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Trusted to serve Scotland

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Dear Alan

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

I am responding to your letter of 13 of December to Douglas Millican asking us to set out how we will improve our regulatory reporting. As Douglas will cease being Scottish Water's Chief Executive before submission of the 2023 Annual Return (AR), I am responding as lead Director for the AR submission.

The letter sets out our response to the three areas of concern to WICS:

- reporting of performance,
- visibility on future investment needs, and
- the high-level asset replacement work.

Below we set out our response to these three areas:

### **Reporting of Performance**

Scottish Water recognises the important role that the AR plays in providing stakeholders and customers with insight into our performance and is also key for evidencing future improvement needs.

We have produced the AR since 2002 and have over many years established a rigorous process and robust assurance framework that ensures that managers and Directors are responsible for delivering high quality data. It's a significant business activity and like all processes there are opportunities for learning and continuous improvement.

Your team identified a number of these for us this year – both in terms of the data tables and the commentary document and we are committed to continually improving both the quality assurance of the data provided in the return. To support us here we appointed EY to undertake an independent review of the annual return process and appreciate your input into this review which has allowed the EY to understand your concerns.

EY have heard several themes from their interviews with WICS, Scottish Water and Binnies:

- the AR process needs to be improved for basic checking against clear specifications for the data reported, and it needs a well-disciplined change control
- we need to better align information reported in the AR with other reports such as the IPPG and DAG to provide a single coherent view of performance
- accountability for content should lie with business areas with active two-way communication facilitated by the regulatory directorate
- Scottish Water's leadership need to take greater ownership of the AR numbers, and relationship building is required across WICS and Scottish Water at the leadership as well as analyst levels.

From these interviews, alongside a review of examples of regulatory reporting across the UK utility sector and analysis of the process and queries EY have identified three outcomes that our improvement plan will focus on delivering:

- 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 WICS's use of AR.

For the coming months will be working with EY and Binnies to implement improvements to AR23 to reduce the number of data quality issues and to significantly strengthen our commentary document.

We have also recognised the need to strengthen the senior leadership in these areas and as you are aware we will be bringing more economic regulation expertise in at both Director and General Manager Level. We plan to expand the analytical skills in our regulatory reporting team and strengthen the link between subject matter experts and the team that manage the AR process.

We would welcome your support to:

- agree definitions and templates by 28th February, and
- establish and agree a change control process

We would also welcome engagement with you and your team and members of the Scottish Water executive team over the coming months to get to a deeper appreciation of the importance and use of the Annual Return and the evidence needed to support SR27.

Your letter also asks how we plan to gain the trust of regulators in how we are applying regulatory accounting rules and pricing transactions between core and non-core activities. We have endeavoured to address your concerns in our responses to your annual return queries. However, we would appreciate your support for a joint "lessons learned" session with our finance team regarding the completion of the new format M tables for 2021/22 and a review of any improvements required to the N tables.

### **Visibility on future investment needs**

We do recognise that it is important that we make investment choices in the context of the wider context of opportunities and risks. Our focus over the first 2 years of SR21 has been to get the investment programme up and running and to focus on 'no regret investment'. Today we are investing 25% more now than across the previous 6-year period.

We welcome the discussions with your team as we develop the *Universe of Risks and Opportunities* concept. This is the completely unconstrained view of all the potential Risks and Opportunities that Scottish Water and stakeholders could possibly envisage that may impact, or customers expect, over the next 25 to 50 years. It builds on the work undertaken to develop our long-term strategic projections yet recognises that this needs to be an unconstrained and more dynamic view. This will be reviewed and updated on a regular basis.

One of the aims of the work is to build confidence with stakeholders that proposed needs being promoted through the IPPG can be sourced back to this analysis to demonstrate that we have a comprehensive grasp of the risks and opportunities facing us.

Our progress to date:

- a workstream is developing the *Universe of Risks and Opportunities* and how it builds on the existing Investment Planning and Prioritisation Framework (see Figure 1 below),
- we have held content workshops with Scottish Water colleagues and are planning to run similar sessions with the Hydro Nation Chair in the coming months and Stakeholder Advisory Group in March, and
- we are working with our strategic consultants on visualisation options to allow us to structure and visualise all of these risks and opportunities into a searchable, consumable communication.

We expect the first minimal viable product (MVP) of the *Universe of Risks and Opportunities* to be shared with stakeholders ahead of our Scottish Water Board meeting in May 2023.



Figure 1 - Overview of the Universe of Risks and Opportunities

As agreed, we will continue to share draft outputs with your team and share progress updates at our regular liaison meetings.

