

**Minutes of the 146th Board meeting of the Water Industry Commission for
Scotland
on 10 August 2022**

Present: Donald MacRae (Chair)
Alan Sutherland (Chief Executive)
Jo Armstrong (Member)
Robin McGill (Member)

In attendance: Michelle Ashford (Chief Operating Officer)
Colin McNaughton (Director of Analysis)
David Satti (Director of Strategy and Governance)
Donna Very (Director of Corporate and International Affairs)

Chair's opening remarks

The Chair opened the 146th meeting of the WICS Board and welcomed Board members.

1. Apologies for absence

There were apologies from Ann Allen (Member).

2. Minutes of the last meeting and regular updates

MIN 03/22

2.1 Declaration of conflicts of interest in relation to the agenda

No members declared any conflict of interest in relation to the agenda.

2.2 Minutes of the 145th meeting

The Board **approved** the minutes of the 145th meeting.

The Board requested that the office circulate the note of the Commission Board update meeting alongside the minute of each formal Board meeting and that the key points are recorded in the next formal Board meeting. This will help ensure that all the relevant points are captured appropriately and that there is an audit trail of the key decisions taken by the Board outside of formal Board meetings.

The Board held an update meeting on 7 July and requested that the following key points of discussion be noted in the minute of this meeting:

- More candour and transparency is required of Scottish Water on the performance of the organisation and the challenges it faces if it is to live up to the principles of EBP.
- The office is reviewing the detail of Scottish Water's Performance and Prospects and will raise questions on areas requiring further clarity and explanation. We will publish an analysis of Scottish Water's performance towards the end of the year following our review of the Annual Return submission and in light of the questions answered on the Performance and Prospects report.
- The Board approved a project to provide further support to Department of Internal Affairs (DIA) in New Zealand. This approval is subject to the following points and final contract review:
 - Appropriate advice and assurance to be sought on tax liabilities including VAT
 - Consideration of the options available to mitigate exchange rate risk; and
 - Advice to be sought on fixed-term employment contracts if analytical staff are to be employed directly by WICS.

2.3 Summary of action points

AP 05/22

The Board **noted** the summary of actions. The following points were arising:

- **Action 1:** The Chair will continue to attend future IPPG meetings.
- **Action 2:** The Chief Executive explained that we have suspended governance code arrangements to allow a robust review of Business Stream to take place. The suspension of the governance code was conditional on WICS having sight of the EY report. The Board requested that this action remains until such time we have been issued with the EY Business Stream report.
- **Action 3:** Closed. An update was provided to the Audit and Risk Committee in May and an information paper is available for Board Members.

2.4 Non-Executive Members Update

The Chair attended a recent Bank of England (BoE) briefing. He explained BoE expect the 2% inflation to return by quarter 3 2024.

The Board discussed the likely level of inflation in the short and medium term and agreed that higher costs will persist for a longer period of time. This will have a significant impact both for the WICS office and for Scottish Water.

Jo Armstrong signalled there is a significant issue with long-term sick and individuals choosing to leave the labour market.

The Chair noted a report from University of Greenwich on the water industry in England and Wales. It outlines historic levels of investment relative to price increases and shareholder dividends. The report found that Scottish Water has invested more per household in infrastructure since 2002 than privatised equivalents.

The Board also noted the ongoing focus on leakage particularly due to the hosepipe bans being experienced in England.

3. Strategic discussion

3.1 IPPF

The Chief Executive explained the historic approach for investment planning and prioritisation, the limitations of this approach and the new framework that was envisaged for SRC21.

The traditional approach to capital investment relied on a clearly defined list of projects for delivery – a ‘technical expression’ – before entering the regulatory period. The Scottish Government led the ‘quality and standards’ process which prioritised the needs underpinning this detailed list.

This approach provided a high degree of visibility on the investment programme, which enabled WICS and other stakeholders to maintain a good overview of Scottish Water’s investment performance. However, this approach offered little flexibility and placed a great deal of emphasis on short-term needs.

For SRC21, it became clear that meeting the dual challenges of asset sustainability and achieving net zero emissions required Scottish Water to think and act much more innovatively and over a longer time horizon. This could not easily be delivered through a pre-determined list of fixed projects within a set regulatory control period.

