needs to be clearer in terms of governance, policies and expectations so that there is not a drift in culture towards more of a private sector mentality with regard to revenue raising and a focus on being successful and winning business.

The other thing to mention is that the Scottish Government has just started the quarterly assurance boards. We are attending each of the boards with the lessons from the section 22 report, to ensure that they are all considering the sponsor arrangements for all public bodies and that the same thing is not happening elsewhere.

**Willie Coffey:** All the governance issues are the subject of the committee's concerns and focus this morning, but what about the commission's overall performance? What is expected of it as a commission? You have said that it is quite profitable in some of its engagements, but how is it judged on its performance and what it does? Who is looking after its performance, outcomes and targets? Where are we with that?

**Stephen Boyle:** That is all set out in the activity of the commission. It is reasonable for me to assure the committee that that has not been the focus of our concern. This process is not about drawing attention to an organisation that has not been discharging its economic regulation responsibilities in respect of Scottish Water. It is doing that.

However, it has also drifted into spending public money in ways that are contrary to the requirements of the Scottish public finance manual and some of the wider foundations of financial control.

**Willie Coffey:** I think that colleagues will come in on that.

The commission is reporting surpluses of more than £1 million and reserves of £3.4 million. Is that unusual for a public body of that size? What will

ultimately happen to that reserve? Where does it go?

**Stephen Boyle:** It is relatively unusual but probably consistent with the revenue that the Water Industry Commission for Scotland has generated through the hydro nation strategy. I can quote for the committee some of the recent directly attributable income and expenditure. In the 2022-23 financial year, the commission generated nearly £1.2 million of hydro nation income, with a direct expenditure of £352,000. That is a considerable surplus.

Ultimately, the importance of the hydro nation strategy and its work will be a key factor in the extent to which it can continue to generate surpluses. New Zealand has been a key component of that revenue generation; that is also time limited. Therefore, if that is going to be part of the continuing strategy—as Carole Grant mentioned, the Government is giving that some consideration—that will have a bearing on its ability to continue to generate surpluses thereafter.

I will bring Richard Smith in on the accounting for surpluses, the commission's ability to keep generating them and what happens next.

**Richard Smith:** On how the commission builds up reserves and what would happen if it continued to build up reserves, the main way that the commission is funded is through a levy on Scottish Water and other licensed providers. That is set for what is called a regulatory period. The current period runs from 2021 to 2027.

We have had some discussion with the commission about the fact that, at the moment, it is making large surpluses and building up cash reserves. As part of that discussion, it was explained to us that, to give some certainty over that regulatory period, because there will always be peaks and troughs over that period, it tries to smooth the levy income. Taking the hydro nation income out of that, the expectation is that, over the regulatory period, the levies would, in effect, fund the core activity of the commission.

However, if it gets to the end of this regulatory period and there is a significant amount sitting in reserves, that money would be returned to Scottish Water and the other licensed providers and it would be considered in the setting of rates for the next regulatory period. The money would be returned to the providers at that point.

**Willie Coffey:** Ultimately, it would be to the benefit of consumers of Scottish Water if that profit goes back.

**Stephen Boyle:** Ultimately, by extension, yes.

**Willie Coffey:** I know that colleagues are waiting to come in on some of the other key issues in the report. Thank you for those answers.

**The Convener:** Before we leave the question of governance, what role do you see for, and what part has been played by, the board? When I look at the audit and risk committee's list of responsibilities, it includes

"the strategic processes for risk, control and governance ... adequacy of management response to issues identified by audit activity, including external audit",

and

"the effectiveness of the internal control environment".

Has it measured up to its responsibilities?

**Stephen Boyle:** Richard Smith attends the audit and risk committee in his role as the external auditor, so he can give a perspective on the work of that committee. However, the extent to which any audit committee can do its job often depends on the material that is in front of it. For example, if, as has been mentioned, some of the use of expenses has been through corporate credit cards, rather than being visible or subject to internal audit activity or management reporting, it would be hard for an audit committee to have full sight of the work. That leads us to a couple of examples in which we are unclear about the extent to which the audit and risk committee was sighted on some activity that we mention in the report.

Again, Richard Smith can offer more detail on this, but this committee will have seen that we refer in the report to expenditure for a member of staff attending Harvard Business School, which required retrospective approval from the Scottish Government because the commission had not gone through due process in terms of approvals from the Scottish Government. There seems to be some debate within the commission and the audit committee about the extent to which they were aware of that, and about the Government taking assurance from the fact that the audit committee was aware of it. There is more to explore, and we will continue to do so, but that level of ambiguity is unhelpful.

I am sure that the Water Industry Commission for Scotland and its audit committee can account for whether they have done their job properly. They will do an assessment of their work, as all audit committees in the public sector are required to do each year. We will do that, similarly, as part of the 2023-24 audit. However, there are some underlying concerns about the audit committee's ability to do its work with the material that was presented to it, and about the extent to which it was reported to Government that the committee was aware of certain transactions. It is not quite clear to us that that is the case.

**The Convener:** But if the audit committee is charged with responsibility for the effectiveness of the internal control environment, does that not suggest that it should be on top of that? It should

be asking questions and seeking further information.

