



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit Committee

Wednesday 19 February 2025

Session 6



The Scottish Parliament
Pàrlamaid na h-Alba

© Parliamentary copyright. Scottish Parliamentary Corporate Body

Information on the Scottish Parliament's copyright policy can be found on the website - www.parliament.scot or by contacting Public Information on 0131 348 5000

Wednesday 19 February 2025

CONTENTS

	Col.
DECISION ON TAKING BUSINESS IN PRIVATE	1
“ADMINISTRATION OF SCOTTISH INCOME TAX 2023/24”	2
SECTION 22 REPORT: “THE 2023/24 AUDIT OF THE WATER INDUSTRY COMMISSION FOR SCOTLAND”	26

PUBLIC AUDIT COMMITTEE

6th Meeting 2025, Session 6

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Jamie Greene (West Scotland) (Con)

COMMITTEE MEMBERS

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

Stuart McMillan (Greenock and Inverclyde) (SNP)

*Graham Simpson (Central Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Kersti Berge (Scottish Government)

Jo Blewett (Scottish Government)

Stephen Boyle (Auditor General for Scotland)

Roy Brannen (Scottish Government)

Gareth Davies (National Audit Office)

Ronnie Hinds (Water Industry Commission for Scotland)

Michelle Quinn (Scottish Government)

Richard Robinson (Audit Scotland)

David Satti (Water Industry Commission for Scotland)

Darren Stewart (National Audit Office)

CLERK TO THE COMMITTEE

Katrina Venters

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Parliament

Public Audit Committee

Wednesday 19 February 2025

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning, and welcome to the sixth meeting in 2025 of the Public Audit Committee. We have apologies this morning from committee member Stuart McMillan.

Under agenda item 1, does the committee agree to take agenda items 4, 5, 6 and 7 in private this morning?

Members *indicated agreement.*

“Administration of Scottish income tax 2023/24”

09:31

The Convener: Agenda item 2 is consideration of the Auditor General for Scotland’s report, “Administration of Scottish income tax 2023/24”. I am very pleased to welcome our witnesses this morning. We are joined by the Auditor General, Stephen Boyle. Alongside the Auditor General are Carole Grant, an audit director, and Richard Robinson, a senior manager, both from Audit Scotland. I am also very pleased to welcome once again to the Public Audit Committee Gareth Davies, who is the Comptroller and Auditor General at the National Audit Office. Alongside Mr Davies is Darren Stewart, who is His Majesty’s Revenue and Customs financial audit director at the National Audit Office.

I think that you are aware that we are quite tight for time this morning. We have some important areas of ground that we want to cover with you, so if you are able to make your answers concise, that would be helpful—and I have leant on the committee to encourage concise questions. Before we get to those questions, I invite both Stephen Boyle and Gareth Davies to make opening statements. I will begin with you, Auditor General.

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

As you mentioned, convener, the purpose of today’s session is to look at the administration of Scottish income tax for 2023-24. HMRC collects and administers Scottish income tax as part of the United Kingdom’s overall income tax system. The National Audit Office audits HMRC’s accounts and the Comptroller and Auditor General is responsible for reporting to the Scottish Parliament on HMRC’s administration of Scottish income tax. I report to the Public Audit Committee to provide additional assurance on the NAO’s audit work, in line with the recommendation from the previous Public Audit Committee in 2014. I also explain what the findings mean for the Scottish budget.

In summary, my report says that I am satisfied that the NAO’s audit approach was reasonable and covered the key audit risks, and that the findings and conclusions in the C and AG’s report are reasonably based.

The C and AG has concluded that the outturn for Scottish income tax was fairly stated, which provides the Scottish Parliament with valuable assurance over this aspect of the Scottish budget.

This is the sixth year that HMRC has published Scottish income tax outturns in its accounts.

Those outturn figures relate to 2022-23, and the difference between actual UK and Scottish tax returns and the amounts forecast at the time is then adjusted for the 2025-26 budget—this is known as the budget reconciliation. The reconciliation for 2022-23 outturns results in an increase in the 2025-26 budget of £449 million. That is the largest adjustment in the budget to date resulting from a budget reconciliation.

HMRC's annual accounts also include an estimate of Scottish income tax for 2023-24, but that does not affect the Scottish budget.

My report highlights that while income tax revenues are continuing to rise, the impact on the Scottish budget is reduced by relatively slower economic growth in Scotland compared with that in the rest of the UK. In the period between 2017-18 and 2022-23, Scottish taxpayers paid an additional £3.4 billion due to tax policy differences, but relatively slower economic growth in Scotland meant that the net benefit to the budget over the same period was £629 million.

Taxes and the economy are important pillars of the Scottish Government's approach to fiscal sustainability. The current economic performance gap underlines the importance of relative economic growth to Scotland's public finances, which needs to be a key focus of the Scottish Government in the coming years.

I will hand over to Gareth Davies, but of course, Carole Grant, Richard Robinson and I look forward to answering the committee's questions.

Gareth Davies (National Audit Office): Good morning, committee, and thank you for inviting me and my colleague to give evidence on our work on HMRC's collection of Scottish income tax.

As in previous years, the content of our report follows the requirements of the legislation and covers the outturn for 2022-23 and, to a lesser extent, the estimate for 2023-24. We have looked at the rules and procedures that are in place to administer the system at HMRC and the costs recharged by HMRC to the Scottish Government under the service level agreement between the two parties. The approach taken by HMRC in calculating the outturn and estimate has remained broadly the same as that taken last year, and I have concluded again that both are reasonable. Both the outturn and the estimate demonstrate growth in the Scottish income tax take, as the Auditor General has already said, reflecting—among other things—the impact of inflation, but also the fact that more taxpayers are falling within the income tax system because of slowly increasing thresholds.

HMRC has corrected some discrepancies that it found in how it calculated the outturn for Scottish income tax in previous years. We cover that in our

report in a bit of detail. Based on our work, we are satisfied that the discrepancies are not material to the context of our audit in any of those years, but I am not satisfied that an error of that kind was present in the system, even if it did not result in material errors in the calculations. We would be very happy to explain the work that we have done to test the adjustments that have been made, but also to ensure that similar errors do not occur in the future.

Although the divergence in income tax policy between Scotland and the rest of the UK widened in 2023-24, and will widen further in 2024-25, HMRC continues to assess the risk of non-compliance resulting from that divergence as low. In response to recommendations made previously by us and by the committee, I am pleased to see that HMRC and the Scottish Government are exploring what further compliance activity can or should be carried out to test that assumption that the non-compliance risk remains low. That work is on-going and we will be tracking it closely through our work. I am sure that you will want to explore that in this morning's session.

My team and I again worked closely with the team from Audit Scotland all the way through our audit, and I am grateful for its co-operation in completing the work.

I am very happy to answer questions. Thank you.

The Convener: Thank you very much indeed. I will turn to a couple of issues that both of you raised in your opening statements. In particular, Auditor General, you referred to something that is in your report. Exhibit 3 shows that £3.367 billion of additional income tax revenue has been raised from the Scottish population, but that that converts to additional budget spend of only £629 million. Presumably, that is a product of the fiscal framework. Do you have any observations about how the fiscal framework is working? What are the implications of that? As I calculate it, for every £5 raised, only £1 is available for the budget.

Stephen Boyle: You are right. Exhibit 3 looks to set out the impact of relative tax policy and economic performance of the Scottish budget as it relates to Scottish income tax. The exhibit tracks that from 2017-18 through to the most recent available data, which is from 2022-23. Fundamentally, we drew on the work of the Scottish Fiscal Commission and its published analysis when compiling the table. I will hand over to Richard Robinson in a moment to set out some of the mechanics of how this works, if that would be helpful for the committee, but it illustrates perhaps one of the core points that we make in the audit insights section the report. I touched on this in my opening remarks: there is a complexity to the fiscal and economic levers that are available to

the Scottish Government and the Scottish Parliament.

One of the key tenets of the fiscal framework is about relative economic performance. Perhaps I can set out for the committee some of the observations that the SFC made in its fiscal update from August 2024, where it explains the differentials in a bit more detail than we have done in our report.

The SFC notes:

“Scottish average earnings have grown 3.1 per cent lower than in the rest of the UK between 2016-17 and 2022-23 while employment has grown 3.2 per cent lower.”

Of course, income tax is based on the number of people in employment and what those people are earning.

There is some very useful analysis in the SFC’s update, but our purpose in referring to that in our report is the continual necessity not for me to make what would be a policy judgment on the appropriateness of the content of the fiscal framework, but to ensure that the complexity is understood, that the trends of data and differentials are also well observed and noted, and that the Scottish Government, especially, is content and satisfied that it is tracking and managing the risks related to fiscal and taxation policy.

I will maybe bring in Richard Robinson, who can give a couple of points of detail that might be helpful to support the committee’s scrutiny.

Richard Robinson (Audit Scotland): At a high level, the fiscal framework does two things. The first is that it allows devolved decisions to be made on the appropriate tax rates and tax balance—the tax policy side of things. Also built into the fiscal framework is incentivising economic growth in Scotland, and, therefore, the rewards and the risks that come with that fall through into the figures that will affect the budget.

How does that translate? We can see that the tax policy is bringing additional funds to the budget. For a number of years, the SFC has been highlighting what it calls the “economic performance gap”. What that means is that, because the tax is devolved, the UK Government will make an adjustment to the block grant—as we show in exhibit 1 of our report—to represent what it estimates it has forgone in taxes by devolving the tax to Scotland. That is based on UK rates and UK rates of revenue growth on an indexed per capita basis. In a situation where the growth in revenues per capita and earnings is greater in the rest of the UK than it is in Scotland, you will see that economic performance gap coming through. As the SFC said, that is acting as a drag on the amount that is hitting through into the budget on the bottom line each year. In the report, we say

that that is one of the areas that the Scottish Government should consider.

The other point to raise is that it does not necessarily have to be this way. The SFC had put into its December 2023 forecast its expectation of faster growth in Scotland than in the rest of the UK. We can see in exhibit 3 a reduction in the 2023 economic performance gap to £624 million from £663 million the year before. However, in its more recent forecasts, the SFC has suggested that perhaps that economic growth—or relative economic growth—will end in 2024-25. That means that the Scottish Government has to actively consider its economic situation and policy, along with the work that it is doing on migration—we refer to that in the report—and how things will translate into what hits the bottom line for the budget.

The Convener: I said at the start we are quite pressed for time, but can I ask you to confirm my calculation? The figure in exhibit 3 is a cumulative figure—I draw attention to it because it is one of your key messages. For every £5 that has been raised through additional income tax in Scotland, only £1 of that—or less than £1 of that; it is about 18 per cent—finds its way into the Scottish budget.

Stephen Boyle: Yes, that is correct, convener.

The Convener: Okay. Let me move on to another area that your report draws attention to and which you mentioned in your opening statement. The reconciliation figure for 2025-26 is £449 million—nearly half a billion pounds—which is the largest reconciliation to date. Is there a likelihood that that level of reconciliation will continue in the future? How does that affect the Scottish Government’s budget setting?

Stephen Boyle: You are right again. I will hand over to Richard Robinson, rather than both of us talking about some of the detail of that. For the committee’s information, we set out at exhibit 2 some of the detail behind the reconciliation—effectively, the difference between the final outturn and the forecast. As I mentioned in my opening remarks, there is also the catch-up nature of budget reconciliations from previous years and the time lag. I will bring in Richard Robinson to set it out in a bit more detail.

Richard Robinson: I will be brief. We see two things happening in exhibit 2. One is the correction for a forecast error. When the SFC and the Office for Budget Responsibility gave the forecast for the budget, they did so during quite a volatile period. They predicted that it would reduce by £190 million—that needs reversing out. The forecast did slightly better on outturns—revenue was greater than the block grant adjustment, adding another £259 million. That takes us to the £449 million that is shown in exhibit 2.

09:45

I do not have to hand the details of exactly what the SFC is saying for future years, but it is expected that the differential tax policy and the fiscal drag from the differential structure of bands will lead to an increased amount coming through into the Scottish budget. What we set out in exhibit 4 is that it is slightly less than was originally expected as a result of revisions in the forecasts that have happened between December 2023 and December 2024.

The Convener: You mentioned volatility. One of the things that happened in the medium-term retrospective look that we are taking is, of course, the pandemic, which was a severe shock to the economy. How does that affect some of the estimates and assessments?

Stephen Boyle: Briefly, convener, the SFC is very clear in its reporting on the significant variability from both the downturn in economic performance caused by the pandemic and then the sharp recovery. Of course, that relates to a point that I suspect we will come back to a number of times today about the relative economic performance of the Scottish economy compared to that of the economy in the rest of the United Kingdom and how that impacts on the outturn of tax revenues. Undoubtedly, there is a lag effect. You will see that in a number of spaces, both in our own analysis and very certainly in the NAO's commentary. When there is a forecast and then tax is collected, and there are associated estimates, there is a degree of complexity. As we will perhaps touch on during our discussion, there is uncertainty and volatility throughout much of the estimates and forecasting.

The Convener: Mr Davies, you might want to respond to that question, but I want to ask specifically about the point that you made in your opening statement about the error, which you have taken a fairly dim view of, I think. Can you talk us through that?

Gareth Davies: On the broader point, the degree of change in the tax estimates is a UK-wide issue. It is certainly not just a Scotland issue. The very large growth in income tax year on year coming out of the pandemic has been a very big feature of the tax system. We did a report on HMRC's overall cost of implementing UK taxes a couple of weeks ago. That report showed how much more complex it has become to administer the UK tax system as a whole, even leaving aside divergence in Scottish income tax rates, because far more people are now paying higher rates of tax across the UK and far more people altogether are in the tax system because of either no or slow increases in the threshold for paying tax. Volatility is a feature of the system UK-wide.

Your second question was about the error that I mentioned in my opening comments. It would be helpful for Darren Stewart to explain a bit more of the detail but, broadly, when HMRC compiles the estimate of tax due for Scotland, it uses the two big databases that it has, which are the pay-as-you-earn system—people in employment paying taxes—and the self-assessment forms that are typically filled in by the self-employed. The point is that it is not as simple as that. Some people who fill in self-assessment forms also have employment income and it is the accuracy of the process for eliminating any double-counting between the two systems that is the issue. HMRC discovered that it had not been eliminating all the double-counting. Perhaps Darren could explain in a bit more detail what has happened and what we have done about it.

Darren Stewart (National Audit Office): Absolutely. I will start by reiterating what Gareth said earlier, which is that while the errors are not material, we take them seriously. We have done considerable work with HMRC to get to the bottom of how the error occurred—Gareth has already captured how that happened—and then think about how we can avoid it being repeated. As Gareth said, in producing the outturn calculation, HMRC brings together information from the PAYE system and the self-assessment system. The self-assessment system necessarily includes employment income. That is just the nature of submitting a self-assessment return. HMRC has always had an adjustment to remove duplicates where it is expecting a self-assessment return from somebody who has employment income. The error arose where people submitted self-assessment returns unsolicited, so HMRC was not expecting a return and had not adjusted for that.

With HMRC, we have looked at the adjustment process and at how to avoid the error happening again. Rather than focusing on the adjustment that HMRC used to make, the process now is that we bring together the two sets of data from the PAYE system and the self-assessment system. Through a computer coding approach, using our digital expertise, we basically compare the datasets line by line, taxpayer by taxpayer, to ensure that all the duplicate entries are completely and accurately removed. I hope that that gives you a good level of assurance that this will not happen again.

The Convener: That might come back to haunt you, Mr Stewart, but we will see. I hope that you are right

My final question is on the overestimates. Your report speaks about calibration adjustments and a calibration adjustment was required to be made in 2021-22. Do you expect HMRC to have to make a calibration adjustment for the tax year 2023-24?

Darren Stewart: That is a necessary and important feature of financial modelling. A calibration adjustment is about looking at recent experience and applying that to the current forecast to make sure that any under or overestimates in previous years are adequately captured and factored into the current estimate. I would expect HMRC to make calibration adjustments every year. I guess that the specificity and the accuracy of those is the key question, but it should make them every year.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Over a number of years now, I have repeatedly brought up my concerns about the figures that are behind the tax collecting. Gareth Davies mentioned working on some aspects of this, but consistently, right across the board, there seem to be an awful lot of assumptions and estimates and so on made and it is quite difficult to see how they would result in an accurate figure. Just to remind you, the service level agreement states:

“HMRC will identify the Scottish taxpayer population and collect from it the correct rates of SIT to ensure the Scottish Government receives the correct amount of income tax revenue each year.”

