

## Methodology Information Paper 17: Our overall approach to assessing Scottish Water's capital expenditure requirements

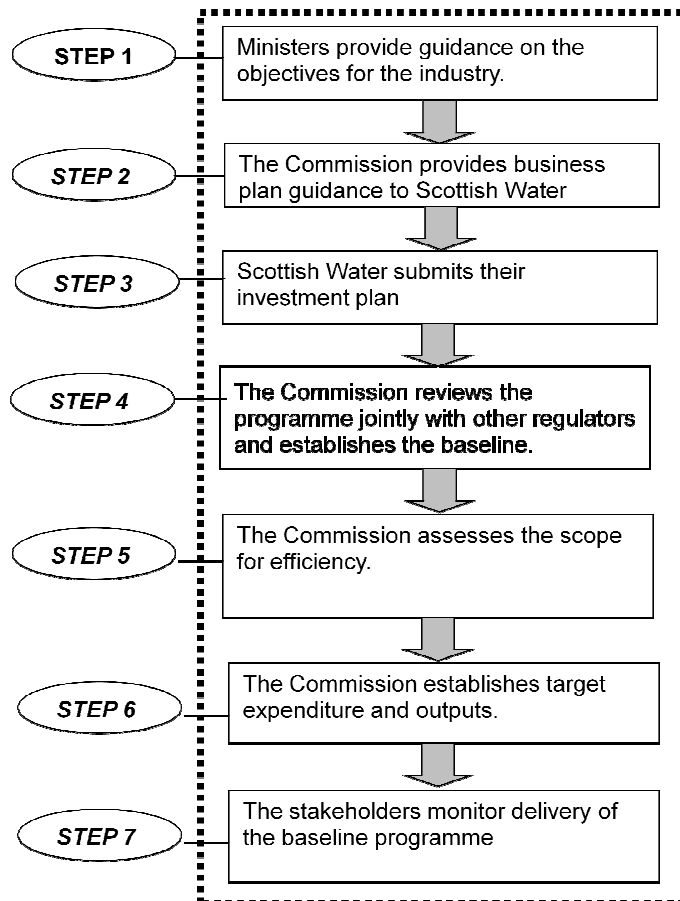
### Introduction

This information paper sets out the key stages in our assessment of Scottish Water's capital expenditure programme for the 2010-14 regulatory control period. Information papers 18 to 24 examine each stage in more detail.

### Our high level approach

Figure 1 summarises our proposed approach.

**Figure 1: Overall approach for assessing capital expenditure requirements**



*Step 1: Ministerial objectives*

Scottish Ministers determine the high level objectives that Scottish Water is required to deliver. Ministers have already provided their initial guidance on these objectives through the 'Quality and Standards 3' process. The outcome from this process was published in February 2005. In the autumn of 2008 Scottish Ministers will issue updated guidance setting out the investment outcomes they require Scottish Water to deliver.

*Step 2: Business plan guidance*

We will issue guidance to Scottish Water concerning its draft business plans on 20 December 2007 and 15 October 2008. This guidance is designed to ensure that we have a clear and defined baseline for the capital programme that is required to deliver the outcomes specified by Ministers. It is, of course, for Scottish Water to decide how they plan to meet the ministerial objectives.

Information Paper 18 'Defining the baseline' sets out the information we will require from Scottish Water.

*Step 3: Submission of the investment plan*

Scottish Water will submit its proposed capital investment programme as part of its draft business plan submissions in May 2008 (first draft business plan) and March 2009 (second draft business plan).

*Step 4: Reviewing the capital investment programme*

We will review Scottish Water's proposed capital programme in detail. The key questions we will seek to answer at this stage are as follows:

- Is the programme properly defined?
- Does the level of definition allow the delivery of the programme to be monitored?
- Is the programme consistent with ministerial objectives?
- Is the programme properly scoped?
- Are the proposed solutions appropriate?

In reviewing the programme we intend to seek advice from the independent Reporter, as well as from independent consultants. Our aim will be to ensure that the capital investment programme is well-defined and sufficient to allow proper monitoring of the delivery of the ministerial objectives.

Information Paper 19 'Reviewing the baseline programme' sets out in more detail how we propose to review the capital programme.

Step 5: Assessing the scope for efficiency

We will then apply a series of benchmarking techniques in order to identify the scope for Scottish Water to deliver the capital programme more efficiently. The techniques that we intend to apply include Ofwat's capital maintenance econometrics and cost base techniques, along with other high level comparisons. More information about this analysis can be found in the following Information Papers:

- Information Paper 23 'Ofwat's capital maintenance econometric models',
- Information Paper 24 'Capital efficiency', and
- Information Paper 25 'The cost base approach'

*Step 6: We establish the allowed for level of expenditure*

Based on the outcome of the review of Scottish Water's capital programme and our assessment of the scope for capital efficiency, we will establish the lowest reasonable overall cost to deliver the ministerial objectives. This allowed for capital expenditure forms a major component of our draft and final determination of charges for the 2010-14 regulatory period.

The draft determination will be published in June 2009 and the final determination in November 2009.

*Step 7: Monitoring the programme*

We will closely monitor delivery of the capital programme and its associated outputs. We receive detailed information quarterly from Scottish Water on its performance against the baseline capital investment programme.

A multi-stakeholder Output Monitoring Group (OMG) monitors the delivery of the ministerial objectives. The OMG meets quarterly and comprises representatives of the Scottish Executive, the Scottish Environment Protection Agency, the Drinking Water Quality Regulator, Waterwatch Scotland, the Commission and Scottish Water.

More information about the OMG and our approach to monitoring the delivery of the capital programme can be found in Information Paper 20 'Monitoring the capital programme'.

**Related documents**

'The Strategic Review of Charges 2006-10: The draft determination', Volume 5, Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.