INTERNAL AUDIT CHARTER

EXECUTIVE OVERVIEW

Our internal audit charter is the guide that guarantees our independence, authority and responsibilities. It gives us the mandate to look at any part of the business, assess risk, and report directly to the Audit & Risk Committee, ensuring we can provide honest, unbiased assurance that the company is protecting its assets and operating effectively.

1. GENERAL

1.1 The Internal Audit Charter is a formal document that defines Internal Audit's purpose, authority and responsibility (the Internal Audit mandate). The Charter establishes Internal Audit's position within the Scottish Water Group and defines the scope of Internal Audit activities. Approval of the Internal Audit Charter rests with the Audit & Risk Committee (A&RC) and will be sought on an annual basis.

1.2 The primary purpose of Scottish Water's Internal Audit Team is to provide independent, objective assurance and trusted insight on the effectiveness of risk management, governance and internal control processes, thereby adding value and supporting the achievement of Scottish Water Group's objectives. Internal Audit helps the Scottish Water Group accomplish its objectives, by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of control, risk management and governance processes.

1.3 Internal Audit activities will be performed in compliance with the Public Sector Internal Audit Standards (PSIAS), which are based on the Global Internal Audit Standards and general auditing standards. This Charter recognises the mandatory nature of the 'Definition of Internal Auditing', the 'Code of Ethics' and the 'Standards' defined in the standards.

1.4 Internal Audit, as part of the 3rd line, is responsible, to the A&RC, for providing assurance that significant strategic, financial, operational, and compliance risks are effectively controlled by management. It is a review activity which does not in any way relieve management of their responsibility for establishing and maintaining effective control.

2. AUTHORITY

2.1 There are no restrictions placed on the scope of Internal Audit's work. For the purpose of its work, Internal Audit has unrestricted access at all reasonable times to all the records, personnel, property, operations and activities of the Scottish Water Group, including those maintained on its behalf by Third-Party Service Providers (where relevant).

2.2 All employees (including Directors, contingent workers and contractors) working for or on behalf of the Scottish Water Group are required to assist Internal Audit in fulfilling its roles and responsibilities. No employee has the authority to supress, delay or unduly interfere with the publication of any Internal Audit Reports, including those to the ELT and A&RC.

2.3 Internal Audit report to the Scottish Water A&RC, with line management provided by the Scottish Water Chief Financial Officer. To ensure that Internal Audit activities are free from interference in determining the scope of internal audits, performing work and communicating results, the Head of Internal Audit has a right of direct access to the A&RC Chair, the Board Chair and the Chief Executive. The Head of Internal Audit will exercise these rights of access in an appropriate manner.

2.4 Both the Chief Financial Officer and the Chair of the A&RC will have a role in the Head of Internal Audit's annual performance appraisal. The appraisal should consider the independence, objectivity and tenure of the Head of Internal Audit. Where their tenure exceeds 7 years, this will include an assessment of their continuing independence and objectivity.

2.5 To establish, maintain, and assure that Internal Audit has sufficient authority to fulfil its duties, the A&RC will:

- Approve the Internal Audit Charter;
- Approve the risk based Internal Audit Strategic and Annual Audit Plans;
- Receive communications from the Head of Internal Audit on the department's performance, relative to its plan and other matters;
- Approve decisions regarding the appointment and removal of the Head of Internal Audit;
- Make appropriate enquiries of management and the Head of Internal Audit, to determine whether there is inappropriate scope or resource limitations; and
- Hold an annual private meeting with the Head of Internal Audit.

2.6 The A&RC reviews the scope and nature of the work of Internal Audit. It receives reports at each meeting, setting out Internal Audit progress in delivery of the Internal Audit plan approved by the A&RC and the executive summary of individual audit reports, including an independent assessment of controls in each area reviewed and details of the issues identified, together with the actions agreed with management.

3. INDEPENDENCE

3.1 Internal Audit does not perform operational tasks, as this would impair its objectivity and neither has it any direct responsibility for, nor authority over, the business activities it reviews. The independence of Internal Audit is assured by its reporting lines.

3.2 The Head of Internal Audit and Internal Audit employees are required to comply with Scottish Water's Code of Ethical Conduct, and all other corporate policies and regulations of their respective professional bodies. This includes conformance with the Global Internal Audit Standards principles of Ethics and Professionalism: integrity; objectivity; competency; due professional care; and confidentiality.