There are lots of other clauses on the same thing, but to me it all rotates around the key word, “correct”. I will take a high-level look at the issue and go through a few of the points of concern that I have picked out. I would be interested in your comments. It is not that making an estimate or an assumption is wrong; it is the sheer number of them. On occasion, you make an assumption based on an estimate, which to me must multiply the divergence and the inaccuracy of that figure. For example, in paragraph 12 of your report you say that HMRC successfully matched 72.9 per cent of address records. What is the equivalent figure south of the border?

Gareth Davies: That is a Scotland-only exercise, partly to calculate the Scottish share of income tax. It is not done south of the border in the same way.

Colin Beattie: You do not do it?

Gareth Davies: No.

Colin Beattie: So you have no idea?

Gareth Davies: No. Obviously, there is a lot of compliance work that goes on south of the border, but that exercise is specifically to ensure that people with an S code, which means that they are liable for Scottish income tax, are matched to a Scottish address. That is a Scotland-only exercise that HMRC carries out.

Colin Beattie: In paragraph 14, you point out that tax policy in Scotland has increasingly diverged from that in the rest of the UK—that has

been so for a number of years now—but HMRC has not yet assessed the impact of that or what it would cost to do so. Why?

Gareth Davies: Obviously, it is for HMRC and the Scottish Government to answer the why question. I think that you are absolutely right: the greater the divergence, the stronger the case for close evaluation of the impact of that, as well as very close attention to the accuracy of the application of those differential tax rates to the taxpayer base. Since I was here this time last year, I have noted that HMRC has for the first time published some of its early research into any evidence for the impact of differential tax rates on taxpayer behaviour. That is a welcome development. It has taken a long time to get to that point and you could say that that work needs to accelerate but, clearly, all that boils down to a question of resource prioritisation, both for HMRC and the Scottish Government. I agree that it would be desirable to have better information on some of the areas of estimated figures so that the calculation can be as accurate as possible.

That is important, not just in retrospect, but it is important to have the estimates as accurate as possible for the future because, as we have heard, it has an impact on Scottish budget setting. For all those reasons, I think that accuracy is very desirable here. The question is how much resource both HMRC and the Scottish Government agree is necessary to put into that level of research to improve the methodology and to understand better what is happening to taxpayer behaviour in the light of such changes so that the information that you are all working on to set the Scottish budget is as accurate as possible. As the auditor, obviously I cannot answer that question about the right level of priority and resource, but I think it is very important that it is addressed.

Colin Beattie: You mentioned one aspect there, which is the behavioural changes, but there must be a process already in place across the UK to assess the behavioural change that any taxation increase or decrease might have.

Gareth Davies: Not as much as we at the NAO would like. One of our big critiques of Government generally, including HMRC, is the surprisingly low level of investment in evaluation of the impact of different policies. I think that it is a general problem in Government and HMRC is no exception. In a lot of NAO reports, one of the main recommendations is, “This needs to be better understood if you are going to make better decisions about the allocation of resources.” That applies in this area too.

Colin Beattie: I am mentioning all these issues because, in the aggregate, they are a concern. For the past two years, HMRC has been having

difficulties in importing land and property transaction data. Two years?

Darren Stewart: That is right. We have reported on that consistently. My understanding of the nature of the issue is that Scotland has a data set on land registry information that would be useful to HMRC, but it is collected for a different purpose and stored in a system that is not compatible with HMRC's systems. It is inherently difficult for HMRC to bring its data together with the land registry data and use the information in the way that it intends. That would be the preferred option, but HMRC has not been able to pursue it at this time.

Colin Beattie: As I say, I am just highlighting examples. In part one, paragraph 1.5, the report says that

"HMRC does not have data in sufficient detail to identify income tax liabilities, reliefs or other adjustments relating to individual taxpayers."

Is that not a bit of a concern? The report goes on:

"The gross total of all the estimates and adjustments made by HMRC totalled £1,077 million in 2022-23",

so it will be more now. That is not a small sum of money. Is the chance of error and incorrect projections based on that lack of data not a concern?

Gareth Davies: Yes. At the heart of that issue and the previous one is the quality of the systems that HMRC is using. Although there has been quite a big investment in upgrading things like the real-time income system, which has been a very important step forward for lots of reasons, HMRC is still using incompatible databases for different elements of its work. The cost of bringing all those systems up to a modern standard is very large. That is essentially the main constraint on its ability to do that, but it will clearly be necessary.

10:00

If we want an efficient tax system, capable of answering the kind of basic questions that you are raising, we absolutely need a system where data-matching is much easier, where close analysis of the data elements that you mentioned is possible and the system is fit for purpose. Behind all the issues for the calculation of Scottish income tax is the fact that the systems were nearly all designed before Scotland had the ability to vary its rates of income tax, so a system not designed to deal with that is having to cope as best it can, and it lacks the design features to make that efficient and straightforward. Behind all this is the need for long-term investment in modern systems that can deliver the job that is now being expected of this information.

Colin Beattie: Again, in self-assessment liabilities, it would appear—and I am interpreting this, so correct me—that the deduction of

"£57 million to estimate Scotland's share of other relevant Self Assessment balances where specific data are not available",

is presumably based on a UK-wide average.

Darren Stewart: Is this in figure—

Colin Beattie: It is in paragraph 1.9. There are a number of other cases—I will not bore you by going into them one by one—where UK-wide data is being used. That has to be incredibly skewed because the south-east of England skews everything.

Darren Stewart: I think that the general point is that where HMRC needs to make estimates, it is generally due to two issues. The first is the timeliness of the data becoming available. An example of that would be where HMRC has to estimate how much Scotland is entitled to through the outturn for taxpayers who have not yet submitted a tax return where one was due, so it needs to make an estimate of that. The other, as you quite rightly say, is where Scotland-specific data does not exist. HMRC need to attribute an element to the Scottish outturn and it does that in a number of different ways. Sometimes it is based on income, sometimes it is based on headcount. You are quite right to point out that where that data does not exist at the Scotland level, an estimate has to be made. That is where HMRC does that.

Colin Beattie: That estimate must get distorted by the sheer wealth of the south-east of England. That would also be so for any area of England, but when you are comparing Scotland, the divergence is huge. Again, in paragraph 1.13 you are talking about basing calculations on UK averages, which, as I have said already, is a bit of a concern.

Excuse me; I am flicking through the report because I have highlighted all the bits that I am concerned about.

Here is one: the Scottish taxpayer population. To me, it looks as though there has been a fall in lower-rate taxpayers, but there does not seem to be any assessment of why that is or how that is working. You have fewer people paying less tax within the lower tax bands, based on previous years. Does that mean that they have moved into a higher tax band and are paying more tax now?

Gareth Davies: Could you say what paragraph you are asking about?

Colin Beattie: Sorry, it is 2.16.

Darren Stewart: I think that that is factual. It is basically the income tax distribution, based on income band.

Colin Beattie: There is no real analysis of why. Those are significant movements within the broad bands. You would hope that HMRC would be providing some data as to how that has arisen, what the consequences are and where we are going with this. There is nothing behind it.

Gareth Davies: I think that those are questions for HMRC and the Scottish Government. Clearly, the scope of our audit is not to get into what is changing the number of taxpayers at different levels, so you will not find that kind of analysis in our report on this exercise, but clearly they are very relevant questions for HMRC.

Stephen Boyle: In relation to the population, the C and AG is right that that is a core part of the future analysis and consideration that the Scottish Government, working with HMRC, will need to undertake to understand the risks from Scotland's tax approach increasingly diverging from that in the rest of the UK. The C and AG's report quite reasonably observes that there has been an increase in compliance activity and that more consideration has been given to some of the risks, and we certainly make that observation.

We recognise that there will be a time lag. It might be 18 months to two years before the Scottish Government is clear about some of the implications of the divergent approach that it has taken, but there are firm steps that the Scottish Government, working with HMRC, now needs to take.

Colin Beattie: I will not go through the other issues step by step, because my colleagues will want to drill down into some of those areas, but, given the overall number of assessments, estimates and assumptions that are made, we cannot have an accurate tax figure—we just do not know.

Gareth Davies: Clearly, the ideal position would be to have full information that allowed us to identify every taxable individual in the country and apply the correct rates across the UK, with no estimates. However, getting to that position from where we currently are with our systems would involve a long journey, so it comes down to priorities and investment plans to create a completely different database from the one that we have now.

Colin Beattie: At the end of the day, will there not always be a major discrepancy between projected tax revenues and what we actually receive?

Gareth Davies: When it comes to the outturn calculation, our exercise shows that we can take material assurance on the accuracy of the figure, most of which is based on actual records of Scottish taxpayers. However, while we have our current systems, an element of it will always be an

estimate. Reducing the uncertainty even further will require significant investment in more accurate Scottish data.

Colin Beattie: I keep coming back to the point that using any assumptions, estimates or projections about the UK as a whole will lead to a big discrepancy, because there is such discrepancy between income levels in Scotland and those in the south-east of England, for example. That will distort every tax figure across the country.

Gareth Davies: That does not affect the basic facts about income tax, because the information is taken from PAYE and self-assessment forms, which we know are accurate for taxpayers in Scotland. Most of the estimates that affect the figure do not involve a UK-wide application of a percentage across the board.

The estimates that remain to be addressed include those on the level of compliance returns for Scotland-based income tax compliance work by HMRC. In other words, when HMRC pursues taxpayers who have not paid the right amount of tax, that is called compliance work, but HMRC's systems do not currently allow identification of Scottish taxpayers who are subject to compliance processes separately from the rest. That is when HMRC applies estimates about the productivity of its compliance work. In that case, Scotland might benefit from UK-wide application, because HMRC's compliance work might generate bigger returns in the south-east than in Scotland.

That illustrates that it is difficult to draw an overall conclusion about the effects of some of the estimates. However, there is a strong argument for better data so that estimates do not have to be made in the first place, which is, I think, your point. The constraint relates not just to the use of existing data but to implementing a new system that provides the data in the first place.

Colin Beattie: To be clear, I am not suggesting that we would get more money out of the tax system if we had accurate figures, but, if we are to base our budgets on anything, the figures must be reasonably accurate in order to give us certainty for the future. My concern is that we will get lumpy adjustments every few years to take into account changes in all the estimates and assumptions, which is not desirable.

The Convener: On that note, I will move things along. I invite Graham Simpson to put some questions to you.

Graham Simpson (Central Scotland) (Con): I will follow up on some of the issues that Mr Beattie asked about. In your report, Mr Davies, you say that HMRC

“has not tested its assumption that non-compliance in Scotland is the same as in the rest of the UK.”

I guess that you would stick to that. You have said that there is an issue with systems—I guess that you are talking about computer systems—and that they need to be upgraded. Is that basically the position?

Gareth Davies: Yes. HMRC’s compliance teams use a system that does not have the separately identified data records that are in the main PAYE and self-assessment system. Darren Stewart can explain the position in a bit more detail.

Darren Stewart: As you correctly stated, our general view is that HMRC has not tested the assumption that the compliance risk in Scotland is the same as it is in the rest of the UK.

In our report, we say that the Scottish income tax board was due to meet in January to start looking at what it could do to move things on. Part of that conversation is about how it can update its compliance system to allow Scottish compliance cases to be flagged and better analysed. Another consideration is whether there is a cost-benefit argument for producing a Scottish tax gap, as is produced for the rest of the UK. Both those steps would be important in having a better view of compliance risk in Scotland.

Last week, we met Scottish Government and HMRC officials to get an update on that work. We understand that a decision was not made at the board meeting in January and that the issue will be brought back to the board meeting in April, which is, I believe, around the time in the cycle that the committee normally speaks to HMRC, so you might want to ask about further developments at that point.

Graham Simpson: Sorry—a decision on what?

Darren Stewart: A decision on what additional compliance activity the board might wish to do.

Graham Simpson: In paragraph 14 in your report, you say that the compliance working group

“expects to report to the Scottish Income Tax Board on the first phase of this evaluation in January 2025”—

which you mentioned—

“including the likely costs of additional compliance work, after which the Scottish Government must decide on the merits of funding any additional activity.”

There is therefore a role for the Scottish Government.

Darren Stewart: Absolutely.

Graham Simpson: Is the Scottish Government waiting for the Scottish income tax board to report to it?

Darren Stewart: The Scottish income tax board includes representatives from the Scottish Government and HMRC, and my understanding, based on our recent conversations, is that it will look at the issue again in April.

Graham Simpson: Okay. Auditor General, in your report, you say:

“The completion of the additional third-party data exercise in 2024, one year earlier than originally planned, is a positive development, however the results of this exercise have not yet been published”.

Have they been published now?

Stephen Boyle: My NAO colleagues might be able to share the most up-to-date position on that.

On the wider point, as the C and AG referenced in his earlier remarks, some additional compliance activity has been undertaken since the committee previously considered the reports. That is welcome, and it speaks to the wider point about having as complete an understanding as possible to inform the Scottish Government’s understanding of the position on tax revenues and the economy.

Timeliness matters. The committee will not be surprised to hear me make the point that we do not yet have an up-to-date medium-term financial strategy from the Scottish Government. I understand that the Scottish Government’s target is that that will be published in the spring. Getting all these dates aligned matters in order to support understanding and parliamentary scrutiny of not just one year’s budget but the medium-term financial picture.

I will pass to anyone who wants to say more about timeliness in that regard.

10:15

Darren Stewart: The results of the address assurance exercise were not available when we published our report in January, but they have subsequently been made available to us, and we will report on the exercise in detail in our equivalent report this time next year.

The analysis that we have seen to date shows broad consistency in performance. The key metric, which you will see in figure 8 of our report, is the number of records that are unable to be matched through that exercise. The report shows that that number was 8,540, or 0.2 per cent of the total records that were identified, and that it has reduced slightly to 7,017, or 0.1 per cent of the total records.

There are two key points. First, the fact that the exercise is being carried out annually is a welcome development, and the committee has been asking for that for some time. Secondly, the

relative stability or marginal improvement in the results is positive, but that position needs to be maintained.

Graham Simpson: I am looking at figure 8—the writing is very small—which says:

“In January 2024 HMRC identified 45,809 cases where ‘S’ prefixes were not correctly applied to tax codes.”

Darren Stewart: The S prefix issue is a different issue. The exercise that I have just described in relation to figure 8 relates to the third-party address issue. The S prefix issue relates to the incorrect application of tax codes by employers.

Graham Simpson: It is still an important issue.

Darren Stewart: Absolutely.

Graham Simpson: HMRC wrote to employers to ask them to update their records. Do you know what the result of that was?

Darren Stewart: HMRC does not gather data at the employer level. The committee has asked about that previously, and I understand that HMRC has committed to giving you an update on it.

We know that, over the course of this year, HMRC has been exploring how it can nudge employers and employees to ensure that tax codes are correct. That can be done through personal tax accounts, with that being administered through the app online, and through targeted communications to employers when repeat offenders are identified.

In the past, the committee has been particularly interested in the broader point about data collection to find regular offenders. As far as I understand, that work is still in development.

Graham Simpson: It should not still be in development, should it?

Darren Stewart: I tend to agree with you, but that is more a question for HMRC.

Graham Simpson: Yes—it sounds as though there are a few questions for HMRC.

I want to ask about one other issue. Mr Davies, in relation to tax relief on pension contributions, paragraph 2.13 in your report says:

“HMRC must identify Scottish taxpayers so that tax relief is correctly allocated. Pension administrators claim tax relief at source on behalf of their members and add this to their members’ contributions. HMRC applies tax relief on pension contributions at the basic rate of 20% for all taxpayers. Scottish taxpayers paying a tax rate above 20% can claim the remaining tax relief through a Self Assessment return or by contacting HMRC.”

I have asked about that issue previously. It strikes me that a lot of people will have absolutely no idea that they can do that and will not know how to go about it, so they could be missing out.

First of all, do you agree with my assessment? If you do, do you have any idea how many people are affected?

Gareth Davies: That is a UK-wide issue—that feature of the tax system affecting pension contributions does not affect only Scottish pensioners—but the additional complexity is that Scotland has different tax rates at the higher level. The Scottish issue is just a variation of a UK-wide issue.

I do not think that we have any observations on whether that is the right system for ensuring the accuracy of tax relief for pension contributions, unless Darren Stewart has anything more to say.

Darren Stewart: I do not. I agree with the broader point that people understanding their entitlements to reliefs and applying for them is not a Scotland-specific issue but a feature of the tax system, which is inherently complex.