**Stephen Boyle:** That responsibility works hand in hand with the responsibility of senior executives. Ultimately, the chief executive was the accountable officer, and this committee knows well the responsibilities of the accountable officer. That is a personal responsibility for the effective use of public money that is under their control. Those responsibilities co-exist, but the question of whether senior officials—principally, the accountable officer—have discharged their role properly would trump the responsibility of the audit committee.

**The Convener:** Okay. I invite the deputy convener to put some questions to you.

**Sharon Dowey (South Scotland) (Con):** Thank you. We note that part of the management response to the annual audit report refers to the spending of more than £77,000 for one person to attend a training course abroad, which was mentioned earlier, as “an oversight”. The governance framework between the commission and the Scottish Government appears to make it quite clear that the commission was required to obtain approval for that spend, as set out in its delegated financial authorities. Do you know why that situation occurred?

**Stephen Boyle:** I will bring in Richard Smith to set out the timeline of our engagement with the commission on that expenditure, but my position is that proper process was not effectively followed for that level of expenditure.

We are not suggesting that learning and development training opportunities should not be explored. I am even resisting passing a direct view, at the moment, on the quantum of that expenditure. However, we know that only universities in the United States were considered as potential providers for that level of management and development and that the above-threshold level of spending did not go through Government approval processes.

Those processes are opportunities, in the wider part of public services, for the sponsor team to take an informed view in advance of whether the expenditure is appropriate or should be incurred. Also, as I mentioned to the convener, there is some dubiety about the extent to which the audit and risk committee was sighted on that expenditure before retrospective approval was requested from the Scottish Government. A fairly mixed timeline of events has unfolded for that expenditure. I will pause there, because it would be appropriate for Richard Smith to set out a bit more on that for the committee.

**Richard Smith:** The Auditor General has already covered a lot of what I was going to say.

The reason why it occurred was that the commission was under the impression that the expenditure did not require Scottish Government approval unless it was more than £100,000. However, it is clearly set out in the financial guidelines that, if expenditure is above £20,000 and does not go through a competitive tendering process, it requires Scottish Government approval; if it goes through a competitive tendering process, the threshold is £100,000.

Initially, the commission was under the impression that the expenditure did not require Scottish Government approval. However, because it did not go through a competitive tendering process, it did require it. As the Auditor General said, we also found severe limitations in the business case and the options appraisal that the commission did in support of those costs.

**Sharon Dowey:** I take your point about learning opportunities, but is it common practice for people in public bodies in Scotland to pay that amount of money to go abroad for a training course? I am wondering about that because the commission classed it as “an oversight”. An oversight would be, for example, if you were going to get authorisation but you just forgot to get it. Is it common practice for people to go abroad?

**Stephen Boyle:** Not to my knowledge. You can attribute the oversight to the process that was followed, rather than taking a wider view about the appropriateness of the expenditure. I do not think that anyone could reasonably say that it was an oversight that they spent £77,000 for the chief operating officer to attend a management development course at Harvard Business School. That was very clearly part of a discussion between the chief executive and the chief operating officer. Just to reiterate, it is not something that we see regularly.

**Sharon Dowey:** It was a very expensive oversight. At the time that it was highlighted, did the commission carry out any internal investigation into its processes and procedures? Did it investigate why that happened in the first place and why it had spent £77,000 on a course for one person?

**Stephen Boyle:** No, I do not think so. Richard Smith might want to say more, but that is certainly not the impression that we have had from the Water Industry Commission of Scotland. I am not aware of any reflection from the organisation on the appropriateness of the expenditure or that provider. Richard might want to say a bit more about the origins of the expenditure, but that seems clear from the potential providers that were identified—Harvard, Stanford and Yale universities.

The clear understanding was that it was appropriate and necessary for the senior leader—the chief operating officer—in the organisation to undertake that type of management development. What is not clear from the list of potential providers is whether any other sources could have provided leadership, management and development training. To be frank, we know that there are other sources. There is a multitude of options available in Scotland, and elsewhere in the UK, that could have provided such training. Again, I will pause and let Richard say a bit more about some of the circumstances.

**Richard Smith:** There has certainly been reflection on the process for getting that expenditure approved, looking at the financial policies in the commission. There has been quite a short time between our audit, the section 22 report and us appearing at the committee today. In that time, a lot of action has been taken, including tightening things up, making sure that the commissioners understand the approval processes and pulling down the threshold to the £10,000 level. Anything above that requires to go through the approval meeting.

I am not sure what reflection has been done on what is appropriate training. That is probably a question for commission officials.

**Sharon Dowey:** Was any explanation given by the chief operating officer for why they thought that it was acceptable to spend that amount of money without getting authorisation from anybody?

09:45

**Richard Smith:** We have not had any direct discussions with the chief operating officer. We would draw the distinction that it was the chief executive who approved that expenditure, and we have not looked at the merits or requirements of that course.

We are highlighting the process by which the request was made and approved rather than the individual or the particular course that they went on. The issue is the process of the request being approved by the chief executive—the fact that it was not supported, in our view, by a robust business case and that it did not go through the expected process to be approved by the Scottish Government.

**Stephen Boyle:** Richard Smith is right that we have not carried out a value-for-money assessment directly on the expenditure at Harvard Business School. However, as I mentioned in my earlier response, we expect that there would have been a much wider range of alternatives at a much lower cost than the option that was ultimately arrived at in the decision by the chief executive and the chief operating officer.

