



**Scottish  
Water**  
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18 April 2023

Mr Alan Sutherland  
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Water Industry Commission for Scotland

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*Emailed to: [Alan.Sutherland@watercommission.co.uk](mailto:Alan.Sutherland@watercommission.co.uk)*

Dear Alan

## **REPORTING QUALITY AND COMPLETENESS IMPROVEMENT PLAN**

I refer to your letter of 21 March setting out principles in respect of Scottish Water's ownership of strategy and investment decisions, and our responsibility to report on decisions, progress, achievements and lessons learned, which we all agreed in the context of the change to a more dynamic approach to investment planning for this regulatory period.

Your letter of 21 March follows your previous one of 13 December, which Simon Parsons responded to as he will be responsible for the Annual Return submission after I leave Scottish Water on 31 May. Simon's response endeavoured to address the questions and concerns raised in your December letter and, in doing so, he shared two draft versions with you:

- A first draft of our response on 31 January, on which you helpfully provided feedback.
- Following submission of a second draft to you on 10 February, seeking any further feedback, Simon issued the final version of the letter on 13 February.

As Simon had shared two draft versions of his response to your 13 December letter, I was surprised to read of some of the concerns and questions raised in your 21 March letter. Nevertheless, I have endeavoured to draw together my understanding of the position in respect of various matters raised by you, in the context of our mutual recognition that achieving the best outcomes in the move to this new regulatory approach requires significant learning and adjustment for Scottish Water and its regulators.

### **Reporting quality and completeness**

In our draft letter of 31 January, and the final version on 13 February, we set out the outcomes that we are working to deliver for this year's Annual Return (AR23), with our partners EY and Binnies, these being:

- A regulatory reporting team that can provide business-led economic perspectives on performance with the bandwidth to meet reporting quality standards.
- Improved reporting processes, definitions and controls with effective change management that significantly reduces errors.
- A leadership team that has a greater understanding of how WICS use the information within the Annual Return.

The activities to deliver these outcomes are set out in appendix A.

I am aware that you are now meeting [REDACTED] and [REDACTED] from EY regularly to discuss progress. Simon will be arranging a session with you and the EY team to cover the improvements planned, set out in appendix A, and how we are putting these in place ahead of AR23.

Since Simon wrote to you, we have recruited [REDACTED] as General Manager Economic Regulation. [REDACTED] will join us by 4 July from the Competition and Markets Authority where [REDACTED] is currently Director of Remedies, Business and Business Analysis. [REDACTED] has an extensive economics, financial and regulatory background and we will arrange for you to meet [REDACTED] in the near future.

### **Visibility of future investment needs**

I understand that presentations were made on the revised investment planning scenario to the Investment Planning and Prioritisation Working Group (IPPGWG) on 15 February and the Investment Planning and Prioritisation Group (IPPG) on 15 March. Given these, and what I understood was positive feedback from your team at the IPPGWG, I was surprised by your comment that you are no further forward in understanding the investment that will be delivered over the 2021–27 period. I have therefore set out below the various steps that we have taken to support stakeholders' understanding of our future investment plans, while recognising that our reporting will continue to refine and improve over the regulatory period.

#### Investment planning and prioritisation framework

During the preparations and planning for the 2021-27 period, the key water industry stakeholders agreed that our investment programme would no longer be fixed at the start of the period, but would build over time, allowing stakeholders to be involved in the dynamic process as reflected in the co-created Investment Planning and Prioritisation Framework<sup>1</sup>.

This framework requires Scottish Water to:

- seek approval from IPPG and Scottish Ministers for any additions ('Needs') to the 'Development List'.
- update IPPG on any changes that have been made to the Development List throughout the year.
- update IPPG on the progress of Needs from the Development List to the 'Committed List' where we set out details of the proposed intervention, timescale and cost of meeting agreed Development List Needs.
- provide a revised forecast of the types of activities Scottish Water expects to address over the rest of the regulatory period.

While we have endeavoured to meet these requirements to IPPG (alongside our first annual update on progress towards the Ministerial Objectives<sup>2</sup>), our reporting to IPPG and individual regulators will evolve and improve during this regulatory period as we seek to provide the most relevant information for each stakeholder's requirements.

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<sup>1</sup> <https://www.gov.scot/publications/water-industry-governance-note-2021-2027/>.

<sup>2</sup> IPPGWG Paper 14/02

## Investment plan

Following extensive discussions and agreement with Scottish Ministers about charge setting for 2023/24, it is inevitable that the revenue available in 2021-27 will be around £0.5bn<sup>3</sup> lower than expected under the Final Determination, with consequences for the finance available for investment. The background to this, and related exchange of correspondence with the Scottish Government, was set out in my 22 December letter to you in respect of the 2023/24 scheme of charges.