Graham Simpson: Yes, I absolutely accept that. I think that most laymen and laywomen have no idea that they can do that and are probably not made aware of it. However, there is a Scottish element, because Scotland has a different tax rate—that is where we come in.

I have no further questions.

The Convener: Thank you very much. I will now pass over to the deputy convener, Jamie Greene, who I know has some questions to put.

Jamie Greene (West Scotland) (Con): I do, convener.

Good morning, gentlemen and lady. I want to cover a few areas. First, I draw your attention to figure 7 on page 21 of the HMRC report, which is probably one of the more helpful tables in what is quite a lengthy and detailed report. It is certainly more visual, from my point of view; I was wanting to get my head around the analysis that has been done on the Scottish tax base in general, and this table paints a picture that we can look at.

Just to make sure I am being accurate, can you tell me whether the table is saying that higher and top-rate taxpayers in Scotland accounted for 13.3 per cent of taxpayers in 2018-19, and that in 2022-23, the latest year we have available, that figure had risen to 18.1 per cent of the tax base? That is the percentage of the tax base, but alongside that—and what is more important—is the percentage of tax that they are paying, which for the same group has risen from 58.6 per cent to 64.2 per cent. Is such a shift normal? If the percentage of taxpayers in any tax band increases, does the amount of tax that they pay also increase proportionately and at a similar or the same rate?

Gareth Davies: It is certainly a pattern that you would observe UK-wide, as well as in Scotland. The fact that a relatively small proportion of taxpayers—that is, the ones paying at the higher rates—pay a large proportion of the total tax is a UK-wide phenomenon. In that sense, then, the answer to your question is yes, that is what you would expect.

Jamie Greene: Does that present any risk at all? For example, when we look at the top rate, we see that less than 1 per cent—0.8 per cent—of Scottish taxpayers paid 17.8 per cent of all tax. In other words, less than 1 per cent of taxpayers account for nearly a fifth of the Scottish tax base. Again, the relevance of this questioning will become clear in my later questions on tax behaviour. You have said that it is a UK-wide phenomenon, but irrespective of that, does that present any risk to any Government when it comes to trying to forecast how much revenue it will get in any given year from its tax income as opposed to from the block grant?

Gareth Davies: I can see that you are heading into policy territory that is probably not for me, as the auditor, to talk about. Our issue here is accuracy of the data rather than the policy drivers behind it. Clearly, though, understanding the behavioural impacts of changes in the higher rates of tax is, as we have said, a crucial factor in understanding the future finances for the budget. However, it is probably not really for me to say any more than that.

Stephen Boyle: I agree with the C and AG. Part of the reason for the change that you are seeing in the percentage of people in either the top rate or higher rate comes down to the pretty well-established phenomenon of fiscal drag. As the bands stay the same and people's earnings increase, more people emerge into these new groupings.

Some of the consequences of that have been the change in ratios and some of the skewing effect. As the NAO has quite starkly set out, 18 per cent of people pay 64 per cent of tax. I come back to that last point that the C and AG quite rightly made; when we think about the increasing divergence of tax rates, we should bear in mind that those who pay the top rate of tax, in particular, are likely to be the most mobile of taxpayers. Therefore, there needs to be a clear understanding of the costs and benefits of the different rates, and they need to be as reasonably and accurately reflected as possible in future projections. That allows me to labour the point that the medium-term financial strategy is ever more important, given the variable context.

Jamie Greene: I would just note, without straying into policy areas, that the numbers themselves show that a relatively small group of

people on that top rate are responsible for funding a huge chunk of Government revenue.

When you say that these taxpayers are more mobile, are you talking about their ability to move their residency to another part of the UK, or even outside the UK, or about their ability to shift money around in different ways that results in, say, their paying less tax? What do you mean by "mobile"?

Stephen Boyle: The NAO might want to express a view on this, should it wish, and it is probably conjecture on my part, but people with more disposable income perhaps have more choices when it comes to where they reside, their tax status and so forth—the factors that you have alluded to.

Jamie Greene: While I have you on the line, Auditor General, I want to ask about paragraph 56 of your own report. I have read it about 100 times and still cannot get my head around it, so perhaps someone in your team can talk me through it.

In that paragraph, which relates to the budget year 2022-23, you state that

"The forecasts originally used ... reduced the budget by £190 million, the net difference between forecast tax foregone by HM Treasury and forecast Scottish Income tax receipts."

On the next page, the report says:

"Outturn data shows that there was an increase of £259 million, a positive difference of £449 million from the forecast reduction."

I have no idea what any of that means, so please talk me through it. It seems quite stark, whatever it is.

Stephen Boyle: I will again pass over to Richard Robinson, but first of all, please forgive us, deputy convener. In some of the report's terminology, we naturally mirror the language used by HMRC, the Fiscal Commission and so forth with regard to forecasting. Richard Robinson can set this out for you, but this is about the difference between the forecast using the best available information at the time and then what actually happened, as shown in the outturn data.

The convener referred to this earlier when he mentioned the context behind the increased variability in some of these results. Our coming out of the pandemic, inflationary changes and the war in Ukraine were all part of the context for the assumptions that were made at one point; however, although they were made with the best available information, they did not quite materialise in the results. Hence, we have a larger budget reconciliation—£449 million—than had been assumed when the estimates were first made.

Richard Robinson: In paragraph 56, we effectively try to explain exhibit 2 in words. When budgets are set, neither the SFC nor the OBR

know exactly what the income tax receipts will be for the coming year, so they both make forecasts. According to the forecasts that were made, and which are set out in the first line of exhibit 2, the revenue that the SFC expected to be generated from 2022-23 was less than the amount of BGA that the OBR forecast would be taken from the block grant. The adjustment that was made for that in the 2023 budget effectively reduced the 2022-23 budget by £190 million. In other words, spending power was reduced by £190 million.

Going forward in time to when we knew the outturn, we were able to say, “Actually, that is not exactly what happened”, for some of the reasons that the Auditor General has mentioned. For example, higher inflation led to different wage bills, fiscal drags and all those types of things. When people looked at the actual figures, they found that, instead of the budget being reduced by £190 million, the revenues came out higher than the block grant adjustment; as a result, the £190 million needed to be given back, and then the difference between the outturn figures, which was £259 million, needed to be added to that.

With the reconciliation of the 2024-25 budget, we get both those things. We get the return of the £190 million that we did not have to spend in 2022-23, plus the difference between the final outturn and the final BGA, which we now know, because we have the outturn figures. Those two figures make up the £449 million.

10:30

Jamie Greene: Can you talk me through exhibit 1, on the block grant adjustment, just so that we can get our head around this? A Barnett-determined block grant is allocated to the Scottish Government, but that is not what we actually get, due to adjustments based on devolved taxation. Can you, in very simplistic terms, talk me through how we get from the block grant allocation, through a net adjustment up or down, to what the Scottish Government actually gets?

Richard Robinson: There is more detail on this in our previous “Operation of the Fiscal Framework” publications, which obviously contain more detail than I will go into right now. However, in general terms, exhibit 1 shows that, before anything was devolved, we had just the block grant. Now that non-savings, non-dividend income tax is devolved, the money that we are talking about and which has been audited for these reports will be added to the block grant adjustment. That is the revenue from NSND Scottish income tax.

To reflect the fact that the UK Government no longer collects that tax, and no longer has it for its own budget, an adjustment is made to the block

grant. Those are the two things that are happening: the tax forgone is being removed from the block grant and the actual tax is being added on. What hits the budget is the difference between those two amounts, which, as you can see, is set out in exhibit 3 of the report.

Jamie Greene: Moving on to exhibit 3—this will all make sense in a moment—can you tell us about the relationship between any increase in taxation that is received through Scotland’s tax policy differences and what is described as the “net position”? Let me take the year 2021-22 as an example, as, according to the table, it was perhaps the starkest with regard to tax divergence. In that year, £749 million extra in taxation was raised, but the net position—however you describe it—was only £85 million, or 11 per cent of the tax raised, which is a tiny amount. Indeed, it is even starker than the figure of a fifth that the convener referred to. Again, can you talk me through the effect of that on the original Barnett-derived block grant versus what the Scottish Government gets? Is the Government getting the tax receipts, or is it getting this 11 per cent net figure?

Richard Robinson: What the SFC has set out in these charts and tables, which come from its fiscal updates, is the net effect of the two boxes that are shown in exhibit 1. Instead of showing the full amount of the revenues coming in and the full amount of the block grant adjustments being taken out, it sets out the net amount and then the amount that one would expect to collect through tax policy differences if economic performance were exactly the same. It then calculates the economic performance gap between the net figure coming through that is being added to or taken from the block grant adjustment, based on outturns, and the expectations based on tax policy differences between Scotland and the rest of the UK.

Jamie Greene: I picked that year, because in an exchange that I had about taxation with Alyson Stafford from the Scottish Government on 25 April last year—we were talking about inward migration to Scotland increasing tax revenues—she made the following statement. This is why it is important, I think, that we understand the numbers, because she said:

“In 2021-22, taxable income in Scotland increased by £200 million as a result of the positive inward migration of taxpayers.”—[*Official Report, Public Audit Committee, 25 April 2024; c 7.*]

Presumably, that £200 million is part of your £749 million in exhibit 3. If we use the 11 per cent calculation that I highlighted earlier, it would mean that that £200 million would result in only £20 million of net benefit to the Scottish budget. Is that assumption correct? I did not have this data to challenge what was being said at the time, but,

nearly a year on, we now have the ability to look at these numbers and see what they mean in real terms to the Scottish Government's budget.

Perhaps that is a question for the Auditor General.

Stephen Boyle: I am not sure how definitive I can be on this, deputy convener. I would quite like to track the various figures that are being quoted and, just for completeness, refer back to Ms Stafford's evidence, so that we understand what was said. As ever, it might be another line of inquiry that the committee might wish to pursue separately with the Scottish Government, with the benefit of hindsight and some of the numbers that we have.

In the National Audit Office report, there is more detail on some of the changes with regard to taxpayers within Scotland as well as some analysis from HMRC on the issue that you highlighted of inward migration to Scotland. What matters is not just the numbers of individuals concerned but the tax band that they are in, which brings us back to some of our earlier conclusions in today's report with regard to ensuring that we have an understanding—a trend analysis—that arises from not just one year in isolation. Given some of the complexity involved, this needs to be known, understood and monitored over a far longer period of time.

Jamie Greene: One of my concerns is that, although taxation has been devolved since 2017-18, there still seems to be no long-term analysis of tax behaviour. In fact, I think that one of the reports—or perhaps both of them—refer to 2027 as the year when we might have a better understanding. That is a decade on from the taxes being devolved, and it is not helping Governments either today or next year make decisions about tax policy.

I am not asking you to comment on the policy itself, but surely the source of this data—that is, HMRC—and the people who analyse it, including the Scottish Fiscal Commission, would be in a better position to inform Government policy if we had that sort of analysis. How can we not know this? You have talked about net inward migration figures being on the increase, for example, but knowing that is irrelevant if we do not know how much extra revenue is being brought in. The number of people is not important; what are important are the amount of money being paid and the net benefit. Is there more that we should be doing in that respect?

Stephen Boyle: The C and AG might want to comment on this, too, but what we have set out in our report brings us back to the divergence point and the increasing complexity and changes that we are seeing in the Scottish income tax system

compared with other parts of the UK. The impact of that matters, and it needs to be known and understood, especially in the context of the Scottish budget.

However, both reports show that there has been a response to some of the committee's previous concerns, with increased analysis and understanding of compliance activity. We do not have all the results of that yet; decisions on it have not yet been taken; and there will be a further time lag before all of this is known. Ultimately, it will be up to the Scottish Government to weigh up how much additional activity it wants to ask HMRC to undertake and the cost benefit of doing that extra work. I have been listening carefully to the C and AG's own analysis and observation of HMRC's systems and ability to do something that informs policy but which represents good value for the Scottish Government.

Gareth Davies: Clearly the committee is one of the main interested users of this data. After all, your job is to hold the Scottish Government to account for how it is using public resources and how it is using that information to make policy decisions. Articulating your demand for more information on all the areas that we have discussed this morning will be extremely helpful. Your sister committee in the Westminster Parliament is equally interested in evaluation information on the impact of all sorts of tax policies, not just income tax rates, but tax reliefs of various kinds and so on. Articulating that demand for better information to inform your scrutiny as well as the Government's decision making will be a very important part of the process.

Jamie Greene: I have one final question. Auditor General, at the start of the session, you talked a lot about Scotland's economic performance relative to the rest of the UK. I want to delve slightly deeper into that. When you talk about slower economic growth, what metrics are you specifically talking about? Has there been any analysis of the effect of that on the Scottish economy?

Stephen Boyle: Exhibit 3 in the report specifically references as the source of that information the work of the Scottish Fiscal Commission, the Scottish Government's own forecasting body. As I have mentioned, we have referred to paragraph 4.18 of the Scottish Fiscal Commission's fiscal update of last August, which cites various factors. The reasons for the economic performance gap being what it is are complex, but the commission notes that, between 2016 and 2023, Scottish average earnings were 3.1 per cent lower than those in the rest of the UK, and employment rates in Scotland grew by 3.2 per cent less than in other parts of the UK.

Of course, there will be other factors. Some of the analysis of gross domestic product growth in recent times highlights examples of the Scottish economy performing better in more recent years than other parts of the UK. However, those were the specific sources that we drew on, particularly as they related to income tax and the performance gap. Certainly, if it would be helpful, we can share some of the detail of our sources with the committee.

Jamie Greene: I was just challenging you on this, because paragraph 60 of your own report makes quite a profound statement. In that paragraph, you talk about the net benefit of the devolution of tax being significantly less than the taxes that are paid, but then you state:

“This is due to the relatively slower economic growth in Scotland.”

It is important that you substantiate that claim, because, as you have said, we will be challenging ministers on that comment.

Thank you very much. I have no further questions.

The Convener: I think that that concludes our session. I was particularly struck by Gareth Davies’s point about the importance of evaluation, especially when it comes to the impact of taxation, both in advance of those taxes being introduced and after their introduction. I think that we would all benefit from that.

You are right to highlight the fact that we, as the Public Audit Committee of the Scottish Parliament, have a particular interest in how public money is spent. However, we are also MSPs who will vote on budget decisions. As a result, this is not just retrospective consideration of the way in which things have gone; it is also about the contemporaneous decisions that are being made on tax policy.

I thank Richard Robinson; Carole Grant; the Auditor General, Stephen Boyle; the Comptroller and Auditor General, Gareth Davies; and Darren Stewart of the NAO very much for their time and their evidence this morning. That evidence is very valuable to us.

I suspend the meeting.

10:43

Meeting suspended.

10:51

On resuming—

Section 22 Report: “The 2023/24 audit of the Water Industry Commission for Scotland”

The Convener: I welcome everyone back to the Public Audit Committee, following our suspension. We are delighted to resume our evidence sessions this morning with agenda item 3, which is further consideration of “The 2023/24 audit of the Water Industry Commission for Scotland”.

I welcome our witnesses who join us in the committee room this morning. I am particularly pleased to welcome David Satti, who is the interim chief executive of the Water Industry Commission for Scotland. Alongside Mr Satti is Ronnie Hinds, who is the chair of the Water Industry Commission for Scotland’s board.

We are also very pleased to welcome back the director general for net zero at the Scottish Government, Roy Brannen. You are very welcome, Roy—it is good to see you. Alongside Mr Brannen is Michelle Quinn, who is the director of offshore wind, but has previously been acting as the interim director general for net zero. We are also pleased to welcome back Kersti Burge, who is director of energy and climate change in that directorate, and Jo Blewett, who is the deputy director for the water industry in the Scottish Government.

As you know, time is quite precious for us this morning, but there are some important areas that we want to cover, so I encourage the committee members to keep their questions precise. If witnesses could be concise in their answers, that would be very helpful.

However, before we get into those questions, we are pleased to invite Ronnie Hinds to speak on behalf of the Water Industry Commission for Scotland, then Roy Brannen, to speak on behalf of the Scottish Government. I turn to Mr Hinds first, to kick us off.