As well as any consideration that we give to the issue, if we do any audit work, both the commission and the Scottish Government will want to take a view on it. We are somewhat struggling to understand why, when the work of Richard Smith and colleagues brought to the commission's attention the fact that the sum was outwith the bounds of the approval limits—and therefore required retrospective approval from the Scottish Government—approval that that was appropriate expenditure was sought and given by the Scottish Government. We are unclear as to how the Government's sponsor team arrived at the position that that was appropriate expenditure, based on the material that we have seen. What we have seen looks to be fairly standard emails backwards and forwards that do not go into the detail that you would expect for that level of public expenditure.

**Sharon Dowey:** I take it that you would have expected the Scottish Government sponsorship team to be aware that the chief operating officer of a relatively small organisation was attending a training course abroad. Does the Scottish Government sponsorship team monitor the activities and engagements of key personnel in the organisations that it sponsors?

**Stephen Boyle:** Carole Grant can say a bit more about the sponsorship arrangement that applies to the commission. To answer your question directly, that varies depending on the nature of the organisation, its activities and the risk profile of the public body. As the committee has heard many times over recent years, the quality of sponsorship varies in the Scottish Government and its public bodies.

The committee knows well that the Government has reviewed sponsorship arrangements, including through Eleanor Ryan's report. I have also raised concerns in my section 22 reporting on the Scottish Government that there is still wide variation in the quality of sponsorship of public bodies. Having said that, I am initially assured on how seriously the Scottish Government is taking the matter from the remarks of the director general for net zero, under whom the sponsorship responsibilities reside. He has responsibility as the principal accountable officer for that part of the Scottish public sector.

However, day-to-day sponsorship arrangements vary, so you probably would not expect the sponsor teams to have day-to-day insight into the activities of public officials in the bodies that they sponsor. More regularly, you would see engagement through periodic meetings with the chief executive or observation attendance at board meetings.

Carole Grant can say more about the water division sponsorship arrangements.

**Carole Grant:** From my engagement with the sponsor team, I saw that there was a lot of engagement but that it was very much in the policy space. It was very much about the regulator role and how the commission was fulfilling that role. It was not wider than that. To be honest, the sponsor team did not view the commission as a high-risk body in relation to the reporting that was being done, because the work that it was undertaking was felt to be relatively routine. There were not a lot of contentious contracts being entered into, for example.

There has undoubtedly been some reflection on the issues that have been identified. As I said earlier, that reflection should take place not just in that sponsor team but across all portfolios, with regard to all sponsor arrangements, to ensure that there is a deep dive, periodically, to get a deeper understanding of what is happening in a body.

**Sharon Dowey:** To what extent was the board aware that the chief operating officer was attending the advanced management training course, of the extent of the costs attached to it and that Scottish Government approval was required but had not been sought?

**Stephen Boyle:** Richard Smith can say more, but that speaks to our uncertainty about the timeline of events. We know that the board was very well aware of the hydro nation strategy and that people in the organisation were therefore travelling internationally. There was no doubt about that; that is very clear. However, that training course was not part of the hydro nation strategy. It was an executive training and management development activity.

Perhaps it would be more straightforward for Richard Smith to take the committee through the timeline of events. There is uncertainty about the extent to which the board and the audit and risk committee were aware in advance that that course was being undertaken. If the committee chooses to take further evidence, that might be something to explore directly with the commission, but we can set out for the committee our understanding of the extent of that awareness.

**Richard Smith:** The answer is that we do not know the extent to which the board was sighted on that, so it would probably be better to ask the commission to answer that question.

What we do know is that, when the email was sent to the Scottish Government seeking retrospective approval for that expenditure, the impression was given that the board was comfortable with it, but, when we attended a meeting of the audit and risk committee in November, the impression that we got was that it had no awareness of that in advance of the issue

being raised through our audit. That is probably all that I can say from our point of view.

**Sharon Dowey:** Thanks. I will move on. The report states that £100 Christmas gift vouchers were given to staff in 2021-22. Can you clarify when the board became aware of those payments?

**Stephen Boyle:** Again, I will ask Richard Smith to say more about the timeline, but I will offer a reflection first. It is quite unusual for the organisation, or for any public body, to award Christmas gift vouchers or bonuses to members of staff. We do not routinely see that type of public expenditure. I suspect that much of that came to light by virtue of our audit reporting, but I will invite Richard Smith to say more.

**Richard Smith:** Again, I am not entirely sure when the board became aware of that. From the discussion at the audit and risk committee's meeting, it appeared that it did not know that detail, which, in a sense, might be expected, given the level of expenditure. However, as Stephen Boyle said, it is quite unusual expenditure. The Scottish public finance manual covers the fact that, if the value of an expense exceeds £75, Scottish Government approval is required. In this instance, because the commission gave a £100 voucher to 26 members of staff, we would consider that to be a gift of £2,600 in total. Therefore, we do not see that as the organisation slightly exceeding the limit; we see it as exceeding the limit by £2,525 rather than by £25. Again, I am not sure how sighted the board was on that.

**Sharon Dowey:** It is unusual for public funds to be used for gifts. Do you know when that practice first began and whether it was ever highlighted to management as part of the previous audit work?