In light of the reduced finance available for investment in 2021-27, we provided a revised Investment Planning Scenario (IPS23) to the IPPGWG on 15 February and, following feedback, an updated version to IPPG on 15 March<sup>4</sup>. IPS23 sets out the investment priorities, how they were made, and the implications of the choices on delivery of Ministerial Objectives in the 2021–27 period. As this is a dynamic process, we will continue to update this investment planning scenario annually.

In terms of investment to be delivered over the 2021–27 period, we have also provided the latest update (Q3, 2022/23) to the Committed List which provided details of projects and programmes with a total value of £1,528m<sup>5</sup>. This included details of the projects and programmes we are committed to delivering, by when, and the associated forecast costs; including much greater reporting of planned asset replacement investment than in previous regulatory periods.

However, despite providing the above information, it is clear from extensive discussions with you and your team that you had expected to receive additional information for this regulatory period together with similar information as provided in previous regulatory periods. We are therefore working towards providing greater investment programme transparency and insight, while doing so in a manner consistent with the nature of the agreed IPPF process.

To help stakeholders with investment monitoring, we provided a set of supporting tables to IPPG and we are now working with your team to incorporate these tables into Table G of our Annual Return at the desired level of granular transparency to allow progress against the revised IPS to be monitored. These tables will be included in our AR23 submission on 30 June. This is a significant step towards greater investment programme transparency than (1) in previous regulatory periods and (2) we had envisaged at the start of this regulatory period. Nevertheless, we recognise this is an appropriate development in the context of ethical based regulation and practice and an important learning from the first two years of the new regulatory approach.

## Transformation and CSOs

I was surprised by your comment in relation to transformation and CSOs displacing the allowed for investment underpinning the Final Determination. The Final Determination contained a high-level expectation for overall investment and an implied expectation for that associated with planned investment and responsive repair and refurbishment: £3.5bn for planned investment through the IPPF process and £1bn for responsive repair and refurbishment.

While the Final Determination contained only a high-level expectation for overall investment, IPS23 sets out our intention to invest in asset replacement at a level consistent with your earlier SR21 Decision Papers. In terms of asset enhancement, the IPPF envisages that investment choices would be determined, and the Final Determination investment allowance deployed, on

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<sup>3</sup> All financial figures expressed are in 2017/18 prices.

<sup>4</sup> IPPG 15/23-02.

<sup>5</sup> £1,840m in forecast outturn prices as reported in the Q3 IPPG Transfers to the Committed List Paper.

a rolling basis and in line with Ministers Objectives and agreed Needs through a prioritisation process. Turning to your specific questions on transformation and CSOs:

- In-line with our Strategic Plan commitment, and your Final Determination expectation, we promoted a Need for a Transformation Plan through IPPF. This Need, following approval by Ministers, was added to the Development List, enabling the financing of the associated investment. The programme to deliver this Need is extensive and will provide significant benefits to customers over the next decade through: higher quality service; greater insight, agility and pace in resolving and improving issues; lower costs; and lower carbon. We are currently forecasting that the Transformation Programme will provide a net benefit across the 2021-2027 period although many of the projects that will deliver these benefits are still at an early stage of maturity. We will continue to provide updates to you and your team as the Transformation progresses.
- While the need to invest in additional CSOs as part of our Urban Water Routemap was identified after the start of the 2021-27 period, this was another agreed Need, determined in conjunction with SEPA, added to the Development List following Ministerial approval, and announced by the now Cabinet Secretary for Net Zero and Just Transition, Màiri McAllan, to the Scottish Parliament on 22 December 2021.

### **Progressing the high-level asset replacement work**

We understand the need for WICS to be updated on asset replacement investment. In addition to the updates through the Annual Return, we plan to provide an update in summer 2023 on our analysis of the annual average replacement value for Category 2 assets that informed your 2019 decision paper.

This work is a build from the long-term sustainable asset replacement project led by your team and Oxera, and including Northumbrian Water, Sydney Water and Watercare (NZ), which paused some months ago. We continue to work with Northumbrian Water, and more recently United Utilities, to share information and thinking on asset health index methodologies and standard asset categories.

Work on improving our asset replacement projections has been ongoing with workstreams underway to develop and improve the quality of our asset replacement forecasts, with input from [REDACTED], as part of our Strategic Investment Planning activity within our Sustainable Investment Decision Making (SIDM) transformation programme. While this work is ongoing and necessarily long-term, we are currently arranging sessions with your team to share progress.