Ronnie Hinds (Water Industry Commission for Scotland): Thank you, convener. My remarks will be of a quasi-personal nature, but I will keep them short. What I really want to say to the committee this morning is that it would be fair to say that, like a lot of people, when I read the Auditor General’s initial section 22 report and followed the aftermath of that, including meetings of the committee and public discourse, I was shocked and dismayed. I was shocked to witness such a severe departure from the expected standards of stewardship of public money in an organisation like WICS, and I was dismayed—this

is the personal bit, if you like—as a long-standing supporter of effective regulation in this country, and particularly of regulation of Scottish Water and the public water model in general. Because of that, I could see the risk to public confidence arising from such obvious weaknesses in governance and management within WICS.

When I was asked after all that to join the board in August last year, I was more than happy to do so. When I was asked to step up as chair in October, I welcomed the opportunity to do so, and I hope that I can make a contribution to turning around the fortunes of WICS as an organisation. My objectives are to restore strong financial management controls, to create a healthy organisational culture and to maintain public trust in water regulation in Scotland. That is what I will try to do in the time that I have as interim chair.

On joining WICS I was immediately impressed by the changes that had already been made and that that were under way. That was in August last year. I must give credit to David Satti, who is on my left, for a lot of the response to what I have, I think, made clear are justified criticisms, and to recommendations for improvement from various sources. He has led on that since his appointment as interim chief executive, back in March last year.

I was also struck by how the organisation was, nonetheless, carrying on with its key statutory responsibilities in relation to the regulation of Scottish Water and the retail market for water and sewerage services in Scotland, despite all the poor publicity around WICS and its leadership's behaviours. For that, I want to give credit to the dedicated and talented staff within the organisation. They have carried on regardless, while this has been going on around them.

I believe that lessons have been learned and I believe that they are being implemented. We are turning a corner and we are transforming WICS's governance, its management and its culture. As I have said, if I did not believe that, I would be hacking my way around a golf course and spending time with my grandchildren, instead of sitting here.

I think that I have probably said enough. I am sure that the committee has many questions for us and our colleagues from the Scottish Government. David Satti and I will answer questions as fully and openly as we can, and I hope that we are able to provide appropriate assurances to the committee this morning.

Thank you.

The Convener: Thank you very much indeed.

Roy Brannen (Scottish Government): Thank you and good morning, convener and committee members. I am joined this morning by Michelle

Quinn, who was in the role of interim DG between last September and January this year. I am also joined by Kersti Berge, who is the director of energy and climate change and lead director for WICS, and Jo Blewett, who is the new permanent deputy director, with responsibility for WICS sponsorship since December.

Since our last meeting in September 2024, you have heard from Audit Scotland in relation to a further section 22 report. Although having a regulatory qualification to the WICS accounts is disappointing, I note that the Auditor General recognised that actions are being taken to address the financial management and governance weaknesses that were identified last year.

The Scottish Government and WICS have made good progress in taking action on the issues that have been identified, and in resetting the sponsorship and public body relationship. However, I acknowledge that we must maintain that momentum at WICS and sponsor level in order to build continuous improvement into our processes to create stability.

Since we last attended the committee, the chair of WICS has resigned and we have agreed that Mr Hinds, who is here today, will act as interim chair to help to guide the organisation through this period of change. You have heard about Mr Hinds's direction of travel, in that regard.

We also continue to improve our sponsorship function within the Scottish Government, in the water industry team and more widely across the organisation, and we welcome the opportunity today to set some of that out.

As always, we will endeavour to address your questions as best we can this morning, and to follow up in writing where necessary.

Thank you.

The Convener: Thank you very much indeed, director general.

Before we get into the nuts and bolts of the section 22 report, there is a matter in the public domain this week that has attracted quite a bit of attention in Parliament, about Scottish Water senior management bonus payments. I think that it was highlighted that three people were in receipt of £330,000 last year in bonus payments. That constituted a 35.9 per cent rise in one year.

The Scottish public finance manual charges you, Mr Brannen, with

“regularity, propriety and value for money”.

WICS's terms of reference say that your job is

“to promote the interests of Scottish Water customers to ensure long-term value and excellent levels of service”.

How do you reconcile the revelations about bonus payments with those terms of reference? I will start with you, Mr Brannen.

Roy Brannen: The bonus scheme has been in existence for some time, and was put to ministers back in 2020 for review. Ministers agreed to the framework at that time. David Satti can go into the details of the various components that it is made up of, but it is there to operate in a market where the market itself is very much geared towards performance of an organisation. Scottish Water's incentivisation through the two schemes is to drive better performance on the journey towards net zero and on the journey towards transformation, and outperformance in financial measures throughout the regulatory review period, which is 2021 to 2027.

Ministers took the information from the Scottish Water remuneration committee, considered it internally within our finance and pay structure and agreed with the decision to go forward with the bonus scheme for the regulatory review period.

As we approach the next regulatory review period, that process will be repeated. We will take any case that is brought forward by the Scottish Water board and consider it internally within the Government, then our advice will go to Scottish ministers for them to make a decision, informed by WICS, the regulator.

11:00

The Convener: You used the expression "ministers"—plural—a couple of times, director general. Who signed off that framework for bonuses to be paid?

Roy Brannen: I was not in post in 2020, so I would need to ask Jo Blewett or Kersti Berge whether they remember which minister responded. I do not have that information to hand.

The Convener: We are looking for accurate information, so if it is better to send us that in writing, that is acceptable.

Roy Brannen: I will do that.

The Convener: The Acting Minister for Climate Action told Parliament yesterday afternoon that the Scottish Government seeks to ensure that executive pay is kept under control. It does not sound like it is being kept under control, though, does it?

Roy Brannen: There are two elements. The pay structure for the new chief executive officer went through a process of rigour internally within the SG. The case for a salary level was made by Scottish Water, initially. Scottish Water provided benchmarking guidance to support that recommendation. Our public pay policy team

reviewed it, then the Scottish Government remuneration committee reviewed it but did not agree with it: there was a challenge from the Scottish Government remuneration committee to what the board was seeking as a starting salary.

Eventually, we agreed what that salary would be and Scottish Water advertised that position. The bonus element was a separate consideration, beyond the salary for the chief executive post.

The Convener: Okay, but does the bonus arrangement not come under the watchful eye of the remuneration committee either of the Scottish Government or, I presume, of Scottish Water, which has its own remuneration committee, has it not?

Roy Brannen: It does, indeed. Scottish Water's remuneration committee put evidence to the Scottish Government to go to ministers for consideration of the case. The Scottish Government's remuneration committee also commented on that particular process. I am content that the process was undertaken in accordance with what we would like to see being done, which is a case being put by the organisation then considered by its remuneration committee, followed by consideration under finance and pay policy within the SG in our remuneration committee, then the fullest possible advice going to ministers for them to make a decision on whether to continue.

The Convener: So, it is a ministerial decision, in the end.

Roy Brannen: In the end—yes.

The Convener: That is fine.

Mr Hinds or Mr Satti, as the regulator and given your terms of reference, do you have any reflections on what has come out in the last few days?

David Satti (Water Industry Commission for Scotland): All that I would add is that the role of WICS is to set the lowest overall reasonable cost of delivering the ministerial objectives. Key components of that are a look at Scottish Water's operational costs and the setting of a global efficiency target. In this regulatory period, it was 1 per cent year-on-year for a collection of costs—we call them tier 1. We measure performance over a collection of costs, rather than any one specific cost.

We do not have a role in the bonuses. What we would like to do—we have outlined this in our methodology for the next price review—is better align the metrics that underpin a bonus scheme with the regulatory settlement during the price-service mix that Scottish Water agrees to for six years. We are looking to create more alignment in the next regulatory period, but generally the

bonuses are based on performance, which is something that the remuneration committee of Scottish Water would decide on.

The Convener: Okay. Mr Simpson wants to come in.

Graham Simpson: Thanks, convener.

I am sorry, Mr Satti, but I have no idea what you were on about there. I genuinely did not understand that answer. Do you think that the bonus scheme should continue or not?

David Satti: The bonus scheme has been used throughout multiple regulatory periods as a way of incentivising performance for the organisation. We have seen Scottish Water's performance increase and improve, regulatory period on regulatory period. We do not have a role in creating the bonuses. All that we do is provide assurance that the organisation is performing in line with the targets that have been set for it.

Graham Simpson: I see that Mr Brannen, who mentioned you, wants to come in.

Roy Brannen: That is the independence element of the performance checking, effectively. The scheme sets out exactly what needs to be achieved, and WICS's role in that is to check the performance against those criteria but no more than that. The scheme is set down by Scottish Water's remuneration committee and agreed by ministers.

There are two elements to it. There is an annual outperformance incentive part, which is across employees, managers and directors, and there is a long-term incentivisation plan for senior managers. It is quite granular, and it is probably a bit much detail to go through here, but it focuses on the journey towards net zero, the journey towards transformation, success of the capital programme and success of the outperformance in terms of financial mechanisms. All that performance is then independently checked by WICS and then, as I understand it, the remuneration committee's role is to look at that and decide how much of the bonuses is actually paid, as they are on a sliding scale.

Graham Simpson: When is the next review of the scheme? You mentioned the regulatory review period. When will the issue be looked at again?

Roy Brannen: That will be before the next regulatory review period. The current period ends in 2027. When we start to move towards the next six-year period, there will be another opportunity for Scottish Water to put forward a business case. That will be checked by Government teams internally and communicated on to the Scottish Government remuneration committee, and then advice will go to ministers on whether they should continue with that incentivisation.

Graham Simpson: Would it be possible for a minister to step in before that and say that the scheme should end?

Roy Brannen: Because the scheme has been set for the whole regulatory period and the bonuses are linked to that performance throughout the period, I do not think that that was the intention. I am sure that ministers possibly could do that, but that is not the intention of the original scheme that was set up.

Graham Simpson: One thing that leapt out for me was the money that was paid to Mr Plant, the chief executive of Scottish Water, who is on a very handsome salary. He got quite a big relocation package to move up from England, and part of that was that we, the taxpayer, paid his land and buildings transaction tax. We paid his tax bill for buying a house. That struck me as wholly inappropriate. Is that covered by the scheme?

Roy Brannen: Those are terms and conditions of his salary rather than the bonus scheme—the two things are separate. Terms and conditions of employment are a matter for Scottish Water. The base salary level was set by ministers once we had gone through that scrutiny process.

Maybe Jo Blewett can say a bit more about the package, but I will put it into context. Compared with other salaries in the industry across the UK, the salary in Scottish Water is far lower than what you would expect in other water authorities. When Scottish Water went out to identify whether that would attract CEOs, nobody said that they would come to work in Scotland on that salary. In fact, 50 per cent of people in the next level down said that they would not come here to work for that salary. As you probably know, the salaries in the water industry are significant and, because water is one of our most important assets in Scotland, we have to attract the best talent and capability to drive performance and the approach towards making the best use of that asset.

Jo, do you want to say a bit more about that?

Jo Blewett (Scottish Government): I would just confirm that the public sector policy is that the relocation package should align with the company's relocation policy. However, I do not have the Scottish Water policy in front of me. I would need to check that with Scottish Water.

Graham Simpson: It sounds from what you are saying that the relocation package was separate from the bonus scheme.

Roy Brannen: Correct.

Jo Blewett: That is right.

Graham Simpson: So that was part of the lure to get Mr Plant here.

Roy Brannen: Yes—it was the terms and conditions of employment. It is a contract-based salary, with whatever other terms and conditions Scottish Water negotiated with the CEO. That is Scottish Water's responsibility.

Graham Simpson: Am I correct in saying that the bonus scheme applies only to the three executives of Scottish Water and nobody else?

Roy Brannen: No. As I mentioned, it is in two parts. There is an annual outperformance incentivisation plan, which is open to employees, managers and directors. There is a long-term incentive plan that goes over a longer period of three years and then a three-year lock-in, which is for senior managers.

Graham Simpson: How many people does that apply to? Is it everyone?

Roy Brannen: I do not have information on the applicability of the bonus scheme in front of me.

Graham Simpson: Maybe not all workers could benefit from the bonus scheme.

Roy Brannen: All employees benefit from the AOIP element if there is outperformance.

Graham Simpson: I know that we do not want to dwell on this, convener, but how are we judging performance to give people a bonus?

Roy Brannen: That is where WICS comes in with the independent review of the performance of the organisation. WICS's advice is put back to the Scottish Water remuneration committee to determine whether those bonuses should be paid, and where on the sliding scale they should be paid.

Graham Simpson: So WICS has a role. It will say yes—

Roy Brannen: It says that the organisation has either met the performance or not, based on the criteria.

Graham Simpson: Whatever the criteria are.

Roy Brannen: David Satti might want to explain that part of the process.

David Satti: We collect quite a large data set from Scottish Water every year and we produce a performance report off the back of it, looking at the metrics that the organisation has committed to over a regulatory period. As I said, and as we outlined in our methodology, we are looking to strengthen some of those metrics in the next regulatory period. That is the role that we play. We make an independent assessment of Scottish Water's performance each year.

Roy Brannen: If it helps, I could get the chair and chief executive of Scottish Water to write to you to set out what the scheme looks like. As I

said, it is quite a complex scheme. It is probably harder to explain it verbally than it is to see it written down and see how it operates in practice.

Graham Simpson: I am genuinely interested, because I am not sure how you can measure the performance of a state-run monopoly. What are you comparing it with? I would be interested in that.

Ronnie Hinds: Without going into that in a lot of detail, I will say in passing that we do that in WICS. We look at the performance measures that we apply to what Scottish Water does and we produce an annual report on that, as David Satti said. As part of that, we look at what is happening to the water authorities south of the border. We have a benchmarking process that allows us to make comparisons. Even though they are in a market and we are not, comparisons can still be made.

I want to clarify something that I think you may not have been fully seeing. As WICS, we are saying two things. First, we are saying that the measures that are used to inform the bonus payments for the senior executives are not exactly the same as the measures that we look at when we monitor the performance. You would not expect them to be identical, but we want to make sure that they are better aligned.

Secondly—this where you might not be seeing clearly what is being said—we do not then say, "Because of that, it's okay to pay these bonuses." That is not part of our remit—we do not do that. David Satti is saying that, for the next regulatory period, we are looking at how we can make some assessment of whether the bonuses are truly based on the performance of the organisation.

Does that help?

Graham Simpson: Possibly not, because Mr Brannen said that WICS does advise on whether to pay the bonuses.

Ronnie Hinds: That is why I stepped in, because I do not think that that is what he was saying, but I could see that that is what you were hearing.

Graham Simpson: Yes—it is what I was hearing.

Roy Brannen: WICS provides advice on the performance of the organisation. The decision to pay bonuses rests with Scottish Water's remuneration committee and board.

Graham Simpson: Okay. Thanks.

The Convener: Kersti Berge wants to come in.

Kersti Berge (Scottish Government): I have one additional point. Incentive schemes are very much the norm; incentivised payment and

bonuses for senior management are very much the norm in large corporations. They are genuinely required to attract the calibre of person needed to run large organisations—in this case, it is an asset-heavy organisation. It is absolutely right to question the detail. However, it is very much the norm that there is, in regulated utilities, an assessment of the performance of the company by the regulator. In the competitive markets, assessment will be based on profits. However, this is very much a standard system across the board in a range of industries.

The Convener: Thanks for that.

Let me disclose that I used to deal with Scottish Water as a trade union organiser. Two out of the three people who are highlighted as receiving those whacking great bonuses are people who I dealt with 15 or 20 years ago.

To recap, Mr Brannen, you are going to supply us with the name of the ministers who are responsible for signing off the framework for the bonuses and you are going to send us details on the bonus scheme and how it operates. Could you also give us some information about the current manager reward review, which is under way in Scottish Water?

11:15

Roy Brannen: I am happy to do that.

The Convener: Thank you very much, and thanks for your forbearance with that.

I want to move on to the section 22 report, which we have before us. I begin by asking Mr Brannen and Mr Hinds, in the first instance, whether you accept the findings and recommendations of the section 22 report.

Ronnie Hinds: Yes.

The Convener: Thank you—that was succinct.

Roy Brannen: Yes.

The Convener: Mr Brannen assents also—excellent.

Could you give us a bit more detail on what you have been doing to address some of the deficiencies, which I think Mr Hinds described as quite shocking when he first read about and understood them? Mr Hinds, what changes have been made to financial management and governance arrangements over the past year, for example?

Ronnie Hinds: If you do not mind, convener, I will ask David Satti to start, because I should give credit where it is due, and this issue started before I joined. However, I can add as necessary.

The Convener: Of course.