**Stephen Boyle:** There is something of a tail to that. As we note in paragraph 7 of the report, that practice also took place in 2021-22. It came to our attention because of the additional focus that Richard Smith, through his risk assessment, placed on the extent of the expenses going through the organisation. Aspects of internal control were not being adhered to in the way that you would expect under the public finance manual requirements.

As a consequence of those arrangements, and likely by virtue of His Majesty's Revenue and Customs assessments, the Water Industry Commission had to enter into what is known as a pay-as-you-earn settlement agreement. Therefore, rather than unpicking every single voucher to a member of staff in order that they can make individual backdated PAYE payments, the organisation has the opportunity to cover the expenditure in totality. In effect, you have a double

hit. In addition to the cost of the voucher, the organisation has had to pick up the personal tax liabilities of the member of staff who received it. That goes back to 2021-22, as we set out in the report.

**Sharon Dowey:** I still do not understand. Why was the issue not picked up in previous audits? Why would it have been missed?

**Stephen Boyle:** Our audit is risk based. We operate on the basis of a sample of expenditure; we do not test every single transaction in an organisation. Those types of expenditure were subject to more audit focus because of the step change in expenses arrangements that Richard Smith mentioned at the start of the meeting. As we looked at expenses and payments in more detail, we saw deficiencies in some of the internal control in relation to the receipting of expenditure and so forth. Those types of triggers warrant additional audit focus and even more testing, as we have seen in this year's audit.

**Sharon Dowey:** Was that a result of a lack of skill or training in the organisation? Whoever was giving out the gift vouchers should have known that there would be a tax implication.

**Stephen Boyle:** There should have been a clear understanding of the requirements of the Scottish public finance manual in relation to gift thresholds. We would expect those to be met.

At the start of the meeting, the convener asked about the head of finance. Similarly, we would have anticipated that senior finance officials would have been engaging with the chief executive and bringing to their attention the thresholds that existed—that is, assuming that there was no intention to breach limits or for the organisation to enter a PAYE settlement agreement in advance. All of that should have been considered before retrospective approval had to be sought from the Scottish Government by virtue of the audit.

**Sharon Dowey:** Paragraph 13 of the report states that the commission's 2022-23 annual report and accounts state:

"There have been no governance issues identified ... However, during the year, some weaknesses were identified in relation to WICS' travel and expenses policy."

It then mentions

"a revision of the policy in January 2023".

Was the spending on the course, the gift vouchers, the meals and so on identified as an issue in January 2023? When was that first highlighted?

**Stephen Boyle:** Those issues were highlighted by the external auditor during the 2022-23 audit. Richard Smith can tell you the months of the year that they came to his and colleagues' attention.

The disclosure that you read out comes from the organisation's governance statement—its assessment of the adequacy of governance—in which it highlights weaknesses. Richard Smith can set out his judgment on the appropriateness of the disclosure.

If I was expressing a view on it, I would say that the disclosure just about covers it, but we set out in our report some of the specific weaknesses that are referred to at a high level in the governance statement. Richard Smith can set out the timeline of when we identified those issues and the commission's policy changes.

**Richard Smith:** We first identified them in October 2023. That was when we brought them to the commission's attention. In terms of the governance statement disclosures—

**Sharon Dowey:** Did you say October 2022?

**Richard Smith:** I said October 2023.

We asked the commission to add additional disclosures, which have been included in the audited accounts, particularly on non-salary rewards, including the gift vouchers, and the expenses issue. In addition to the governance statement, we asked for non-salary rewards to be included in the remuneration report, which has a specific section covering that. We asked the commission to add additional disclosures in the governance statement, and it accepted that that was appropriate.

**Sharon Dowey:** What was highlighted in January 2023, and by whom? The commission's statement mentioned that issues were highlighted—there was an issue in January 2023, but was it not highlighted then?

**Richard Smith:** That was not highlighted by us. I think that it was highlighted internally and that the commission looked at the expenses policy at that point, but I am not aware of what changes were made. We have not seen any change in the expenses policy that would have permitted that expenditure under the old policy or the new policy.

**Sharon Dowey:** The chief executive officer did not resign until 31 December 2023. If the commission highlighted the problem in January 2023, why was he allowed to stay in position for a whole year?

10:00

**Stephen Boyle:** That might be a question for the Government and the commission. As Richard Smith set out, the assessment that he and colleagues received to audit, as part of the governance statement, did not, in the view of the audit team, sufficiently cover the extent of the

issues that are set out in our report, and nor was there that detail in the annual audit report.

The reference to January 2023 encompasses the totality of the timeline. Some of the examples go back to 2022, and some were highlighted during the course of the audit and the subsequent retrospective approval from the Scottish Government.

The former chief executive is best placed to speak for himself on the expenses policy. Richard Smith might want to say a bit more about this, but it is reasonable to say that, during the course of the audit and when the recommendations were made, there was debate about the extent to which the expenses were accepted or otherwise. We are clear that the commission and the Scottish Government now recognise the seriousness of the issue, but the fact that the expenses took place at all suggests that cultural issues in the organisation needed to be addressed. That is the judgment that I arrived at.