### High-level asset replacement

Our SR21 called out the twin challenges of climate change and asset replacement and the need to increase investment to meet these two demands. A key to this is the ability of us to evidence the need for asset replacement, repair and refurbishment expenditure over time.

We had been working with Oxera, Northumbrian Water, Sydney Water and yourselves on a programme of work in relation to high level asset replacement. Whilst that programme has petered out, we have continued to work with Northumbrian Water and others to progress the work.

We are currently working on improving the analysis and evidence in the long-term forecast of repairs refurbishment and replacement (AR3) activities on our existing and future asset base including the consequence / impact of a change in investment and strengthening the link to the near-term demand. The workstreams coordinate inputs from economics, analytics, asset data, costing services and planning teams together with significant consultancy support.

The summary AR3 'plan on a page' is shared below (Figure 2). These are building to an initial updated range of long term AR3 estimates ahead of the September 2023 Scottish Water Board meeting.

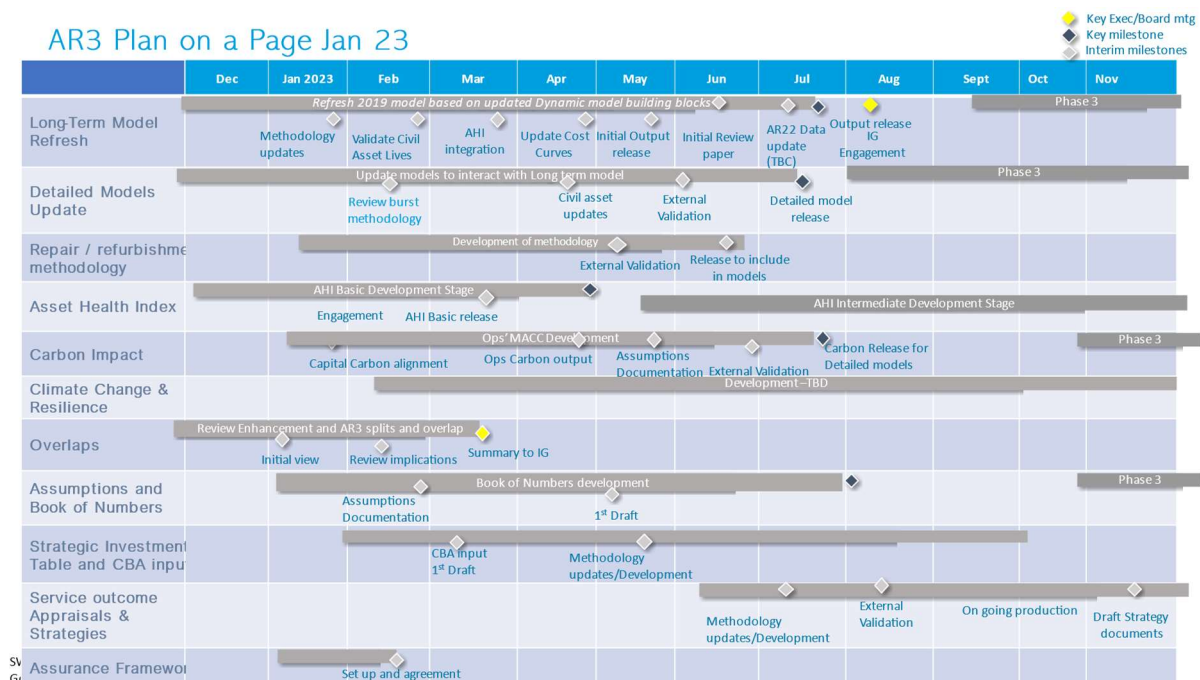


Figure 2 - AR3 2023 workplan

We recognise that this has not been visible to you or your team and will review the detailed plan of workstreams with your team, to make sure we're covering all the key questions and arrange sessions to review draft content from the different workstreams as it becomes available. We will also share progress updates at our regular liaison sessions.

### Summary

We welcome your feedback on our regulatory reporting as an opportunity to continually improve both the quality and explanation of our performance. We want to be providing information to our customers and stakeholders that meets the highest standards of openness and transparency.

We recognise that this year hasn't met your expectations and we are working with EY to identify best practices from across other organisations to help shape how we can continually improve our processes, capability and reporting.

We are committed to continue to work closely with your team on the visibility on future investment needs and the high-level asset replacement work.

Yours sincerely

A handwritten signature in black ink, appearing to read 'SP', with a stylized, cursive flourish.

**Simon Parsons**

Director of Strategic Customer Service Planning