David Satti: As the Auditor General highlighted when he presented evidence, there has been a robust response by the organisation to the first section 22 report. The first step was to undertake an internal review of transactions, which spanned the 2022-23 year and the final nine months prior to the former CEO's departure. We then looked at enacting or delivering a 21-point action plan that we agreed with the Scottish Government.

A key element of that was the revisions to the expenses policies and the governance and controls. Those include spending limits for meals; a revised policy on travel; removal of the office credit cards, which we have heard about in previous meetings; the removal of reimbursement of alcohol; and stronger receipt documentation. As I think the Auditor General described it, a lot of those were basics. A lot of that was put in place during the final three months of the 2022-23 year.

As highlighted in the current section 22 report, there were no more instances—the issues stopped in December. In the final three months of that reporting year, we could demonstrate that WICS had changed.

If you like, I can go on to talk about all the additional organisational changes that we have been undertaking.

The Convener: Please go ahead.

David Satti: After the 21-point action plan, the focus was very much on the organisational change programme. The first step was to hire human resources support into the organisation. That was the first time that WICS has had HR in-house since 2009. We undertook a review of the leadership team to clarify roles and responsibilities. As part of that review, which was done in full collaboration with the board and with constant dialogue with the sponsorship team, we consolidated five roles of the leadership team—excluding the CEO—into four roles and undertook an independent selection process, not least given the concerns that were highlighted in the SG governance review about how posts were filled in the past.

That selection process was completed. We now have to recruit two external directors for two posts that remain unfilled. Those roles will be market tested and we will undertake a recruitment process in parallel with the recruitment process for the permanent chief executive.

I estimate that, once we have embedded the leadership team in full, WICS will be saving around £250,000 on its leadership team, or around 10 per cent of its remuneration budget, which we can then redeploy into functional gaps in the organisation. That will mean that we have to spend less on consultancy to fill those gaps. That

process is well under way and is very much a priority for WICS in the forthcoming 12 months.

The Convener: Thanks for that. Mr Hinds, do you want to come back in?

Ronnie Hinds: I will underscore a couple of points, if I may, convener.

David Satti has been a little bit shy about some of this. The way that he is trying to lead the organisation and help with its reform is to depart from the previous model of what I would call heroic leadership.

The Convener: I am sorry—"heroic leadership"?

Ronnie Hinds: "Heroic leadership"—yes. It is managementspeak, which I am stealing. The idea is that a single person should have a limit to their authority. I think that the history of WICS demonstrates that that approach did not apply as well as it should have done. There was too much authority vested in one individual, hence the "heroic leadership" tag. David Satti's style of leading is different: he is modelling it with his colleagues and there is a much more collaborative approach.

Management of expenditure was one of the key gaps in control. Now we—the board—see in detail the expenses that go through the organisation. Reports go through a prior process with management, then come to the board, so we are sighted—which I think was not the case previously—on all the expenditure that is incurred. We can, in turn, give assurances to the committee that it is not the case that expenditure is not being scrutinised or governed by the board.

The last thing that I want to say about the restructuring that David Satti has talked about is that there is now clarity about roles and responsibilities. That might sound a bit like jargon, but it matters, because where we did not have that in the past there were gaps through which things could fall. People are now much more clearly aligned in respect of what they are supposed to be doing: they understand their respective roles and there is clearer accountability that funnels its way back to the board. That is still work in progress, because we are still going through the process of appointing people to the new structure, but the culture is already visibly shifting, as a result.

The Convener: I will ask a particular question about one of the things that is identified in the section 22 report. It is highly unusual and is something that we have not seen before. It is highlighted by the Auditor General that the limit on the amount of public money that can be spent on meals, subsistence and so on was removed in January 2023. I will turn to the Scottish Government first. When did you become aware of

that? If you did not know about it, why did you not know about it?

Roy Brannen: I was not aware of that and I would not, as the DG, normally be aware of such issues. This is an important point about the independence of the body and how it is structured and is set up. Once the body is appointed, with a chair and board members, and they are clear about what the body exists to do, and there is an accountable officer, who has the accountable officer letter, operating in accordance with the SPFM, the body should be operating in accordance with the policies that have been set down by the body itself.

I would not ordinarily see such issues coming up to my level in Government. The sponsor team's role—we have accepted that this is where there was a breakdown in terms of support and challenge by the sponsor team—is to try to triangulate any such issues that come up and to challenge whether or not spending is appropriate. In this case, that did not happen.

Kersti Berge: Shall I come in on this? I was not aware that the expenditure limit had been removed and I believe that the sponsorship team was also not aware of it. It was a highly unusual move. If such a limit were to be removed and there was a reason for that, one would expect the sponsorship team to be informed. None of that happened. The bottom line is that the sponsorship team was not aware of the change.

The Convener: The change was approved by the board of WICS at the time. That is our understanding of what happened: we have been told that.

David Satti: Yes. I can outline the events at that time. You are right. The board approved a trial to revise the expenses policy in January 2023. That followed a recommendation from the audit and risk committee. The rationale for it at the time was that we were all coming out of Covid, and oil prices—which I think had moved from \$80—

The Convener: Hang on. This was in January 2023.

David Satti: It was to do with issues that had been identified within the expenses policy at the time, between January 2023, when the revised policies had been established, and when we were looking to trial the revised policies. Ultimately, the reason for the change was that colleagues were highlighting issues in respect of undertaking some international work, particularly in relation to flights, against the backdrop of there being increased air fares. As you have said, the audit and risk committee and the board approved a change to the expenses policy in January 2023, which included removal of the limits. Since then, we have

revised our financial policies twice. The first time was to reinstate limits.

Today, WICS is an organisation that is fully compliant with its policies and controls, and we have had more than a year of that being in action. The policies have expenditure limits for travel and subsistence.

The Convener: Okay. We will come to the international work later in our evidence session this morning.

I turn finally turn to you, Mr Brannen—but feel free to delegate to your team.

I am quite surprised that you did not know that something like that was happening. If the matter went to the audit and risk committee and the board, I would have expected there to be some oversight of it. Do the board and the audit and risk committee not produce minutes? At the very least, did the person who was in Jo Blewett's position at the time not read the minutes that were generated in order to keep an eye on what was going on in a public organisation like WICS?

Roy Brannen: I will bring in Kersti Berge, in a minute. As I said at the outset, we accept that there were weaknesses and failures in the sponsorship arrangement. That has been borne out by the internal review that we did on sponsorship, in which one of the issues that was highlighted was challenge of and intelligence gathering of activity at the board by reviewing board papers and risk papers, and through regular discussions.

The current organisation and its relationships are different from what was in place back then. That is the important thing. We have had reviews from Grant Thornton UK LLP, we have had the independent review from the SG and EY, and we have had the sponsorship review. I feel that we now have all the issues out on the table and have put actions in place to address weaknesses, both on the sponsorship side and on the WICS side, and that we have the leadership to drive us forward.

If we come to it in questioning, I can outline what more we are doing across the SG in terms of sponsorship. I now feel much more comfortable that the sponsorship relationship will uncover some of the issues that are still being reported in the 2023-24 report.

Kersti Berge: I can come in on the back of that. I said in the evidence that I gave to the committee back in September that there were shortcomings in how we had carried out our sponsorship function. I think that that was fair.

Like WICS, we have taken a number of measures to strengthen our role and our sponsorship function. Roy Brannen touched on

them, but one of the key measures is that we have strong and effective, but also challenging, relationships at all levels in the Scottish Government. One of the criticisms was that sponsorship was very concentrated in one individual, so we now have regular structured sponsor team meetings. Roy Brannen and I meet monthly with the chair and the interim chief executive. At some point in the future, the meetings will become less regular. Having such relationships at the different levels means that different people bring different perspectives, which I think is helpful.

As Roy said, we have new senior leadership, with Jo overseeing the division, and I have split the sponsorship function from the policy function. They still work together, but there is a bit of separation between the professional role of sponsorship that requires challenge and support from the people who work more closely with WICS day to day.

I think that your point was about assurance. We get information from WICS on changes, through the various meetings, but we also scrutinise written information much more carefully. We look at board papers and at WICS's risk register, and we monitor progress in the actions that WICS has put in place. We have taken a number of steps and have made a lot changes to the sponsorship function, so that we can provide effective challenge as well as support to WICS. I think that we are doing that.

11:30

The Convener: I am going to move things on. The deputy convener has some questions in that vein, so I hand over to Jamie Greene to put questions to you.

Jamie Greene: Good morning.

I will start by reflecting on the most recent correspondence that the committee has had, which is a letter from Ms Berge to the convener of the committee on 14 February. Thank you for your St Valentine's day letter—it was the only one I got. I want to focus on the content of it and to give you an opportunity to clarify what happened.

My understanding is that when the committee looked at appendix 4 of the business case for the settlement agreement for departure of the former chief executive, the original draft was, of course, famously heavily redacted for us, but there was a signature on the document. The accountable officer stated that the business case was appropriate and that it complied with the Scottish public finance manual guidance. It was signed by Roy Brannen on 4 March 2024. Your letter seems to allude to that being an error. How so?

Kersti Berge: As you will be aware, the settlement agreement was signed, and WICS then came to us asking for approval of payment of the settlement agreement. The process requires a business case to provide views on the settlement agreement to provide payments. All that happened about a year ago—in March last year, I think.

Normally the accountable officer of the organisation would sign off a settlement agreement. In this case, obviously, the accountable officer was one of the signatories to the settlement agreement. The team at the time was trying to work out what to do in a case in which there is no accountable officer in the organisation. At one point, the team had understood that it was, in the absence of an accountable officer at WICS, the portfolio accountable officer who needed to sign off the business case. It was subsequently clarified that that was not the case: in fact, WICS could designate somebody to sign off the business case, and that happened.

To be clear, the business case process was one that we had to follow. To be absolutely clear, I note that the settlement agreement had been signed and was, to some extent, done and dusted. This was about completing the process.

What happened was that we failed to communicate that to WICS. WICS had, as a placeholder, put Roy Brannen's name down when we had understood that it was to be signed by a portfolio officer. We failed to inform WICS that what it had done should not be the case and that it had to take his name off. Unfortunately, his name stayed on. When WICS submitted its evidence to you back in July, Roy Brannen's name had stayed on the document. That was part of, I think, 100 or 130 pages that we sent to you, and we did not pick it up. I wanted to write to correct the record, just to be absolutely clear. Roy Brannen was never in a position to sign off the business case. He did not sign off the business case—that was an administrative error on our part.

Jamie Greene: Thank you for your candour and what I think was an apology. At the end of the day, we received a document that was key and fundamental to the whole conversation around the business case, as was who signed it off or who did not sign it off. There was a name attached to it, which we now learn was erroneously added to the business case.

I presume, Mr Brannen, that you had no sight of the business case and that you had no involvement in the sign-off. The business case was written after the severance package had been agreed between, and signed by, the two parties, which in itself is a worrying development that the committee has looked at.

Roy Brannen: Kersti Berge has laid out the circumstances of the error. I picked up on it when I returned from medical leave and it found its way into the section 22 report. I queried it because I remember asking at the time why I was being asked to sign off the business case. The business case was in circulation within the SG, but I queried why I was being asked to sign it off. Subsequently, the team checked internally with the legal team and compliance colleagues, and it was confirmed that I had no role to play in it, because I was not the accountable officer.

The error that occurred was that the name section had been prepopulated in the form—it is a name, not a signature—but was not subsequently removed as it worked its way through the process.

Ultimately, though, the business case was retrospective to the settlement agreement being signed, which was a legally binding position. I think that you heard evidence from the team in September about that. At that point, the decision had been taken that a payment would need to be made as a result of the settlement agreement. The business case was, in effect, the WICS's board's justification for how it arrived at the settlement.

Jamie Greene: The exit, for the record, cost the taxpayer £104,000. Is it normal for agencies that are sponsored by the Scottish Government to come to you after they have spent the money and ask, "Can you retrospectively approve this?"

Roy Brannen: No.

Jamie Greene: Is it malpractice?

Roy Brannen: The Scottish public finance manual is very clear about what we need to do with settlement agreements. The committee has heard that evidence previously, so I will not repeat it, but a sequence of events did not occur. The settlement agreement was entered into faster than the process that would normally have been undertaken would have allowed.

Jamie Greene: Thank you for your clarification.

Were you involved in any of the discussions at any point around the departure or performance of the former chief executive of WICS?

Roy Brannen: No. I cannot remember when exactly I knew that he was resigning—I found out about 19 or 20 December that he had resigned. The terms had been checked with the public sector pay policy—the question that had been asked of the sponsorship team was whether it was payment in lieu of severance. Again, as you have heard in evidence, the first that the team heard that the settlement agreement had been used was on 12 January.

Jamie Greene: Were you involved in the telephone call between Donald MacRae, the

former chair of WICS, and a number of Government officials, about which he claims that, in that call, approval was given for the severance? He also states that that was confirmed in a second phone call on 20 December, and that the words that were used were “You can do this”. Were you involved in that?

Roy Brannen: No, I was not involved in those conversations.

Jamie Greene: Who was, then?

Kersti Berge: Can I come in on that and clarify? My understanding is that only one person from the Scottish Government was involved in those telephone conversations.

Jamie Greene: Did that person erroneously give approval for the business case?

Kersti Berge: My understanding—and again I was not in the call—is that the discussion was around whether, were the CEO to resign, he could be paid contractual terms, that is, payment in lieu of notice. It was my understanding—this is verbal, but also I think we have records—is that the discussion was around whether payment in lieu of notice was contractual.

Jamie Greene: I understand that. On 19 September, the former chair said this to the committee:

“we sought approval from the sponsor team for that approach. The approval was given in a phone call involving the deputy director in the sponsor team”.—[*Official Report, Public Audit Committee, 19 September 2024; c 30.*]

I will repeat the question. Was that approval given erroneously?

Kersti Berge: The sponsor team confirmed that payment in lieu of notice was reasonable, because that was part of the contractual terms. My understanding is that there was no broader approval around the approach.

Jamie Greene: I am sorry, I am not trying to be difficult; I am trying to get to the bottom of this. Someone has not been entirely truthful with the committee. Someone is not being entirely honest about what has happened: either the former chair of WICS, in his commentary to us about the approval process, or someone sitting in this room. I want to get to the bottom of it. I know that we have laboured this in the previous committee session, but it is important. Did someone from the Scottish Government give approval for the package? He says that that is what happened.

Kersti Berge: There was no mention of the settlement agreement in—

Jamie Greene: There was; it was part of the conversation. He said that there was a phone call on 19 December—

Kersti Berge: I believe that the chair wrote a follow-up email to the deputy director in the Scottish Government, and there is no mention of a settlement agreement in that email. The first that we heard of the settlement agreement was when WICS contacted us on 12 January to ask for payment for the settlement agreement.

Jamie Greene: Mr Brannen, does this whole line of questioning not strike you as concerning? We have heard conflicting views from all the protagonists involved and the committee is as yet unable to establish the truth of the matter about this business case. There is an opinion from the board, there is an opinion from the individual who has since written to us about his departure, and there is an opinion from the cabinet secretary, Ms Màiri McAllan, who, in letters to the committee, expressed a view about who was at fault. On two occasions, this committee has heard from members of the Scottish Government about what they think happened.

Our poor clerks have to write a report on this, and I think that they will struggle to identify the truth of the matter. What is your view?

Roy Brannen: I think that we have tried to lay that out. It was laid out in that session in September—I did not attend that meeting, but Michelle Quinn and Kersti Berge were there—and subsequently in written form. The timeline was very clear. The individual had resigned. It was communicated to the deputy director. The question was asked: is it possible to pay the individual severance in lieu? That was checked internally with the Government, and that was communicated back.

As far as I am aware, there was no communication around the settlement agreement until an email came in on 12 January that stipulated that a settlement agreement had been used. Immediately at that point, the payment was halted, and then we went back to communicating what the process should have been before a settlement agreement had been entered—the need to provide a business case, for views to be sought on that business case internally and for that to be communicated back to the board of WICS.

Jamie Greene: Let me ask another question on this in light of what we heard in the opening statement from Mr Hinds, the new chair. He said that he was “shocked and dismayed” by the content of the section 22 report. He talked in detail about weaknesses in financial governance and a loss of public confidence in the agency. My question is quite simple: why on earth was the former chief executive allowed to resign from his position? Why was he not sacked?

Roy Brannen: Again, as I think that you heard in evidence back in September, that was entirely a matter for the board. The Government does not have a role in the employment of the chief executive. The board members gave you their answers back in September in terms of their justification for the action that they took. We did not have a role in that.