**Sharon Dowe:** I have a final question. The chair of the board is accountable to Scottish ministers. When the issues were highlighted, do you know who in the Scottish Government was informed and whether any action was taken? If somebody in the private sector was totally ignoring all policies and procedures and spending that amount of money without authorisation, they would probably lose their job. There would be a disciplinary process. Who in the Scottish Government was told about the matter, and what did they do? Are you aware of any communication between the commission and the Government?

**Stephen Boyle:** We are aware that the Scottish Government received communication from one of the executive team of the commission requesting retrospective approval for the vouchers and the Harvard training course. That was responded to and approval was given on both counts. We are less clear on what the role of the board was with regard to engagement with its sponsor team in the Scottish Government, but Carole Grant might have more insight on that. If she does not, that is perhaps a matter for the Government to speak to.

**Carole Grant:** I do not have much more insight to offer, other than that the engagement has now been accelerated into much more formal, regular meetings between the chair and the sponsor team. When the Government is looking at matters, it makes judgments on the extent to which it engages. As I said, that was largely in the policy space. Now, it is stepping more into the governance arrangements, so that there is better understanding and everyone involved has clarity on what is expected in that regard.

**The Convener:** Is there a transparency issue here in relation to, first of all, the previous point

about what contact was made between the executive directors, non-executive directors and the chair of the board, which the deputy convener referred to, and the Scottish Government? Is that in the public domain? Is it possible to understand what form that took?

Secondly, in quite a number of the answers to the deputy convener's earlier questions about the role of the board and so on, you said that we do not know what the board knew when, but the board publishes minutes, does it not? Is there a transparency issue that the minutes of the board do not sufficiently represent what was discussed at board meetings?

**Stephen Boyle:** We have not identified a transparency issue in relation to the recording of board minutes. That leads us to the view that the items were not being discussed at board meetings. The timeline is important in relation to the specifics of the report. Our report was published in December 2023 and the clearance process took place a short number of weeks before that. We will consider the extent to which that was subject to board discussions as we go through our audit during 2023-24.

However, there is a wider issue about the adequacy of sponsorship arrangements. Although the Scottish Government was engaging on policy progress, it was perhaps less concerned about the overall internal arrangements of the organisation. I do not think that it is an unreasonable leap to say that, because the organisation was generating significant revenue from its role as part of the hydro nation strategy, that resulted in less focus from the sponsor team on other parts of its activity.

I am not clear about the extent of direct engagement that the chair of the commission had with the sponsor team. The commission and the Government would need to speak to that.

**The Convener:** Okay. I am sure that we will pick up that sponsor division responsibility, because, in the words of your report, there were

"significant weaknesses in the governance and financial management arrangements",

and that the commission fell "far short" in that regard. This committee does not often see a report from you that is as clear and as condemnatory as the one that we are discussing today.

I will move on to Colin Beattie.

**Colin Beattie (Midlothian North and Musselburgh) (SNP):** You may think that we have done expenses to death, but I still have one or two questions about that. From what you say, the commission had in place proper policies that should have been adhered to. Is that correct?



**Stephen Boyle:** Policies were in place, but I will add one piece of additional context: alcohol was not excluded from the expenses that could be reclaimed, as we typically see in other public bodies' policies.

**Colin Beattie:** I will leave that particular aspect aside. Were the policies in place considered by the audit and found to be adequate? I would expect that looking at policies and at adherence to those policies to be part of the audit process.

**Stephen Boyle:** They are, and Richard Smith can say more about the specifics behind that. However, thresholds were applied in the commission that were different to those that we see in other organisations.

**Colin Beattie:** Has that been consistent for a number of years?

**Stephen Boyle:** Policies change, but I do not have a timeline of when previous policies were enacted. Richard Smith can say a bit more about that detail, if we have it.

In general terms, the policies were, for the most part, adequate; adherence to the policies was less so. However, that does not sufficiently address the point that we have touched on about the expenditure on the training course in America. That was clearly not subject to either application of the policy or fuller consideration of value for money.

**Colin Beattie:** I have a final question about policies. Compliance with policy would have been part of the audit. You might say that that is why we have the report, but the issues did not happen overnight. It is clear that there has been divergence from the policy over a period. It did not miraculously appear in one report. Therefore, what has been picked up in the past in terms of compliance with policies?

**Stephen Boyle:** As I mentioned, our report sets out the findings from the audit during 2022-23, including the concern about compliance with policies and wider concerns about financial management and associated governance issues. The trigger came by virtue of Richard Smith's risk assessment of the significant increase in expenses during the audit, hence there being more focused testing on that part of expenditure than the previous audit team would have undertaken.

There are wider cultural issues, some of which were touched on in the discussion with the deputy convener, about the use of PAYE settlement agreements, vouchers and so forth. What we have not seen, including through the audit evidence that was presented to me in previous years, are more widespread issues relating to the use of expenditure.

**Colin Beattie:** What concerns me is whether there is something that can be learned about the progression towards the point that the organisation reached. Were there trigger points that could have been picked up in previous audits, which might have indicated that? I realise that you are talking about a big increase in expenses in one particular year, and that is pretty much what we are focused on. However, again, that did not happen overnight. There must have been some indication of that cultural change in previous years. Is there anything to learn about how to pick up on that compliance issue?