The investment planning and prioritisation approach envisaged for SRC21 sought to remove any regulatory barriers and was designed to allow Scottish Water to achieve these longer term goals. Scottish Water was expected to prioritise investment based on the relative urgency and importance of a dynamic universe of needs. As priorities are identified, all options would be appraised and added to a committed list for delivery when the best long term option was identified. This confirmed list would identify what will be delivered and by when. This would be shorter than a technical expression but complimented by a much more extensive list of what could be delivered and by when.

The expectation was that Scottish Water would use the Investment Planning and Prioritisation Group (IPPG) to discuss the urgency and importance of needs and assess whether it was still on track to deliver longer-term deliverables and ultimately the industry vision.

The Board **discussed** and the following observations were made:

- For the IPPG to operate in the way it was envisaged for SRC21, Scottish Water need to provide a greater level of analysis and candour on the needs and opportunities that it sees.
- This lack of information has meant that Scottish Water has been unable to articulate the real priorities and challenges it faces to stakeholders, customers and communities. This was the reason the Board agreed to the comprehensive information request earlier in the year.
- The consequences of not progressing a particular need or project in terms of outcomes or service levels is required in order to communicate the implications of each investment decision on both current and future customers.
- Investment planning and prioritisation can only be successful where a full universe of needs is in place. There is always the risk that urgent issues are tackled at the expense of

important longer term issues. If the urgent is prioritised in isolation, there could be a potential burden on future customers.

- The way in which Scottish Water approaches investment appraisals risks limiting strategic or innovative solutions which is critical if long term assets replacement and net zero are to be delivered in an economically optimal and robust way.

The Board **agreed** that WICS would have to see an effective investment planning and prioritisation in operation during this regulatory period if it were to continue with its current regulatory approach. Clear visibility of investment needs and priorities is an important prerequisite for this.

WICS will issue a further letter to Scottish Water confirming and clarifying our expectations in this area in advance of us preparing our methodology for SRC27.

The Board also **requested** that the office update its timeline for the next Strategic Review of Charges and overlay the input that the is required of the Board and the ARC. This will help inform both the nature and frequency of meetings for the coming years.

4. Business update

4.1 CEO update

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The Chair asked Members to indicate any areas they would like to discuss or seek further clarification on. The Board made the following observations on the content of the CEO report:

Risk

Robin McGill explained the Audit and Risk Committee has found that risk management processes are working well and as intended. There is some further work to consider ways in which we may reduce the impact of some identified risks.

The Board thanked the office for its work on improving its risk management approach.

Scottish Water

The Director of Strategy and Governance updated the Board on our progress reviewing Scottish Water's Performance and Prospects document. Questions will be shared with the Board.

International

The Director of Corporate and International Affairs updated the Board on our recent international work in New Zealand. The project to support DIA is still in its preparatory stages and it is expected that the contract will be signed in the coming weeks.

On 9 August, the Chief Executive gave evidence to New Zealand's Finance and Expenditure Committee and answered questions on Three Waters Reform and WICS' analysis for DIA.

The Board queried progress on seeking the required assurances around tax in relation to our work in New Zealand. The Director of Corporate and International Affairs confirmed that Grant Thornton is currently carrying out a review of our tax liabilities including VAT. This review also will inform final arrangements for New Zealand staff employment arrangements.

Finance

The Director of Strategy and Governance provided an overview of financial results. The only variance to note relates to remuneration savings.

The Board congratulated the office on its financial results but recognised issues around rising inflation and the impact this will have on public sector pay. It will likely become increasingly difficult to keep up with private sector pay and benefits meaning we and others in the public sector may experience recruitment and retention issues. Our international income will become increasingly more important if we are to retain staff.

ARC update

Robin McGill provided an update on the Audit and Risk Committee (ARC) held on 10 August:

- The audit plan for the year has now been signed off and approved by the ARC.
- The Business Continuity Plan has been approved. However, some further queries have been asked in relation to supporting information included within the detailed appendices.
- There was a point of discussion around maintaining a robust audit trail of decision making and important discussions between WICS and Scottish Water.
- WICS's expenses policy is currently under review as current allowances are no longer fit for purpose. However, it is important to ensure there is temporary flexibility on current allowances to allow staff to travel to carry out WICS business.

Robin McGill also highlighted that there will be two ARC Member renewals at the end of this year. He agreed to provide a recommendation to the Board regarding the most appropriate membership of ARC moving forward.

Meeting close

The Chair thanked Board Members and the team for their contributions and brought the meeting to a close.

Date of next update meeting: 8 September 2022