### **Management Approaches**

The investment planning Management Approaches that we introduced for 2021-27 are a significant development, enabling a more rigorous and consistent approach to investment decision making; aligned to our statutory duties, Ministers Objectives, and our risk appetite.

As a relatively new development, we will continually improve the underpinning data supporting our Management Approaches including inspection surveys, analytical modelling and costing to inform the revision process. As part of our SIDM programme, we will be working with [REDACTED] to improve how we appraise the choices within the 'asset' Management Approaches. This work will be undertaken over the next year and applied to a selection of the existing Management Approaches.

While the granularity of the current Management Approaches enables our teams to make well informed investment decisions, we recognise that reporting on them to you should be rationalised to allow review and analysis against long-term investment projections. As discussed with two of your Directors on 30 March, we plan to further develop the rationalised building blocks after the AR23 process has been completed.

A completed AR23 return will provide a better basis to consider the collective view of the particular tables and level of granularity that are most meaningful for both of us. We are committed to this activity and hope that a joint working approach to reaching agreement will be most productive.

### **WICS immediate priorities**

I understand that you discussed issues covering core and non-core services, the associated accounting treatments and transparency of cost allocations and transfer pricing at a meeting with [REDACTED] on 22 March. From that discussion, I understand your concerns in this area relate primarily to the future challenges for provision of non-core services and how Scottish Water can maintain/grow non-core business within a challenging environment for public finances. These are matters that the Scottish Water Board will continue to pursue with the Scottish Government to ensure that we can finance and exploit appropriate future opportunities.

With regard to current reporting activity, and following [REDACTED] meeting with you on 18 January, [REDACTED] wrote to you on 31 January regarding options to enhance information flows and encourage increased joint working to improve reporting coverage. At the meeting with your representatives and members of [REDACTED] team on 8 February, the accounting treatment of costs as operating or capital expenditure was discussed, and our requirement to comply with the appropriate accounting standards with regard to the capitalisation of costs. At that meeting, it was agreed to follow-up specific issues at a future session with your team, including a walkthrough of our approach to capturing and charging costs to projects and capital investment but, unfortunately, the follow-up meeting on 23 February was postponed.

### **How the priorities relate to the methodology for the Strategic Review of Charges 2027**

Thank you for sharing your timetable for the methodology and guidance for SRC27. Thank you also for providing early sight of the strategic questions you are considering as part of your planning for SRC27 at our meeting on 1 February. [REDACTED] and [REDACTED] found the subsequent conversations with your team on these questions to be a useful stimulus as part of their strategy development work. They will build on these questions as we lay out our evidence for the strategic choices Scottish Water will need to make when considering the progress we will make towards the Water Sector Vision over the coming regulatory period. This will set the strategic context for the next SRC27 submission. It may be helpful for us to produce a series of "thought papers" for discussion over the coming months on these topics.

I hope this update addresses the concerns that you believe had not been previously addressed.