**Stephen Boyle:** It is a fair challenge to ask whether there were any triggers in previous years. I will take the opportunity to look at that. However, I will say something about the expectations on the auditor relative to the responsibilities of the board and the accountable officer, who are personally tasked with the effective discharge and use of public money.

The board would have been sighted on the progress of the hydro nation strategy. The associated income from that ramped up significantly after the Covid pandemic. As I mentioned, it had jumped from under £0.5 million in 2021-22 up to £1.2 million in 2022-23. The board might have been interested in the scale of progress and revenue generation, but was it exploring the associated costs that went alongside that? Was the accountable officer accounting to the board for the expenditure that supported the delivery of the strategy? I would contend that those are more direct factors to consider, Mr Beattie.

**Colin Beattie:** I agree that the board should have been challenging the internal audit process more. I presume that the external audit would have spot-checked that. My concern is that there was clearly non-compliance. Could that non-compliance have been picked up earlier not just by internal audit but by external audit? That is why I am asking whether there is something that we could learn for the future.

**Stephen Boyle:** That is something for me to take away to look at and to seek clarification on the external audit arrangements in previous years. For external audit, the auditor's responsibility is to express an opinion on the annual report and accounts—whether they are true and fair, and whether they comply with the regularity of expenditure under the appropriate budget act. There has been no qualification in previous years and no matters have been drawn to the reader's attention. There is an opportunity there, but the balance of the responsibility for the effective administration of public funds rests with the board and the accountable officer.

**Colin Beattie:** I do not disagree that there is a huge responsibility on them and that that responsibility was not exercised.

I will move on. Who normally approves the chief executive's expenses?

**Stephen Boyle:** Richard Smith can update the committee on the arrangements in the commission. Typically, we would expect them to be subject to either board approval or consideration by a remuneration committee. Richard can clarify that.

**Richard Smith:** In the commission, the chair of the board approves the chief executive's expenses.

**Colin Beattie:** The chair of the board personally approves them.

**Richard Smith:** That is our understanding. It was the chair who approved the chief executive's expense claims.

**Colin Beattie:** Is that part of the policies that were in place?

**Richard Smith:** Yes. Going back to your earlier question, I confirm that the finance policies and guidelines set out the arrangements for approval and the thresholds. We felt that the policies were adequate, putting aside the business entertaining costs element that has been discussed. It was the adherence to the policy that we identified issues with.

**Colin Beattie:** The chair approves expenses on the basis that they adhere to policy—or that is the theory.

**Richard Smith:** That is our understanding.

**Stephen Boyle:** I would add that there is clearly a deficiency in the application of the policy, alongside that. As we mentioned in the report, there were multiple instances where expenses were approved without receipts. It is a fundamental for the approval of any public expenditure that receipts go alongside expenses.

**Colin Beattie:** Presumably, we are talking about expenses in general and about specific expenses for the chief executive that were approved by the chair.

**Stephen Boyle:** Correct. Both of those were factors.

**Colin Beattie:** I suppose that I have to ask why that was not challenged at any point. Although the chair had approved the claims, when the documentation was sent to the finance people, would they not have said, "Hey, there are documents missing here. It doesn't comply"? Was there not a route by which the finance people could have raised that issue?

10:15

**Stephen Boyle:** In an organisation that is functioning effectively with appropriate checks and balances, yes, but there are signals in the annual audit report, which draws on the section 22 reports, that such an approach was not applied. You would have expected a finance team and a chair to query the volume of expenditure or missing receipts and for those expenses not to be subject to approval. That is what makes the report so unusual. It is not the sort of activity that we see. It requires very thorough and careful reflection by the Water Industry Commission for Scotland, supported by the sponsor team, so that it is absolutely clear what the standards and expectations are with regard to the use of public money.

**Colin Beattie:** Somebody must have told the finance people, "Nah, it's okay. You don't have to worry about that. If they've been signed off by the chair or whatever, that's okay." Somebody must have said that.

**Stephen Boyle:** We do not know about those conversations, but I do not think that you are making too much of a leap to think that there were, as I think that I have referred to it, cultural issues that meant that the usual policies, checks and balances did not operate properly.

**Colin Beattie:** Your report highlighted one or two fairly extreme issues, such as the cost of a dinner. However, your report also says that there are

"widespread issues with expense claims being submitted and approved without supporting itemised receipts"

and so on. Can you tell us a bit about some of the issues that were not high level so that we can understand the scope and extent of how that process has been operating?

**Stephen Boyle:** Yes, we can do that. Richard Smith has that detail so I will bring him in. The chief executive made 47 expenses claims from April 2022 to October 2023, totalling £4,500, that were not supported by itemised receipts.

**Colin Beattie:** What were those for?

**Stephen Boyle:** I have given the committee a flavour, but Richard can set out some detail and, if he has it, some information on the wider application of expenses.

**Richard Smith:** I have given these figures before but, with regard to there being "widespread issues", we identified 84 items over the 19-month period from 1 April 2022 to 18 October 2023. To put that in context, that was 13 per cent of the claims that were submitted during that period so, in effect, one in eight of the claims was not supported by itemised receipts.

**Colin Beattie:** I am sorry to interrupt you. A large proportion of claims were properly supported by receipts. It was only a certain proportion of claims from a particular source that were not supported.

**Richard Smith:** One in eight claims across all the claims that were submitted by the senior management team and the chief executive were not supported by receipts.