Jamie Greene: What is your opinion as a director general? Is it good practice to allow somebody who is at the top of an organisation that has just been issued a section 22 report from Audit Scotland to be allowed to simply walk away from the process before a public audit hearing?

Roy Brannen: It depends on the circumstances with the section 22 report and how that individual will face whatever is within the section 22 report.

Jamie Greene: However, the individual did not face it. That is the problem.

Roy Brannen: As I say, I was not party to the discussions that went on at the board level with the individual. Those are matters for the board and the individual.

Jamie Greene: Let us ask the new chair of the board. Mr Hinds, if you were sitting in the position that Mr MacRae was in at the time, would you have approved the resignation request or would you have preferred to go down a misconduct route?

Ronnie Hinds: I was not there and I do not want to speculate because I am not aware of all the circumstances.

Jamie Greene: However, given everything that you said in your opening comments about the behaviour of the management at WICS—

Ronnie Hinds: I will answer in the best way that I can. If we had a situation like that now—and we do have people within the organisation who may not be with us for that much longer because of the changes that we are bringing about—I would need very strong persuasion, not just legal advice, which I understand that the former chair took, that it was in the interest of the organisation and its reputation to sever the employment of someone on the terms that pertained in relation to the previous chief executive.

I am not saying that what was done should not have been done in that situation because I was not there, and I am not going to try to be clever after the event, but I would be looking for advice along the lines of the need to weigh on the scales how it will look to the public if we are perceived to be paying people to go without any recourse if they perhaps deserve to be sacked as opposed to going with some severance agreement. Most of the legal advice that I can see that was given to the chair at the time was around employment law,

which is complex, and the rights of the individual, which are enshrined in that law. I can understand why he would think that that advice was clear and determining. I would say more than that, because I would ask, “What about the public perception of all of this?”

11:45

Jamie Greene: And what about the public perception? If anybody in this room had been subject to the damning report that was issued and everything that has since come to light around financial mismanagement of public money, we would have been out the door on our ears in seconds—we would be on the front page of newspapers already. There is no way any of us could walk away from that with six months’ pay. WICS is a public body, and we are talking about public money. Can you understand why there is so much public anger around this?

Ronnie Hinds: I can indeed. To echo what the director general has said, as I understand it, the largest part of the money that was paid was compatible with the terms and conditions of employment and the contract of employment of that particular individual. I cannot just dismiss that out of hand as if it did not matter. What matters more to me is the perception that somehow, as a result of a settlement agreement, there is no recourse against the individual in terms of the performance that led to that situation or, indeed, any learning of lessons that might be applied in the organisation following the individual’s departure. That concerns me more.

Jamie Greene: Is there perhaps a risk that Mr Sutherland has been used as an easy scapegoat for all the failings, given that he is no longer part of the organisation?

Ronnie Hinds: My view, as I said earlier, is that the nature of the leadership within the organisation goes all the way to the top, and that would mean the former chief executive in this situation. It is not unreasonable to be looking to that person to be modelling the behaviour that you want. It is clear from the Auditor General’s reports that we did not have the behaviour that we would want. I do not think that I would call it scapegoating; I would say that that is where responsibility ultimately rests.

Jamie Greene: In November, after the last time we met to discuss this in September, we received a submission from Mr Sutherland, which I want to refer to. I do not know whether you have a copy of it. There is one particular item that struck me as of interest. I am quoting:

“On leaving WICS, I was required to delete or destroy all materials relating to my employment. I did not question this request.”

He goes on to say:

"I was required to destroy any and all materials ... I did so diligently."

Who asked him to destroy any and all materials relating to his employment, and why?

David Satti: I can start with that one. WICS follows standard data management processes that were in place during the former CEO's tenure and remain unchanged. Those processes are there to ensure that individuals retain their personal information and do not take away confidential information. The former CEO was afforded the time to take his personal details, personal notes and documentation from his systems before WICS suspended his access to his accounts before, ultimately, deleting them.

I am pretty sure that, if there was a desire to retain documentation, he could have had a conversation about that with the former chair at that time. All that we were doing was undertaking our standard offboarding processes.

Jamie Greene: There are lots of other questions around this, but my final one on the severance issue is for the Scottish Government, because, ultimately, you are the sponsor of this public body.

What are you doing differently now, given what we now know about the sponsorship arrangements between the Government and WICS? Can you give me and the public some reassurance that we will not see public money similarly spent and squandered in future?

Roy Brannen: Yes. As I said at the outset, that is where the journey has been for us in Government on sponsorship in general, building on Eleanor Ryan's review, and looking to see how we strengthen those particular relationships. I will let Kersti Berge talk about the specifics of the WICS sponsorship relationship, but I think that the fundamental thing that came through the reviews is that there was too much contact resulting in one individual and one relationship. There is now a multilevel engagement process, with different layers. Jo Blewett and Kersti Berge can walk you through that in terms of what that looks like and who is involved.

Separate from that, I have been having meetings with the CEOs and chairs of my public bodies. Between Michelle Quinn and I—Michelle Quinn in my absence—we have covered 17 so far. That has allowed me to triangulate at a different level issues around governance, finance, deliverability and risk and public sector reform, and to ask some very specific questions. The very last thing that I ask each chair and the chief executive is: is there anything else you need to tell me today? That is separate from the daily sponsorship relationships that are going on, and it

gives me an opportunity to tease out issues at the portfolio accountable officer level.

It is entirely appropriate that we are not involved in the day-to-day running of these boards. There are 131 boards and, if we set them up properly with individuals who are competent, competent chairs, competent board members and accountable officers who understand their duty under the SPFM, the portfolio accountable officer's role is to ensure that the sponsorship relationship is well-documented in the framework and that that sponsorship relationship actively provides challenge and support in equal measure through the process.

We are making progress within the DG family and much more widely across the SG. I brought this issue to the executive team of which I form a part quite early in the process, and we have had further deep dives in each of the DG families. We have considered what has come through that, so there are a few additional activities that will be undertaken. There will be an annual deep dive across all the DGs. There will be a peer-support network of sponsored individuals—I think that there are more than 200 sponsor individuals in the organisation. There is a move towards professionalising sponsorship as a role, so rather than there being a side-of-a-desk approach, it will be based much more on professional competencies and on what it is intended that people do, with clear objectives for sponsored individuals as well, so that they are clear about what their roles are and how they undertake them.

Another element involves building more capacity in the organisation, particularly within the WICS team. Some of the errors that you cited earlier were a result of the chop and change that was occurring and also the pressure and stress of dealing with the section 22 report and the follow-up. There is much more breadth and depth in the team now—Jo Blewett can say a bit more about that if she wishes. It is about making sure that you have the capacity and capability in the team to have that good, open, trusting conversation with the public body itself.

I will come back to two points, so that they are clear. The public body is responsible for whatever it is set up to do under statute. There is a process in place to make very clear that governance, risk and accountability lie with an individual.

On the point about the former CEO, the corporate plan made very clear the approach to accountability, financial management and governance—I think that that is set out in outcome 7. The former CEO's individual letter on accountability would have been clear, in terms of section 15 of the Public Finance and Accountability (Scotland) Act 2000, about what he was personally responsible for. What has come

through the various reports is clearly an indication of processes and guidance not being followed. I will leave it there.

Jamie Greene: Thank you. It is good to see you back in good health.

Roy Brannen: Thank you.

The Convener: I have a couple of questions on a similar area to those that were raised by the deputy convener. One is about Mr Sutherland's written submission, in which he goes further than what has been said so far. He says that he suggested that he should retire in October 2024, but that it was suggested to him by the Scottish Government deputy director that he might want to leave before then, so that he did not have to appear in front of the Public Audit Committee.

Roy Brannen: I was not a party to those conversations, so I cannot comment much further on what the former CEO has written. What you do not have is the other party's approach to that.

The Convener: We may return to explore that a little bit further. Another thing—I have raised this before, so you might be prepared for it—is that it strikes me as quite odd that Mr Sutherland's contract provided for him to receive 12 months' notice on dismissal and only 6 months' notice on resignation. Is that normal in the Scottish public sector, in your experience?

Roy Brannen: Again, that is before my time. We are looking back at the records on that. In general, I think that those were the terms and conditions in contracts back then, but I would need to absolutely confirm that that was the case. We are talking about two different contracts: one from 2005 and another from 2007. There was a change—

The Convener: He did not sign the 2007 one, though, did he?

Roy Brannen: No, but there was a change in the timings for dismissal in the 2007 contract. At some point, policy must have changed between 12 months' dismissal and—what is now more common—three months' dismissal.

The Convener: That is helpful and interesting. What you are saying is that that was not some unique deal struck by the former CEO and the then Government or the board or whatever. It would have been quite common across the Scottish public sector up to the year 2007, approximately.

Roy Brannen: That is my understanding. Again, we are happy to try to clarify that.

The Convener: In 2005, there would have been other people who would have signed similar contracts to the one that Mr Sutherland signed up to, with similar terms, notice period and so on.

That is helpful. If you could furnish us with more details on that, that would be extremely useful to us.

I invite Colin Beattie to put some questions to you.

Colin Beattie: Looking at the overall picture, we can see that there have been quite comprehensive changes in WICS. There have been changes of personnel at senior level and changes in processes and almost everything you can think about. Have either WICS or the Scottish Government undertaken any assessment to determine the extent of the issues that have been reported in, for example, the section 22 report and the spin-off from that. Huge efforts have been required to address the issues. Have they impacted on the ability of WICS to perform its regulatory role? I am not sure who would want to come in on that.

Roy Brannen: I will go first and then perhaps David Satti and Mr Hinds can comment. It definitely has had an impact on the organisation because of the culture and the focus that has been on the organisation, but I do not see any diminution in WICS's standing as a regulator; it has quite a high standing in how it undertakes its regulation function and holds Scottish Water to account.

Back in 2022, the Organisation for Economic Co-operation and Development cited the WICS approach to regulation as a standard to be looked at. That element of the organisation and its core work is important. We will need that quite a lot as we move into this next strategic review period, which is where we need to focus our efforts. I have not seen any diminution.

Colin Beattie: Has there been an assessment of that?

Roy Brannen: No, I have not undertaken an assessment of that.

Colin Beattie: My understanding is that the international side of its business was frozen.

Roy Brannen: We have now agreed with ministers that we will pause that until we get through the strategic review period, so that the focus can be entirely on the core function. I do not know whether you want to come back to its international activity later. At the minute, the focus is on getting the organisation to the highest level of governance and operation and on the final determination for the next strategic review period.

Colin Beattie: I think that the international aspect will be picked up later.

Ronnie Hinds: I will go next, and David Satti can fill in because he knows the business better than I do—I am still learning. As I said in my

opening remarks, I was concerned about the potential impact, and, as well as trying to help to manage change in the organisation, I have made it my business to understand and assess any impact that it might be having on our statutory role. I can tell you that I do not think it has done.

We have to work to quite a strict timetable for the main and obvious piece of business, which is the regulation of Scottish Water and the forthcoming strategic review of charges. All the milestones on that plan have been hit in the time that I have been involved with WICS, which is the past six months or so, and we are well on schedule to meet our target to complete that piece of work next year. That is the most significant piece of regulatory work. Alongside that, we have a role in regulating the licence provider markets in Scotland. That is not so much driven by timetables as by our determination to make that as effective and as much in the interests of consumers as possible.

David Satti can add an awful lot more detail about that. Papers have come to the board that are impressive in their depth and complexity about how best to do that, and there are consultation processes that we go through with the people who provide those services in the market as well as with those who receive them. All that work is well on track and its quality is very impressive indeed.

12:00

That is why I gave credit to the staff and the workforce: they have carried on doing that work while these other things have been going on. As interim chair, I do not feel that there is any great risk to the organisation on the regulatory front, so long as we keep our foot to the floor in sorting out the internal governance and management of the organisation and remove that risk fully.

Colin Beattie: Has WICS done any tangible assessment of the possibility of any impairment of the ability to perform?

Ronnie Hinds: Yes, we have. One element in the governance of WICS that was not as strong as I might have hoped was risk management and our approach to it. We have spent quite a lot of time in the past six months looking at our risk management plan and the practices that we follow to address perceived risks. On the question that you are asking, the risk to the regulatory role and our fulfilment of it is front and centre in that plan, as well as other things.

I am satisfied that we have moved risk management along quite significantly. It goes into the box of work in progress. If I am honest, there is still more that we can and will be doing to improve it; we have it clearly in our sights now. That is an

assessment of whether there is any impact that might cause difficulty for our regulatory role.

Colin Beattie: Leading on from that, I have a question for the Scottish Government. Has any assessment been undertaken on whether, in its regulatory and consultancy work, WICS is value for money?

Roy Brannen: I am not aware of our having undertaken that as a sponsor team.

Kersti Berge: The regulatory system in the water industry in Scotland is seen as very well performing. David Satti might know more of the detail about this but there was an OECD report that flagged that. Efficiencies have been systematically driven in Scottish Water. It compares quite well to a number of other water companies, and the regulator plays an important part in that.

On your previous question, there will always be a risk. It is absolutely essential that WICS focuses on making the changes to governance and financial management that we talked about, but it is not without risk. It is difficult for an organisation such as that. There is a risk to its reputation, and there are a lot of talented good staff in WICS who do a fantastic job and are about to embark on the regulatory period.

We cannot say that that is not a risk, but it is important that the organisation is allowed to focus on the change to governance and on the important regulatory job that it has to do, particularly over the next couple of years as it sets up the next strategic review of charging.

Roy Brannen: Jo Blewett can say a bit more about this, but one of the things that has come out of the sponsorship review is establishing a clear performance framework for the organisation going forward. Perhaps Jo will set out the timetable for that.

Jo Blewett: As a sponsor team, we already look across the water sector. As you can imagine, it is a big investment programme. We sponsor Scottish Water, WICS and the Drinking Water Quality Regulator for Scotland, and part of our role is to ensure that everybody plays their part in the right way across that programme. We pick up perceptions about one another's performance through that, and nobody is expressing concerns about WICS's performance. Over the next year, rather than take a collective view, we would like to pull that down to what it means for WICS's performance. For example, can we get some more metrics so that we are properly measuring outcomes?

Colin Beattie: Quite a few people—obviously those who are not involved in this—have questioned whether WICS is value for money.

Given that it is the regulator of the water industry, I realise that there is a bit more to it, but, basically, it looks after Scottish Water. There are 20-odd people in WICS. Could that work be done by another body—the Scottish Environment Protection Agency, for example?

Kersti Berge: WICS is recognised as having done a good job and driven efficiencies in Scottish Water.

Colin Beattie: I do not think that we are questioning whether it has done a good job. It is a question of its value for money as a stand-alone regulator.

Kersti Berge: WICS is the economic regulator for Scottish Water, the water industry and the retail market for businesses. That is an economic regulator role, and there are not many other economic regulators. SEPA is more of an environment regulator. The nature of economic regulation is quite different, which is why WICS was set up. I think that it is our only economic regulator in Scotland.

Colin Beattie: Coming back to the point, have you done any assessment as to its value for money?

Kersti Berge: As Jo Blewett said, we are doing further work on benchmarking across a range of areas, and we assess WICS's performance in terms of its regulation of Scottish Water, which, as I said, is recognised as having driven efficiencies over the past 20 years. As Roy Brannen set out earlier, it is making a lot of progress on its objectives in driving net zero and building resilience for the impacts of climate change so that the assets are robust and can serve customers in Scotland. The way in which we assess that is quite a lot about the outcomes of the company that it regulates.

Of course, going back to the other matters that we have discussed in this evidence session, WICS absolutely needs to do that in a way that delivers best value, propriety and regularity. We have seen a number of incidents where that did not happen, and it is important that, as an organisation, WICS addresses that. We are seeing a lot of positive things and a clear reset of the organisation in that respect.

Roy Brannen: I have just pondered on your question, Mr Beattie. WICS is quite a specialised regulator. Its focus is on the improvement of Scottish Water—our asset in Scotland. It sets quite stretching targets as part of the strategic review period. David Satti can correct me if I am wrong, but I think that the efficiency target was about 1.5 per cent, which is at the higher level of what the industry was expected to deliver.

Without a specialised regulator that understands the sector, there would be a risk that we would go further back from getting the maximum outcomes for the minimum input to our national asset, Scottish Water. That is why it is important that we maintain the focus of the regulator on the improvement process in the organisation that it regulates.