3.3 For the purposes of this Charter, the role of the Board is delegated to the A&RC, which is the Board sub-committee charged with responsibility for approving the Internal Audit Plan and receiving the findings of Internal Audit work. Where necessary, the A&RC will escalate the findings from Internal Audit reports to the Board.

4. PLANNING AND REPORTING

4.1 The Head of Internal Audit is responsible for developing the Internal Audit Strategic and Annual Audit Plans, by reference to the business process audit universe and on the basis of risks identified by the business risk assessment process (including stress testing completed to support the viability statement and highest scored risks in

Corporate Risk Register), previous audit findings, experience and changes in the underlying systems of internal control.

4.2 The Audit Plans, and the resources to deliver these, are subject to annual approval by the A&RC. Any significant changes to the Annual Audit Plan required during the year, are reported to the A&RC at the earliest opportunity, for their consideration and approval. Also, progress in delivery of the Audit Plan will be regularly reported to the A&RC during the year.

4.3 The Strategic Internal Audit Plan will be prepared with input from management. It will be risk based and will have regard to the business plans, strategic direction and vision of the Scottish Water Group as a whole. The Annual Internal Audit Plan will then be developed with reference to the Strategic Internal Audit plan.

4.4 Internal Audit will report the findings of its work, including opportunities for improving the efficiency of control, risk management and governance processes, by means of reports to the appropriate operational management, the Chief Executive, the Chief Financial Officer, members of the ELT and the A&RC. All reports will be copied to the External Auditors.

5. RESOURCES

5.1 Internal Audit work is delivered by an in-house team. When required, this is supplemented by additional resources from the business, secondments and external specialist firms. Any external resources engaged will be required to comply with the principles of this Charter.

5.2 The Head of Internal Audit is required to have a professional accountancy and/or internal audit qualification and appropriate experience. Internal Audit Team members are also required to have appropriate qualifications and/or experience.

5.3 All professionally qualified staff are required, as per the relevant professional body, to comply with Continued Professional Development (CPD) requirements, to ensure they maintain and enhance their knowledge, skills and audit competencies.

5.4 The Head of Internal Audit also coordinates activities, where possible, and considers relying upon the work of other internal and external assurance and consulting service providers, as needed.

5.5 Internal Audit may perform advisory (Trusted Advisor) activities, the nature and scope of which will be agreed with management, provided Internal Audit does not assume management responsibility, there is no potential conflict of interest, and independence and objectivity are not compromised.

6. RESPONSIBILITIES

6.1 In all contacts, Internal Audit staff and employees will treat each other with respect, courtesy, politeness and professionalism. Any confidential or sensitive issues raised with or reported to Internal Audit, will be dealt with in an appropriate manner.

6.2 It is management's responsibility to determine and maintain the system of internal controls. The internal control system comprises the whole network of systems established in Scottish Water to provide reasonable assurance that business objectives will be achieved. Also, management has primary responsibility for resolving all issues reported by Internal Audit, in the manner and within the timescales agreed, in Internal Audit reports.

6.3 Internal Auditors must exercise professional scepticism when planning and performing internal audits and will, in the undertaking of individual audits, provide assurance, and draw attention to any deficiencies, inefficiencies and potential reputational risks, to the A&RC and management that:

- Internal control systems (including computer systems), risk management and governance processes are adequate and functioning efficiently and effectively;
- Corporate assets are being safeguarded;
- Policies and procedures established by management are complied with, are appropriate in current circumstances and are not wasteful; and
- Information furnished to management in connection with the decision-making process is reliable.

6.4 Internal Audit will, through effective followup procedures, monitor and report progress in implementation of all actions agreed during audits to the A&RC and management.

6.5 In addition, Internal Audit will:

- Provide an annual opinion and report, including an opinion on the overall adequacy and effectiveness of control, risk management and governance processes;
- Complete fraud related investigations, as required, in compliance with its responsibilities defined in the Fraud Management and Response Policy;
- Be the primary recipient of all reports from the external whistleblowing line;
- Provide advice, guidance and assistance, relating to controls, risk management and governance, sometimes through specific reviews or involvement in projects, as requested by the A&RC or management;
- Have membership of and provide support in the activities of the Counter Fraud Group;
- Support Scottish Water participation in the National Fraud Initiative run by Audit Scotland, including investigation of reported matches; and
- Ensure trends, emerging issues and common audit themes that could impact Scottish Water, are considered and communicated to management and the A&RC, as appropriate.