**Colin Beattie:** Therefore, all the unsupported claims came from the senior management team and the chief executive.

**Richard Smith:** Yes—those are the ones that we have details for.

**Colin Beattie:** The broad sweep of stuff from staff was okay.

**Richard Smith:** Yes, as far as we are aware from our testing. Obviously, we did not test—

**Colin Beattie:** No, I realise that you do not check every transaction.

**Stephen Boyle:** It was one in eight, so you could say that the vast majority are okay, but that still speaks to a very significant concern. We do not see that type of activity in other audits. Depending on the size of the organisation, we test hundreds upon hundreds of transactions when we audit a set of accounts. Whether it is expenses or large invoices—large-item expenditure—claims are almost always supported by the appropriate paperwork. Therefore, although you can maybe say that seven out of eight claims were okay, a significant proportion of expenditure—for that type of expenditure—was still not supported with receipts.

**Colin Beattie:** I agree.

I come back to my original question. If we leave aside the headline stuff that we have been discussing, what sort of run-of-the-mill expenses were being claimed without supporting documentation?

**Richard Smith:** The majority of the expenditure relates to what the commission termed “business entertaining costs”—in other words, food and drink for international delegations. For example, if it had a group of staff visiting from New Zealand, they would go out for a meal. Those claims were not of the same extent as the example highlighted in the report of a dinner at more than £200 per head; it was expenditure that was sometimes within the threshold and sometimes outwith it, although, as I have said, not to the same extent as that example. The claims included a sum of around £1,500 for international work and subsistence costs—the cost of meals for staff when they were in New Zealand, for example. That is the detail that I have with me

today. We do have a more detailed breakdown of the individual claims but that is the kind of—

**Colin Beattie:** Broadly, then, the claims are from the senior management team for entertaining.

**Richard Smith:** Yes, and it is pretty much all for international delegations that are visiting Scotland to learn about the water industry and the meetings that they had around that.

**Colin Beattie:** Surely it would have been easy to get documentation for that; there would be bills from the restaurants, hotels or whatever. Whether those complied with policy is a different thing, but they would be able to produce the piece of paper. How difficult is that?

**Stephen Boyle:** It ought not to have been difficult, but the supporting information was not there. That is what has led to a significant component of today’s report. The fact is that, even if we park the appropriateness of the claims, the supporting detail, beyond a single line on a credit card statement, is not there.

**Colin Beattie:** In the course of the audit, was any request made to the senior management team to see whether it could backfill that information?

**Stephen Boyle:** I think that that would probably be an after-the-fact component—

**Colin Beattie:** No, it still does not make it clean.

**Stephen Boyle:** Ultimately, the public body has responsibility for its arrangements and compliance with them to ensure that it is satisfied that the expenditure has been appropriately confirmed. As the expenditure has been made, we would, from an audit perspective, say, “It was incurred.” However, its appropriateness is not something that we can make a definitive judgment on.

I contend that is not the role of audit to say, “Can you go and find the receipts for this?” That is for the body itself or the chair, as part of his responsibilities.

**Colin Beattie:** Do you know whether the body has tried to find those receipts?

**Stephen Boyle:** Again, that is a question for the commission itself.

**Colin Beattie:** A question that leads on from that is whether any work has been done to review expense claims from previous years.

**Stephen Boyle:** That is an appropriate question for the board to consider. In the Government’s response to the report, it expressed its concern and said that it is working on an action plan. Richard Smith has talked about some of that, but the scope for a more thorough consideration would be appropriate as part of the Government’s

and the commission's review of arrangements and to satisfy themselves that there are no other unidentified areas of concern.

An important point to make is that an external audit does not cover every transaction. This is classic territory for the auditor—that is, the expectations gap between what an external audit looks at and the work that we actually need to do in order to give a sound opinion on a set of financial statements. Materiality is a significant component of that. In the work that we do, we look at whether there are no material misstatements in a set of accounts—that is the work undertaken on audits—while individual transactions are the responsibility of the accountable officer and the board, supported by the work of internal audit. Therefore, a range of reflections will be available for previous years.

**Colin Beattie:** Finally, without mentioning names, which positions comprise the senior management of the commission?

**Stephen Boyle:** There are—

**Colin Beattie:** I am just trying to find out how many people are involved.

**Stephen Boyle:** There is a chief executive, a director of strategy and governance, a director of corporate and internal affairs, a director of analysis and a director of price review. Therefore, there are five directors in the organisation. I am sure that you will note that that did not include the chief operating officer, because they sit below that tier of senior management.

**The Convener:** We are now in the final stretch of our evidence session, and I invite Graham Simpson to put some questions to you.

**Graham Simpson:** I just want to mop up some things that have occurred to me during the meeting. Following on from Colin Beattie's excellent line of questioning, Mr Smith, I believe that you said that one in eight expenses claims had no receipts, and that those were largely for entertaining foreign visitors. Were there any favourite haunts that the commission took them to? Did that issue crop up?

**Richard Smith:** I do not have that level of detail. Some locations were visited more than once. We have that level of detail on file, but I must apologise—I do not have it with me today.

**Graham Simpson:** The other thing that occurred to me is that we did not get into the detail of the amounts spent on foreign travel and staying abroad when we discussed it earlier. Was the commission booking first-class flights? Were people travelling economy? Were they staying in five-star hotels?