Colin Beattie: I will move to something slightly different and talk about expenditure. Parts of this have been covered already but I will try to get a little more detail. There were some expenditures—three, in particular—that did not meet the requirements of the SPFM. These related to travel and subsistence expenses. If I remember correctly, not all these expenses were subsequently approved. What does that mean?

Roy Brannen: Is that a question for the Scottish Government?

Colin Beattie: Yes, it is for the Scottish Government.

Roy Brannen: Are you referring to expenses beyond delegated limits?

Colin Beattie: Correct.

Roy Brannen: Right. Retrospective approval was not given for expenses beyond delegated limits; it was not provided in those circumstances.

Colin Beattie: What does that mean?

Roy Brannen: Do you mean what does it mean in practice?

Colin Beattie: What is the penalty?

Roy Brannen: Ultimately, they resulted in a qualification to the accounts.

Colin Beattie: A qualification to the accounts does not seem even to be a rap on the knuckles.

Roy Brannen: Well, it results in a section 22 report and attendance at this committee to justify why expenditure was outside delegated limits. It comes back to the point of accountable officers understanding both the framework document that sets the delegated limits and their letter of accountability, which says that they need to operate within the limits of the framework and within the SPFM.

Colin Beattie: What you are saying, in effect, is that the Scottish Government's action of not approving the expenses triggered the section 22 report.

Roy Brannen: The Auditor General would have taken a view on the accounts anyway, but the qualification to the accounts resulted in further scrutiny by him.

Colin Beattie: Why did you not retrospectively approve the expenses? In other areas that the committee has looked at, there has been retrospective approval of expenses, but, in this particular case, the decision was taken not to approve them.

Roy Brannen: I think that that was the sponsorship team maturing in line with understanding proper governance. Following the scrutiny that the organisation had been under during the course of the year, it was entirely appropriate for the sponsorship team to take that position. Although it was a legacy matter—I think that I am correct in saying that it came before the 2023 section 22 report—it still would have been important to show the step change that had been made by the sponsorship team in its relationship with those particular issues.

Colin Beattie: Okay. I will move on to a slightly different point. In response to a question from the convener, I think, David Satti talked about the audit and risk committee and the board approving the removal of limits per head for reclaiming expenses. If I remember correctly, that happened in January 2023, and it was for a trial period. First, how long was the trial period intended to be? Secondly, I did not understand the reference to oil prices and so on driving the change. That does not seem to be a reason.

David Satti: I can provide clarification, Mr Beattie. You are correct. I did say that a trial began in 2023, for which the rationale—from looking at the documentation and the history—was that there were concerns at the time about WICS's expenses policy and its ability to undertake some of the international commitments that it was embarking on. The limits on flights, for example, were seen as an impediment, not least because of flight prices in response to increased demand and oil prices. The cost of flights was inhibiting. People could not book flights, given the limits that were in place at the time. That was discussed at the audit and risk committee and at the board, which led to a revision of the financial policies and, ultimately, the approval of the trial, which was initially for a six-month period. The policy was then formally approved by the board later that year.

Colin Beattie: But surely you would not change an entire expenses policy in such a sweeping way just based on airfares.

David Satti: No—so that was one of the reasons. There were multiple reasons. For example—

Colin Beattie: Maybe you could tell us a few.

David Satti: At the time there were issues about WICS's policies not being able to separate out certain expenditure, such as business development. In previous evidence sessions, we

have heard the explanation about business development expenditure, but that was one of the motivations for looking again at the financial policies and procedures.

Colin Beattie: So you just take the limit off all the expenses, both for the business development side and for the rest of WICS. Is that the answer?

David Satti: The revisions to the financial policies and procedures took away limits on the basis that that then put the responsibility on to the individual to demonstrate that a transaction represented value for money.

Colin Beattie: How would they do that?

David Satti: They would do that by looking at multiple different options for flights, for example, and being able to demonstrate that the one that they were booking was best value. Following the Auditor General's first section 22 report and the concerns that were highlighted in it, we again revised—indeed, we overhauled—the financial policies and procedures to bring them much more into line with public sector norms.

Colin Beattie: To be honest, the reasons that you are giving are fairly thin. There are many different ways—well, not many, but there are a few—to approach this. I speak from my experience in the private sector and, in general, I have never seen or heard of unlimited expenses—taking the cap off—and relying on individuals to decide whether something is value for money and to determine their own flights and all the rest of it. That does not happen.

12:15

David Satti: That is why we have changed the policy and why it is not WICS's policy today.

Colin Beattie: I am relieved to hear that, but opening up a six-month window that could potentially allow a free for all does not sound like the best way forward. I would question why the audit and risk committee would even consider putting that forward to the board. To me that is also unheard of.

Ronnie Hinds: Can I come in on that? I agree with you. Let us be clear; David is trying, as best he can, to explain what seems to have happened in the past, not to justify it. I do not think there is any justification for that, notwithstanding that I was not there for those circumstances.

I come back to what I said earlier. This was a form of executive overreach. I think that the chief executive had too much authority, if you like, within the context of WICS as a whole. That was supported by his role in setting up the consultancy work, which brought a lot of income into the organisation. I think that that changed the culture

and weakened some of the governance that you would expect. Again, I emphasise that I am trying to understand in retrospect, not to justify anything for a second, but, for me, that goes some way towards explaining the situation.

I also think that the board should have been much stronger in its resistance to the change in the expenses policy that we are talking about. That did not happen, but it is the case now that nothing like this would go through the board. If there were such a request, it would not be entertained. That is not just learning and benefiting from the experience; what happened is not appropriate for a public sector body. I think that the organisation was unduly influenced by the significant amounts of income that were being brought in from international consultancy work. That contaminated the culture of the organisation and its processes. For me, that goes a long way to explain what happened.

Colin Beattie: Well, we can at least agree on that.

I have one final question. There have been a lot of changes within WICS, and big efforts have been made to bring WICS to the standard that is needed to ensure that all expenditure complies and represents value for money, and that there is also proper scrutiny and governance. Have the changes that have taken place been an overreaction? I do not know—I am just putting this to you. Often what happens when something goes wrong is that you immediately put layer after layer of scrutiny on it, to the extent that that scrutiny itself becomes something that is not value for money. What is your opinion on that?

Ronnie Hinds: I do not think that that has happened, but it is a fair question. This comet has got a long tail. The events that surround it and the Auditor General's first report are only about 15 months old, but the build-up goes back a lot further. There are other things that we have not touched on in relation to expenditure on Queen's counsels and King's counsels and all the rest of it. That is what I mean by saying that it has a long tail. I think that we must bear that in mind when we ask whether we are in danger of overreacting in the short term to what was an abrupt wake-up call for the organisation. I do not think that we are there. I think that we are getting to the point of diminishing marginal returns ourselves in archiving the nature of the problem and understanding it. We understand it pretty well now, but I think that there is still quite a long way to go to make sure that the culture of the organisation, in particular, is right.

That comes down to a lot of things and we probably do not have time to talk about them today. I am trying to assure the committee that some of this—quite a lot of it, in fact—is about

modelling good behaviours. You can see what happened when they were not modelled in the organisation and the effect that that has had on our processes and our governance and, indeed, in some respects, on the staff. David and I in particular are trying to model different behaviours, and I think that I am beginning to see some of the benefits of that coming through. We are going through an organisational change programme that will facilitate some of the changes in culture that we need. Until we get through that and see it behind us, I will not be able to say whether we have overreacted or not. At the moment, I do not think that we have.

Roy Brannen: Can I come in on the back of that? I do not think that it is an overcorrection. I go back to my earlier evidence when I talked about the Auditor General's section 22 reports, the Grant Thornton work, our external review and our review of sponsorship. The examples of non-compliance with guidance and of policies that should have been laid down are quite extensive. However, WICS is on a journey. A sample in the first Grant Thornton report showed 53 per cent compliance, which was up to 73 per cent at the tail end of the period. David can quote the figure of where WICS is now. That is the journey that we need to see for the organisation.

More widely, I think that the situation has helped us to re-establish some rules around sponsorship: not concentrating too much effort on one individual, looking at the length of time individuals are in key posts, and making sure there is a stratification of engagement across the piece with bodies.

Within the wider SG and my DG—and much more widely—WICS and the learnings from it are well known. My senior team is probably sick of me bringing the issue up at senior management team meetings. I have done so on 17 occasions over the past year. It is raised at nearly every DG assurance meeting—we covered it in some detail at the most recent DG assurance meeting, which Audit Scotland attends. I think that it has been useful, although really painful, to try to move us to a position where we can learn from this not just for WICS but so that other public bodies can take a good, hard look at it. I come back to the point that the core functioning of a system, if it is put in place properly, should deliver what is required—an arm's-length body, a statute under which it delivers whatever it must deliver, a governance structure that is clear about accountabilities, and a sponsor relationship that provides constructive challenge and support in equal measure.

The Auditor General has probably said this already. We have 131 public bodies, but thankfully, we do not have 131 section 22 reports. We have one here. I am not saying that there

might not be other issues, but the clear focus now is on trying to get us to a position of having the highest levels of governance and sponsorship arrangements between public bodies and the Government.

The Convener: Thank you for coming in on that. It was useful to get that on the record, director general.

I will turn to Graham Simpson for a final set of questions. You said that Colin Beattie had asked a fair question, Mr Hinds. All our questions are fair.

Graham Simpson: They certainly are. One of the reasons why we moved the committee's meetings to a Wednesday from a Thursday is that that allows us more time to delve into such issues in greater detail. I am afraid that I do not have just five minutes of questions; it will take a bit longer, but we will try to get through them.

Mr Hinds, you said earlier—and you have repeated it—that people may not be with WICS for much longer because of the changes that are being made. I guess that you are suggesting that the headcount may go down. Is that accurate?

Ronnie Hinds: Yes.

Graham Simpson: How many people are you planning to lose?

Ronnie Hinds: Well, we cannot say at the moment because we are going through the change process step by step, as you would expect. It starts at the top of the organisation and works through the rest. David Satti can say more about how we plan to do that.

We have just carried out interviews at director level, which is the most senior level in the organisation, apart from the chief executive position itself. I think that David Satti said earlier that the number of directors is going down from five to four, and that will have implications as we work our way through the organisation.

It is hard for me to foresee that that will not mean that we will not have some of the roles that we have now. Clearly, that has ramifications for people. I do not want to be indelicate and I do not want to get into details about those people; I am just being honest about this.

That is one way in which our expenditure will come down. We have already identified a figure. Taken together, one fewer director and some significant salary reductions for the new director posts comes to a reduced expenditure in the organisation of about £250,000. There may be further instalments as we go through the rest of the organisation. However, I do not want to get ahead of ourselves. It is not fair to the staff.

Graham Simpson: Just to be clear, if I am picking you up right, you are talking about

reducing the number of people at director level and potentially changing roles, so you may be asking people to apply for new roles that do not exist now.

Ronnie Hinds: Yes.

Graham Simpson: Presumably you have people in post right now who are being told, "Your role is redundant. These new roles are going to exist. You can apply for them." Is that right?

Ronnie Hinds: David Satti can answer about the detail, but I do not think I would use the word "redundant" in this context.

Graham Simpson: Well, some roles will not exist. Can I put it that way?

Ronnie Hinds: My broad response would be to say that, in my view, there is a separation between the part of the organisation that faces the regulatory role—that is, the one that deals with Scottish Water and other bodies—and the internal, or corporate, part of the organisation. We must look at those parts differently. I think that the corporate part needs a bit more scrutiny as to whether it is necessary and does the job that we want. For example, unfortunately, we have not had any in-house HR support in WICS for a good number of years. Maybe if we had had some of that support, it would have helped to deal with some of the issues that we have had to confront because of the Auditor General's report. We need to remedy that. By the same token, there might be other aspects of the corporate role that are not really necessary for the organisation going forward.

I do not want to get into the detail of that, but I do want to say that the consultation that David Satti initiated with the staff before we embarked on the organisational review was clear about the process of trying to match people into posts in the new structure, that people would have every opportunity and that, if they were unsuccessful in applying for posts, they would be looked at as we went further into the organisation. That is why I am baulking at the word "redundancy"—we are not talking about that for people at all.

Graham Simpson: But you could be looking at redundancies.

Ronnie Hinds: Well, you have asked me the question and I have said that is not what we are doing. There could be people who decide that, for them, this new future is not what they want. That happens in every organisation.

Graham Simpson: Would that involve paying people off?

Ronnie Hinds: Well, yes, it might. There is such a thing as voluntary severance—we have all gone through that in our organisations.

Graham Simpson: Have you budgeted for that?

Ronnie Hinds: Yes.

Graham Simpson: What is the budget?

Ronnie Hinds: We have got money in the organisation to pay for that. We cannot have a budget for a number of people that we have not yet have a conversation with.

Graham Simpson: You have just said you have budgeted for it, so what is the budget?

Ronnie Hinds: Well, we have a budget in the organisation for dealing with the organisation as a whole.

Graham Simpson: Yes. Well, what is it?

David Satti: As Mr Hinds was saying, we are not aiming to invoke any voluntary severance. This is all about role clarity. The organisational change is, from the very outset, all about clarifying roles. As we highlighted in previous evidence, the survey that was undertaken following the departure of the former CEO shows that a lot of staff wanted clarity on what their roles and responsibilities should be. The first step is to do that at director level in a very open way and have people apply for those roles, and then do it for other layers within the organisation so that people are matched with roles. We are only 21 individuals. In response to Mr Beattie's line of questioning, I would say that, if anything, we are light as an organisation. There are a number of vacant posts, and there is an intention to recycle any savings from reductions in salaries and the like into known functional gaps within the organisation so that we reduce spending on consultancy and achieve better value for money. As Mr Hinds was saying, some individuals might decide that WICS is no longer for them and ask to have a different conversation, and we will deal with that case by case.

Graham Simpson: Okay. Mr Hinds, as chair of the board, have you had any comments about the culture of the organisation from current or previous employees?

Ronnie Hinds: I am not quite sure what the thrust of your question is. Do you mean has somebody written to me about this?

Graham Simpson: Has anybody written to you about it? Yes, let us put it that way.

Ronnie Hinds: Well, not as such. Clearly, we are going through a process, as I have described. There are also other processes internal to the organisation to do with staff discipline and so on. I see some of the paperwork around all of that. I see that, as you would expect, people have raised grievances about the way they think that they have been treated in the organisation, so they will make comments about the culture of the organisation.

My reflection on those comments is that they refer to the status quo ante, if you like. My memory might not be entirely reliable here but I do not think that I have received any comments from anybody saying that the current culture of WICS is something that they find deplorable or anything like that. The comments are about the historical events that we are here to talk about.

The Convener: I am not going to allow us to get into individual cases here. This is not the appropriate forum to do that, just to be clear.

12:30

Ronnie Hinds: Not all questions do feel fair—I think we have to be careful about that.

Graham Simpson: That is fair enough, convener. I will move on.

Mr Brannen, you have said that the international work is on pause at the moment. How long is it on pause for?

Roy Brannen: We have agreed that we would pause it until the next review period, so it is paused for two years.

Graham Simpson: From now?

Roy Brannen: Yes.

Graham Simpson: Okay. What kind of assessment will be made after that?

Roy Brannen: Jo Blewett can say a bit more about this. We are going to do a piece of work this spring to look at hydro nation—the water vision, in effect—and the legislation that we may require, and we will do a little bit of consultation on what is appropriate as we move forward. Things have changed since the original hydro nation drive. We are now much more focused on water as an asset and the impact of climate change, so hydro nation needs a bit of a refresh.

Jo Blewett: We need to take a bit more of a strategic view about where we are collectively going to address some of the challenges and add value. Effectively, we need a business case, and if international work turns out to be one of the areas that we want to continue to focus on, we will need to work with WICS on what that business case is, whether it could be resourced and what the commercial model around it is. A full assessment piece would need to be done there.

Graham Simpson: If the decision was to not continue with the international work, that would affect WICS's headcount quite a bit. Even if the headcount is already being reduced, presumably WICS would not need as many people as it would do if that work was going to continue.

Roy Brannen: I will let David Satti and Mr Hinds consider exactly how much staff resource is going

into it now. There was a very clear objective in the corporate plan that the former CEO had a foreword to; that focus on international activity was strategic objective 3. Outcome 7 was very clear that WICS looked to grow that international activity over the course of the plan.

Whether WICS will need fewer staff is entirely a matter for it, as it looks at its organisational design.

