

## A OVERVIEW

### Introduction

The business plan is the key document from Scottish Water for the Strategic Review of Charges. The overview summarises the key points in the plan and their implications in terms of:

- Customers
- Competitors
- Costs
- Compliance
- Competencies.

### Business plan

The Business Plan needs to be consistent with the general principles established for the Strategic Review of Charges process based around Scottish Water's preferred strategy but with sensitivities to its key material assumptions. These key assumptions must be realistic and be set in the context of expenditure needs, the scope for efficiency and financing constraints. The business plan should:

- Enable Scottish Water to set down and explain in a consistent and fair way its application for price limits
- Take account of all the issues that Scottish Water faces over the period 2006-07 to 2013-14 and beyond, including the quality improvements required by Ministers and guidance from regulators

- Inform us of all the relevant factors that we need to review the challenges facing Scottish Water and determine fair and reasonable price limits for Scottish Water consistent with its statutory duties.

Scottish Water should set out its preferred strategy for 2006-07 to 2013-14 and in the longer term in the light of this guidance. Scottish Water should ensure that they draw together all the major issues facing them into an integrated plan, which is agreed and signed off by its Board.

We will closely analyse the business plan to inform our determination of price limits.

We require the whole of the business plan to be subject to effective and focused scrutiny by the Reporter, and, where appropriate, by Scottish Water's Auditor

Format of the business plan

The business plan has four distinct but inter-related parts:

- Part A Scottish Water's strategy;
- Part B Key components;
- Supporting information (including the Q&SIII investment programme submission, leakage strategy, water resource strategy, sample drainage area plan and sample distribution zone study)
- Part D Public domain summary.

### Part A Scottish Water’s strategy

Scottish Water strategy is at the heart of the business plan submission.

No formal tables are required although Scottish Water may wish to draw on or refer to numerical data in other prescribed tables. The text should focus on explaining:

- why the outputs have been selected for Scottish Water’s preferred strategy and, for the draft business plan, for each reference plan;
- the rationale for the balance of activities chosen to deliver them;
- the resources required allowing for improvements in efficiency
- the charges that Scottish Water considers its customers should pay.

Scottish Water should explain how and why it believes its strategy, reflects its customers’ views on services and prices.

Scottish Water may also wish to comment on whether within its strategy it is able to balance the views of its customers with those of other bodies, such as the quality regulators or the Water Customer Consultation Panel.

Scottish Water should set out a clear summary of the outputs, activity and expenditure necessary to deliver these outputs, and the revenue required to secure Scottish Water’s financial viability within the strategy adopted for each of the reference plans.

We suggest that Scottish Water’s strategy should be divided into seven sections (see below) thus providing a framework for Scottish Water to explain its strategy for the period 2006-07 to 2013-14, and in the longer term.

Scottish Water strategy	
Section 1	The overall strategy
Section 2	Achieving the right balance for customers
Section 3	The post 2005 environment
Section 4	Strategic objectives
Section 5	Delivery of the strategic objectives
Section 6	Costs of delivering the strategic objectives
Section 7	Financial projections for Scottish Water

#### **Section 1 – The overall strategy**

Section 1 provides for Scottish Water to summarise its strategy, to identify the implications of the strategy for price limits and how these translate into average household bills, both in real terms and actual likely bills (money of the day) through the period. The forecast bills should also be clearly related to Scottish Water’s current charging policies.

Scottish Water should set down the key assumptions underpinning its strategy.

Scottish Water should highlight its assessment of its recent service performance and whether it has incorporated any changes in its proposed price limits to reflect this comparative performance. Any such adjustment would need to be explained in relation to our policy for taking account of past projected performance.

### **Section 2 – Achieving the right balance for customers**

Scottish Water should use this section to explain how its overall strategy reflects the views of its customers on the overall balance between service levels and prices and on the priorities for improvements. This should include confirmation of the delivery of all the outputs required under Q&SII. It should take account of the latest consultation on service, quality, costs and standards.