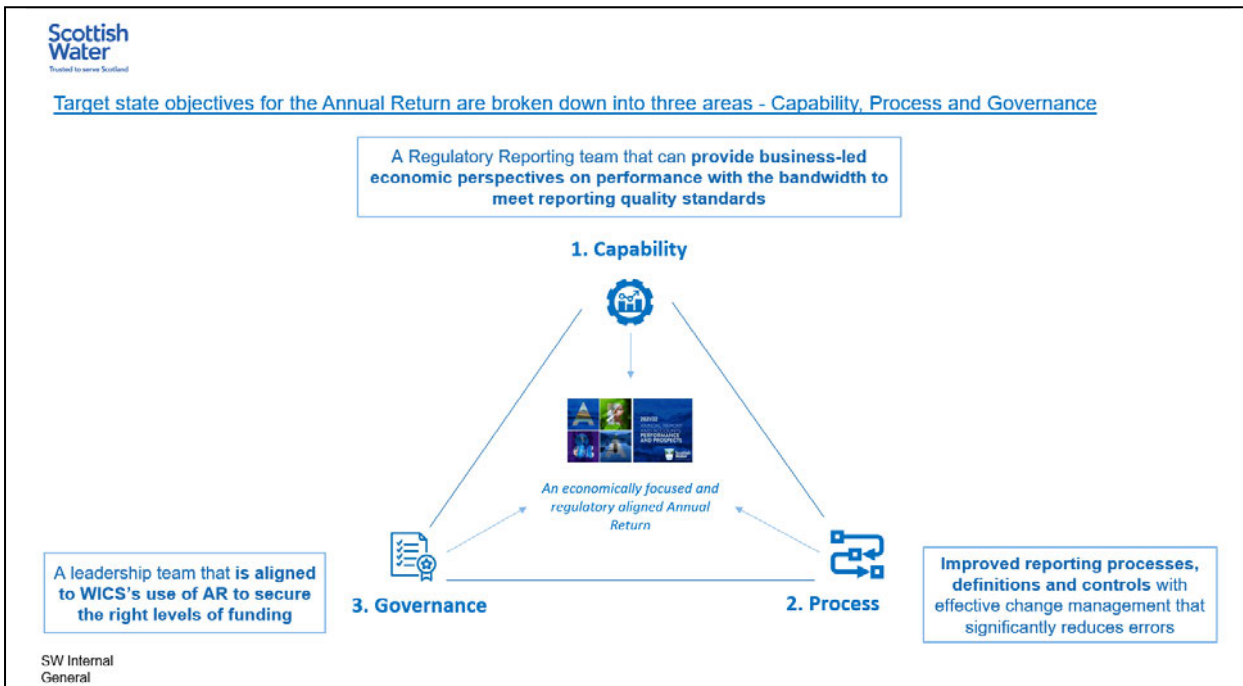
Yours sincerely



**Douglas Millican**  
Chief Executive

Cc: Jon Rathjen

AR23 Improvement Plan



**Capability**  
A Regulatory Reporting team that can provide business-led economic perspectives on performance with the bandwidth to meet reporting quality standards

**Capability Enhancements in preparation for AR23**

- Deployed enlarged team to support delivery of AR23
- Clearer communication on purpose of the annual return and stronger engagement from the business
- Economically aligned commentary through provision of draft templates and additional guidance
- Provision of toolset to improve data quality, consistency and controls and enhanced analysis
- Strengthened engagement with the ELT and commitment to the additional commentary requirements
- Consolidated data set and model to enhance consistency
- Greater management understanding of the criticality of the AR through a joint SW and WICS leadership Summit

**Enduring Capability Enhancements**

- Long term staffing of new GM, Regulation and Reporting Lead and additional Reporting team members
- Enhanced use of digital tools to automate data collection, develop data controls and improve data analysis for the Annual Return and other key SW reports
- Data driven culture, building accountable data literate teams where good quality data enables better decision making
- AR improvements implementation plan post AR23
- Tailored dashboards to improve engagement and decision making
- Improved open access to data and reports, self-service by default

Example 1: AR23 cross table consistency checks

Example 2: Self service Trend Analysis tool

Example 3: SW on demand analytics

Example 4: Category analysis over time

SW Internal General

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## Process

Improved reporting processes, definitions and controls with effective change management that significantly reduces errors

### Process Enhancements in preparation for AR23

- Additional functional table focussed support
- Dashboards to monitor progress and completeness
- Implementation of more robust, continuous quality control processes
- WICS requirements managed, reviewed and agreed through formal change control process
- Early engagement from the Reporter to add economic perspective to commentaries and provide ongoing critical review
- Additional sign-offs implemented for business sign-off on commentaries

### Enduring Process Enhancements

- Underlying systems and processes established for quality and change management which form the new baseline on which to build in future years
- Increased trust between WICS and SW that underlying processes are robust through ongoing review and transparency
- Post AR23 implementation of prioritised list of process improvements and data quality enhancements
- Comprehensive reporting redesign delivering efficiency and consistency
- Data requesting workflow process for data publishing both internally and externally

Example 1: AR23 Change control Process

Example 2: Change Impact Assessment

Example 3: Change control process flow

Example 4: AR23 QA guidance

Example 5: detailed QA requirements

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## Governance

A leadership team that is aligned to WICS's use of AR to secure the right levels of funding

### Governance Enhancements in preparation for AR23

- Improved engagement from ELT and leadership commitments to the quality of AR23 content
- Summit being scheduled between SW leadership team and WICS to drive better alignment on purpose and value of the annual return
- Documentation to enable cascade of summit output and commitments made
- Governance process and responsibility trackers enhanced and implemented

### Enduring Governance Enhancements

- Improved risk and issue management processes
- Further transparency between SW and WICS
- Earlier engagement in the reporting year to agree proposed changes or updates
- Review and update of SW methodologies in partnership with WICS
- Meeting effectiveness guidance documentation
- Investment reporting suite of dashboards to improve governance
- New or updated Scottish Water data policies supporting open data sharing
- Digitised app for automating the data requesting workflow process

Example 1: SW RAID log

Example 2: WICS reporting line level responsibility tracker

Example 3: SW Governance process AR23

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