6.6 Internal Audit staff will treat as confidential and appropriately label and store, all information obtained in carrying out their duties. Internal Audit will not disclose any information held, unless there is a business need, it is appropriately authorised or there is a legal or professional requirement to do so.

7. QUALITY ASSURANCE AND IMPROVEMENT PROGRAMME

7.1 Internal Audit will maintain a quality assurance and improvement programme, that covers all aspects of the Internal Audit department. The programme will include an evaluation of Internal Audit's conformance with the PSIAS and an evaluation of whether Internal Auditors apply the Code of Ethics. The programme will also assess the efficiency and effectiveness of Internal Audit and identify opportunities for improvement.

7.2 The Head of Internal Audit will communicate to senior management and the A&RC on Internal Audit's quality assurance and improvement programme, including results of internal assessments and external assessments, conducted at least once every five years, by an external qualified, independent assessor or assessment team.

8. OPERATING FRAMEWORK

8.1 All Internal Audit reviews are completed in accordance with the approach and standards defined within the Scottish Water Group Internal Audit Manual. Further details are included in Appendix 1.

8.2 Internal Audit will maintain close working relationships with the External Auditors, including sharing of the Annual Audit Plan, in order to compliment the work of each other and to avoid any unnecessary duplication of work.

9. KEY PERFORMANCE INDICATORS

9.1 To assist the A&RC in assessing the performance of Internal Audit, a set of Key Performance Indicators (KPI's) have been defined and were previously approved by the A&RC. Performance against these KPI's is included in the Quarterly Internal Audit reports and/or the Annual Internal Audit report tabled at the A&RC. Details of the KPI's and targets are included in Appendix 2.

APPENDIX 1 – GROUP INTERNAL AUDIT MANUAL

The Internal Audit Manual contents are as follows:

APPENDIX 2 – INTERNAL AUDIT KPI's

KPI Area		Measure	Target
Plan delivery and coverage	(i)	Delivery of the Internal Audit Plan, measured as the proportion of planned audit reviews completed during the year, taking account of constraints on management availability, competing organisational priorities or emerging risks requiring reprioritisation	100%
	(ii)	Percentage of high/critical organisational risks or key processes (e.g. water quality, health & safety, procurement) audited at least once in a rolling 2–3 year period	90% +
	(iii)	Percentage of audits delivered on or before agreed planned completion date	90% +
Quality	(i)	Results of internal/external quality assessments or self-assessment against Global Internal Audit Standards and public sector IA guidance assessment against Global Internal Audit Standards and public sector IA guidance	No major issues / gaps
Findings and remediation	(i)	Initial follow up of management agreed actions within two weeks of due date.	100%
	(ii)	Enhanced reporting on repeat findings, indicating whether control weaknesses in high risk / key areas like asset management, water, waste water or regulatory compliance are truly resolved	Two reports per year
Stakeholder value, engagement and impact	(i)	Stakeholder satisfaction score from Audit & Risk Committee members and senior management, using a short survey bi-annually	No major issues

	(ii)	Control improvements highlighting opportunities for cost savings and efficiency gains (e.g. cost savings, avoided losses, efficiency gains) as well as significant control gaps	50% of reports
	(iii)	Number of management requests for internal audit involvement in projects or advisory work completed	Five per year
	(iv)	Quarterly meetings with the Risk Management Team and summary reports for major findings and control deficiencies to be discussed	Four per year
Efficiency and people	(i)	Overall productive time as a percentage of available time (e.g. not administration)	90%+
	(ii)	Percentage of auditors with relevant professional qualifications and minimum annual training hours *(note: the KPI allows for internal development of SW employees and involvement with the Graduate Programme)*	70%+
Safety, Health & Wellbeing (SH&W)	(i)	Completion of office-based staff SH&W training	100%
	(ii)	Reporting all near misses / incidents observed during site and office visits	100%