### **Section 3 – The post- 2005 environment**

Section 3 provides for the Board of Scottish Water to set down its views on the environment, in its widest sense, which will set the parameters within which it will have to operate during the period 2006-07 to 2013-14. This would encompass, for example, Scottish Water view of changing demands from its customers. This provides the opportunity for Scottish Water to explain the position it has reached on the risks and uncertainties that exist or are likely to exist in the next five years.

Scottish Water should clearly set down its current performance and the state of its systems, especially its infrastructure and non-infrastructure assets, where these are relevant to the environment in which it shall be operating.

We need to understand Scottish Water's strategy for achieving and maintaining leakage at the economic level and how these figures have been derived.

### **Section 4 – Strategic objectives**

Section 4 builds on Scottish Water's assessment of how the post 2005 environment will influence its decisions on its strategic objectives for the period 2006-07 to 2013-14 and beyond. These will cover both the policies it adopts and the outputs it will deliver for its customers and the community over the period. We need to understand how these strategic objectives are reflected in charging policies. This is of general relevance to Scottish Water's proposed price limits, but also of specific relevance as to how Scottish Water expects to meet changing demands.

Scottish Water should set out the strategic objectives that it will want to achieve over the next price limit period and the relevant key outputs.

Scottish Water should give an overall assessment on trends in serviceability for customers. This assessment should relate to trends over the period preceding the submission.

### **Section 5 – Delivery of strategic objectives**

Section 5 provides for Scottish Water to explain how the delivery of the strategic objectives translates into programmes it will have to carry out during the period. In many instances this will be the continued and improved operation of existing assets or maintaining and improving existing practices. Where the delivery of the objectives involves renewing, replacing or extending physical assets

Scottish Water should report the levels of overall investment activity carried out in the current price limit period, and set out its projections for the 2006-07 to 2013-14 period. Investment activity will be carried out in order to maintain serviceability, or for enhancement reasons, that is to ensure compliance with improved standards of service to customers and the environment, or to maintain the balance between supply and demand

The activity numbers reported in the Business Plan should form the basis of Scottish Water's expenditure projections. The activity projections should be consistent with the individual schemes appearing in the Q&SIII investment programme submission.

Scottish Water's judgements about the scope for improving efficiency should be explained and justified. They may be informed by the comparative work published by us and by Ofwat, the results of Scottish Water's own work on benchmarking its activities, or relevant work by others.

Scottish Water should explain how it intends to improve its efficiency over the period and thus be able to carry out the necessary programmes at lower costs than would have previously been the case.

### **Section 6 – Costs of delivering the strategic objectives**

Section 6 provides for Scottish Water to explain and set down its judgements on the expenditure that it expects it will incur in meeting the strategic objectives. These costs will reflect the earlier judgements on the activity/work needed to be carried

out and the improvements in efficiency that Scottish Water is committed to delivering. In other contexts, for example the supply/demand balance, it will also reflect the extent to which Scottish Water has put in place charging policies that generate the revenues commensurate with the costs of meeting changing demands. Scottish Water's judgements on the implications of the delivery of the objectives should be summarised.

### **Section 7 – Financial projections for Scottish Water**

This section completes Scottish Water's strategy. Scottish Water should set down the implications for its financial performance and its judgements on revenue required to fund its strategic objectives. This should take account of impact of improvements in efficiency on the likely expenditure of Scottish Water within its strategy.

Scottish Water should explain its decisions on how it proposes to finance its strategic objectives and the revenue it believes will be necessary to ensure its business is financially viable for Scottish Water's strategy. Scottish Water's judgement about the cost of capital and its capital structure should be explained and justified together with an explanation of its proposed dividend policy.

Scottish Water will wish to set down any accounting policies that have a material effect on its judgements. In particular, we will want to understand the level of current cost depreciation reflected for Scottish Water's strategy and whether this is comparable, over the long term, to the level of capital maintenance expenditure.

## **Guidance to Reporters and Auditors**