**Richard Smith:** Again, I apologise—I do not have that level of detail. I know the expenditure that they incurred on that, but I do not have with me what that specifically entailed.

**Stephen Boyle:** If you are looking for that level of specificity, the commission would be able to provide that, Mr Simpson.

**Graham Simpson:** If we are looking at value for money, I think that that is a legitimate question.

**Stephen Boyle:** I agree. The foreign travel that you refer to was part of the delivery of the hydro nation strategy. Multiple trips were taken by senior officials to New Zealand as part of the provision of service to the water industry in New Zealand as it was going through its evolution, using the skills, reasonably, that the Water Industry Commission for Scotland had to offer. If it is that level of detail that you are looking for, the commission will be able to share it with you.

**Graham Simpson:** I think that the convener picked up on this, but you also mentioned dubiety over who knew what about the Harvard trip. I am struggling to understand that. Is it a case of you not getting straight answers to straight questions?

**Stephen Boyle:** To recap, I would say that that refers to the retrospective approval that the commission sought from the Scottish Government in respect of two things: the vouchers and the Harvard Business School course. From the correspondence that we have seen, it was presented to the Scottish Government that the audit and risk committee was aware of the Harvard expenditure. Richard Smith might want to add more, given that he was in the room, but our impression from attending the audit and risk committee was that that was not the case and that board members were not aware of the totality of the expenditure on the Harvard Business School, or that it had not followed proper procurement processes.

**Richard Smith:** Adding to what the Auditor General has said, I would point out that the email sent to the Scottish Government suggested that the board was aware of that expenditure but, certainly from the discussions that we witnessed at the audit and risk committee, it did not appear that its members had had any awareness of that in advance.

**Graham Simpson:** Who sent the email to the Scottish Government?

**Richard Smith:** The email was sent by the director of corporate and international affairs on behalf of the chief executive, so the chief executive had input into its wording.

**Graham Simpson:** So, the director of corporate and international affairs sent the email on behalf of

the chief executive, saying, “Don’t worry—our audit and risk committee knows all about this.”

**Stephen Boyle:** The email sought retrospective approval for it. In the commission’s view, it was a necessary and appropriate course for the chief operating officer to attend, and assurance was given that there was governance oversight of the expenditure in advance.

I do not know the specific text that was shared, but that is the relevant detail, Mr Simpson, and it is concerning. The board members of the Water Industry Commission for Scotland should be able to speak for themselves as to whether they were in favour of that instead of their being represented by the view of one of the directors.

10:30

**Graham Simpson:** Are you able to share that email with the committee?

**Stephen Boyle:** Yes, we can.

**Graham Simpson:** It would be useful for us to see it.

I have two further questions, the first of which is about the £100 gift vouchers. Where were the gift vouchers for?

**Richard Smith:** They were Amazon gift vouchers.

**Graham Simpson:** My final question is about the tax bill that the commission is going to pick up. There is a tab for payments that staff had been asked to pay. Do we know what the total bill is?

**Stephen Boyle:** It has two elements. There was the payment of £3,384 in October 2023, as set out in paragraph 15, and then there was a further voluntary disclosure of £5,400 for prior years, so the total is approaching £9,000.

**Graham Simpson:** Is that it? Will there be anything else?

**Stephen Boyle:** I do not think that I can say that there will be nothing else, as any organisation could be subject to further inspection and review. Given some of the discussion that we have had this morning, the commission will want to be absolutely clear that it has met all its tax responsibilities.

**The Convener:** Willie Coffey has a final question.

**Willie Coffey:** On the retrospective approval email, I would think that, if you were seeking such approval, some alarm must have been raised for that to happen. However, nobody seemed to be aware of anything, and the audit and risk committee did not know about it. Who raised the

alarm that led to a retrospective request being made?

**Stephen Boyle:** That was us. Richard Smith identified it in his audit.

**Willie Coffey:** So, nobody in the organisation was aware of the issue. It was your intervention that led to that. The organisation did not think to request it of its own volition.

**Stephen Boyle:** Absolutely. It was how I arrived at the judgment that there were cultural issues in the organisation. A range of the items of expenditure set out in the report ought to have been subject to further consideration and/or challenge, but they were not.

**Willie Coffey:** Had you not done that, no one would have sought retrospective approval and we would never have heard anything about the matter.

**Richard Smith:** Until the issue was raised through the audit, the commission was under the impression that it did not require approval for items such as the gift vouchers or the costs of the training course that were attended by the chief operating officer.

**The Convener:** That is quite a shocking note to finish on. As a reminder, I would point out that the statutory duties of the organisation that we are talking about include ensuring that

“customer charges reflect the lowest reasonable overall cost for Scottish Water”

and that its job is to challenge Scottish Water

“to become more efficient and sustainable”.

An organisation with those responsibilities really ought to lead by example, and I am not sure that we have heard that it does.

I thank the Auditor General for the evidence that he has provided, and I thank Richard Smith and Carole Grant for their valuable input. Thank you for being resourceful in your very helpful answers—we will be following up on some things.

I now draw the public part of the committee’s work to a close and move us into private session.

10:34

*Meeting continued in private until 11:35.*



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Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

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