I will say one other thing about international activity, which is very important. As we go through this next period of public sector reform, we need our public bodies to think creatively about revenue generation, cost recovery and any activity that will bring down input cost and increase the outcomes for the nation.

It is not so much that international activity or any activity is at fault. It is the functioning of the governance around the finance control that has failed—governance has fundamentally failed, and it is important to get that point across. WICS is well recognised as a regulator internationally. I mentioned the OECD. Other Governments called on the regulator to give them advice about how to do things well. How you do things within operational costs is the important part that has gone adrift.

David Satti: I would like to come in on that, not least because many in the organisation will be watching this, and I do not want to send the wrong impression, Mr Simpson.

The international part of the organisation was always about managing the workforce. WICS operates over a six-year regulatory cycle, of which some periods are very intense and some are not as intense. My job is to get better planning so that there is not so much ebb and flow. During the first part of the corporate planning period, the organisation exceeded its six-year target as a result of deploying some staff in the international work, and now we are very focused on undertaking a strategic review of charges, on which all the analytical staff are focused, and they are doing a great job. There is no intention to look at headcount. If anything—I made this point earlier—we are looking to recycle some of the savings into known functional gaps so that we are not deploying consultancy expenditure in the way that we have done in the past.

When we look at the international work, after we complete the strategic review of charges, part of that will be asking how we resource it. However, at this time, we are certainly not looking to make any cuts or reductions, because all the staff are needed to undertake the strategic review of Scottish Water charges.

Graham Simpson: The international work has been controversial and its associated spending has sparked controversy, but it earned quite a lot

of money. Correct me if I am wrong, but the figure was about £1 million a year. What was that money used for?

Roy Brannen: I will let David Satti cover the accounts.

David Satti: We had a target for £1.3 million over the regulatory period and that was baked into the overall financial package for our corporate plan. Some of that was used to mitigate the levy increase that we would put on water customers and licensed providers. Over the past six years, we have exceeded the international revenue target and therefore we do not need to have conversations about the levy that we place on licensed providers or Scottish Water. In fact, we have elevated cash balances and we might look at distributing some of that back to licensed providers and Scottish Water over the next couple of years.

When we look at the next corporate planning period and make a decision on international work, we will have to look at whether there will be any income from international consultant activities and whether we will have to look to rebalance the amounts that we take and the amount of levy that we get from Scottish Water and licensed providers. We will do that in the coming years, once we have got through the strategic review of charges.

Ronnie Hinds: It is worth adding that that leaves us with a more than healthy set of reserves in the organisation's accounts, which are, I think, much larger than anybody would expect to see for an organisation such as WICS. We are currently undertaking a review about the best way to treat those reserves, which is what David Satti is referring to.

That also tells you part of the answer to an earlier question, which is that the organisation clearly did not gear up its expenditure to match the income that it was generating, otherwise it would not have a surplus that has fed those reserves. A lot of the workload was carried by staff who were paid to do a day job on regulation. We are unwinding that as we go, and the last part of the jigsaw will be to ask what we do with the reserves that have accumulated because of that period.

Graham Simpson: How much do you have in reserves?

Ronnie Hinds: I think it is about £5 million.

Graham Simpson: That does sound a lot.

Ronnie Hinds: It does.

Graham Simpson: What do you think should happen to it?

Ronnie Hinds: We are undertaking a review, so I do not want to second guess that, but David Satti has already referred to looking at how we are

funded. Income largely comes through the charges that are levied on Scottish Water and other providers, so we would have to look at that among other things in deciding how best to reduce those reserves.

Graham Simpson: Could you not pass it to Scottish Water to help it to cut our bills?

Roy Brannen: That has been done in the past.

Graham Simpson: It has been done. That is a great idea, then.

Ronnie Hinds: It will be part of the review.

Graham Simpson: Scottish Water is about to whack up our bills by nearly 10 per cent, while paying bonuses to executives.

Ronnie Hinds: That is less than anywhere else in the UK, of course, but, yes, 10 per cent is still a lot.

Graham Simpson: That could be done. There you go, Mr Brannen—a good idea for you. You could press for some of that money to come back.

I feel that I ought to ask about the correspondence that we received from the former chief executive, because he made a couple of points that I want to put to you. He says in his written submission that the corporate plan

“allowed for expenditure to develop”

WICS’s

“international footprint”

and that there was

“an agreed allowance for the development of WICS’ international activity.”

Is that the case? I guess that that is a question for the Government.

Roy Brannen: We have no record of an “agreed allowance” or what that refers to. It comes back to the point that I have made on several occasions now: international activity could go ahead, but as accountable officer, you would still need to apply the rules of your role, in terms of value for money. Fundamentally, when you are booking accommodation and flights, that is the element that you need to take account of. We do not recognise that there was an “agreed allowance”. I cannot find any record of that. I do not know whether Kersti Berge or Jo Blewett can.

Kersti Berge: No. It is not clear what that refers to.

Graham Simpson: Okay. He also said that he felt “consistent” and “considerable” pressure to pursue international revenue.

Roy Brannen: Again, I do not recognise that but I will come back to the point I made earlier

about the corporate plan. Objective 3 in the corporate plan was to undertake international activity. The former CEO wrote the foreword to that corporate plan. Outcome 7 explicitly said that there were opportunities for growth in international activity. The corporate plan was set up at the start with the key functions and direction of travel. I am not entirely sure what other pressure there was or where it was coming from.

Graham Simpson: I am going to move on. I want to ask about staff education and training, which is another area that has attracted a good deal of interest. WICS has spent around £300,000 on executive education in the form of masters of business administration. I think that you, Mr Satti, have an MBA that you received during your time at WICS, and others have MBAs as well. We have heard about Ms Ashford who went to Harvard. How many of the staff who went on these programmes remain in the business? Obviously you are one, Mr Satti. Of the people who were either sent abroad or elsewhere in Britain on these management programmes, how many are still in the business?

David Satti: I think that the former CEO in the evidence that he provided made a distinction between the MBAs and executive education courses for senior management. In that context, Mr Simpson, I will answer your question in two parts.

The former CEO referred to two individuals in relation to the MBAs. Only one of those individuals is now in WICS and that is me. The other individual moved roles towards the end of last year for a salary that WICS could not compete with, so now I am the only one who was part of that MBA programme.

The executive education courses were offered to senior members of staff. There are two individuals who took part in them, one of whom you have mentioned.

Graham Simpson: So, were there two people who went on those courses?

David Satti: Two senior managers went on courses at the time, as the former CEO articulated when he presented evidence. There was also one individual who was junior at the time—one of the analysts—who was part of the MBA programme.

Graham Simpson: Okay. Now, I mentioned Ms Ashford and I am not going to go into her case but I understand that she is no longer with the business. I am not asking about the details but am I right that she is not with the business any more?

David Satti: There are on-going HR and legal processes within WICS that we would prefer not to comment on.

12:45

Graham Simpson: That is fine. I am not going to ask you about it.

In these evidence sessions—by the way, I hope that this is our last session with you, and you probably think the same—we have heard about various instances of what I might describe as lavish spending. At the last meeting we asked about the money paid to the KC who was on a retainer. We had a figure of travel and accommodation costs in 2023-24 for this KC of £1,441—it does not sound like a big number, but we asked for a breakdown. We received a breakdown of that from the Auditor General, which was very helpful. Of that, £543 was for two nights' accommodation in Edinburgh in July 2023—that does sound like a lot—and £384 was for return flights from London to Edinburgh, also in July and for the same trip. I would query that. That is a lot. He obviously did not fly on a budget airline or take the train, which would have been cheaper. There is £514 for a meal in London in October 2023 at a restaurant called Smith & Wollensky—the Auditor General has put “Woltensky”—which seems to be a rather high-end steakhouse; that is £541 for three people, which is £177 each. In a previous meeting, I read out a menu with prices. I am not going to do that now, but I have checked the menu and it would be very easy to rack up such a bill at that restaurant. The question we have asked repeatedly is: is this sort of expenditure is appropriate?

Ronnie Hinds: No.

Graham Simpson: Of course it is not. Why did it happen?

Ronnie Hinds: That takes us back to some of the earlier evidence. At the risk of repeating myself, I will say that if you look at the detail of that issue you will find that most of it clusters around the ex-chief executive officer and the way that he sought to fulfil his role in the organisation.

As well as the specifics about the use of a KC, previously a QC, that you are drawing attention to, Mr Simpson, I think that it is worth being clear about the fact that we had a retainer arrangement for that individual for at least six years that we are able to ascertain—possibly for as long as 20 years. From the figures that we can ascertain, over six years, something like £250,000 was spent on the services of a KC, previously a QC, of which roughly £100,000 could be related to some activity of a legitimate nature that had we asked that individual to undertake, which was to give us legal advice, leaving the balance of about £150,000 having been spent on the retainer. I take exception to that as a way of spending public money and I think that that is a pretty poor example. In my view, some of the other questions around meals

and flights and so on are almost ancillary to that. It just demonstrates that there was a culture of saying, “We can have this information, we can have this advice, and we can travel up and down to London to make use of it if we like.” I do not think that that is compatible with the public sector ethos and it is not something that happens now.

Graham Simpson: Good. Well, we agree on that. I am going to finish by asking about the area that Colin Beattie was exploring, which is the fundamental question of why we need an economic regulator. I suppose this is a question for you, Mr Brannen and maybe Mr Hinds. If WICS did not exist, would we notice the difference?

Roy Brannen: The answer is yes, because Scottish Water in a regulated environment is pushed and focused on delivering for the strategic review period: fundamentally, the stretching final determination that WICS sets out is what Scottish Water must deliver over that period. If we did not have WICS then potentially we would not have the impetus to deliver on efficiency saving, reduced taxpayer bills and the improvement of the asset over the period that we are considering. In a regulated market, whether that is rail or water, it is important to be able to push the individual organisations responsible for delivering the service at hand.

Graham Simpson: Before Mr Hinds comes in, I put it to you that WICS is essentially regulating a Scottish Government body and WICS itself is a Scottish Government body. If we got rid of one level of regulation, Scottish Water could perhaps just report to you as the sponsorship team, and you could regulate it.

Roy Brannen: That is exactly the argument that I was trying to make earlier about the distinction of arm's-length bodies. Fundamentally, the gestation of all of that is the 131 public bodies—or at least the 26 of them that I would then look after. That is not how the Government should be running. You set up bodies that are under statute with a clear direction of activity and put the governance structure in around it. To subsume that entirely within Government would be a big mistake.

Kersti Berge: Could I come in on that? Most regulators sit at arm's length from Government; it is quite a technical job so they have to have that expertise and they are also arm's length. For energy, Ofgem is the energy regulator and there will be similar arrangements in other areas. The Competition and Markets Authority is another example, probably.

Ronnie Hinds: I am glad you came back to that Mr Simpson, because I think that Mr Beattie's earlier question was, for me, the right one. Do we need this organisation or not? Well, that is a policy issue; that is the easy answer. If you are looking

for an assessment, which is I think what Mr Beattie was looking for, we could spend all morning talking about that again but I will give you a couple of headlines. We think that we can demonstrate over the 20-year history of WICS as it is currently constituted in its relationship with Scottish Water that there has been a 40 per cent reduction in Scottish Water's operating expenditure in real terms—that is to say it has nothing to do with inflation. That corresponds to roughly £400 million-worth of savings over that longer period. Now, it is always difficult to say with confidence that that would not have happened anyway but what we can say is that the Scottish Water model and the regulation of it is a contributory factor to the efficiency and effectiveness of Scottish Water and that those figures demonstrate quite significant savings to the Scottish public. It takes about £110 off the average household bill, which would be higher if not for what WICS had done.

If you ask about value for money for WICS, we cost roughly £4 million a year—that figure is declining, but that is roughly what we cost. When compared with the figure that I have just quoted about the overall savings because of the regulatory activity, I think that we can make a case for WICS's value for money.

However, there is an awful lot more that would need to be said, particularly in the light of the most recent developments. It is not unreasonable to ask questions about whether an organisation such as WICS is needed when it has not proven its ability to govern its own arrangements satisfactorily. The baby and the bathwater syndrome would be part of my answer; we need to be careful what would be lost without WICS and anything that replaced it would have to be as effective as WICS has been in its regulatory role. That is important for me as we go forward.

I hope that by the time the committee finishes its deliberations and, within WICS, we get a bit further down the road that David Satti and I have been trying to describe, we will be able to put minds at rest not only about the fact that can we continue to regulate Scottish Water and other bodies effectively but that our own costs in doing so are on the decline.

Graham Simpson: Thank you. I will leave it there, convener.

The Convener: I am very conscious of the time but we have two outstanding questions that we want to put to you before we finish—one of them is from the deputy convener. Before we get to that, following on from what we have just been talking about, we were told by the former CEO that there had been discussions—I think that we have alluded to this in previous evidence sessions—about the tension between the regulatory role and the consultancy role and whether there should be

a distinct and separate operation. He mentioned that a name for a separate organisation to cover the consultancy work was discussed at the board on numerous occasions and I think that that name was registered but never activated. Can any of you shed any light on why that never emerged as the way to separate out some of the difficult issues that we have discussed this morning and in previous sessions?

Roy Brannen: I will maybe let Kersti Berge or Jo Blewett come in on that point. To go back to the first point about the tension between the roles, I will quote the corporate plan, which says:

"It should be noted that our involvement in hydro nation work has not been to the detriment of the role we undertake in Scotland. Rather, it provides a number of real benefits that ensures that we are a more effective regulator of Scottish Water."

So, again, there is a bit of a tension between the evidence that you have received and what was stipulated in the corporate plan, where it is very clearly articulated that the two roles could be managed concurrently. Kersti Berge can comment on the specifics.

Kersti Berge: It is not clear to us why that did not happen. That is exactly the kind of thing that we are looking at in the work that we are doing in reviewing hydro nation, and, were WICS to resume the international activity, we would look to it taking exactly that approach.

The Convener: So, do you think that that is the way forward if there is a resurrection of that international consultancy work?

Kersti Berge: We have covered this quite a bit. There need to be two things. One, it needs to align with the cycle of the really important regulatory work that WICS does, and separately there would need to be some form of separation and clear rules around how it does the international consultancy activity.

The Convener: Right. That is slightly at odds with what Mr Brannen said earlier, which is that, in the end, it all must be compliant with the Scottish public finance manual and good governance arrangements, value for money and so on.

Kersti Berge: It would need to do that as well, but there could be some differences and nuances around what was done in some activities compared to others. We have not done the work yet but the expectation would be that it would need to comply with the public finance manuals and to be very transparent. For example, exactly how this would all work would need to be set out in the framework document.

Roy Brannen: You have had a piece of evidence from the public bodies unit on other bodies that are revenue raising. It is entirely

possible to undertake such activity within the confines of the SPFM. What Kersti Berge is describing is if there is something unique about such international activity that requires a different model then that would need to be explored, but I would expect the same principles of the SPFM of accountability and value for money to be applied in whatever structure is put together. You do not disassociate the two things.

The Convener: Okay, thanks. As I mentioned, the deputy convener has a final question. It might invite a yes or no answer.

Jamie Greene: This question is aimed at whoever can best answer it. Did the former chair of WICS leave the organisation of his own accord or was he asked to leave and did he receive any financial settlement as a result of his departure?

Roy Brannen: I will hand over to Michelle Quinn as she was in post when I was absent.

Michelle Quinn (Scottish Government): At no time did we ask that he should leave and he did not receive a settlement agreement. He was only paid for the work that he completed.

Jamie Greene: Okay, so he resigned or he retired. What was the circumstance?

Michelle Quinn: He resigned.

Jamie Greene: He resigned his position.

Michelle Quinn: Yes.

Jamie Greene: And that was accepted and hence the presence of Mr Hinds. Okay; that is understood.

The Convener: Thank you for your forbearance. It has been quite a long session and some of it was quite testing but we very much appreciate your presence here and your willingness to answer the questions that we have put to you. On behalf of the committee, I thank Ronnie Hinds and David Satti from the Water Industry Commission for Scotland, and Michelle Quinn, Kersti Berge, Jo Blewett and director general Roy Brannen from the Scottish Government. As other members of the committee have said, it is good to see you back and thank you all for your evidence this morning. Michelle Quinn even got in just at the end there so I can include her in that vote of thanks. I will now move the meeting into private session.

12:57

Meeting continued in private until 13:11.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000

Textphone: 0800 092 7100

Email: sp.info@parliament.scot



The Scottish Parliament
Pàrlamaid na h-Alba