# Appendix 1:
# Glossary of terms and definitions

**Annual Return:** The Annual Return is the largest single information request that we issue to Scottish Water each year. The format of the Annual Return is based closely on Ofwat's June Return. The Return provides detailed information about each area of the water and waste water business and all associated costs. It comprises more than 20,000 items of both input and calculated information.

**Amortisation:** An annual charge taken through the Income and Expenditure account to allow for the fall in value of an intangible asset. This is similar to depreciation, but for intangible assets.

**Asset lifecycle:** The period from when an asset is purchased to when it is decommissioned.

**Benchmarking comparison:** A method of comparing the performance of different companies. The leading performers in a given area are used as a standard or benchmark for the others.

**Better Regulation Task Force:** This independent body advises Government on action to ensure that regulation, and its enforcement, accord with the five Principles of Good Regulation. The Better Regulation Task Force has recommended that regulators adopt five principles of good regulation in their approach to price setting: proportionality, accountability, consistency, transparency and targeting.

**BOD:** Biological oxygen demand – a measure of the pollution potential of raw sewage and treated sewage effluent.

**Business plan:** A business plan is a company or organisation's statement of its strategy for the future. It should present clearly its forecast of revenue and costs. Scottish Water's two business plan submissions supplemented the information contained in the standard regulatory returns and set out its strategy and objectives for the coming period. The business plans formed a key element of the Strategic Review of Charges.

**Capital asset pricing model (CAPM):** An economic model used to provide an estimate of the expected rate of return on a financial investment, based on the riskiness of that investment.

**Capital maintenance:** Planned work carried out by Scottish Water to replace and repair water and sewerage assets to provide continuing services to customers.

**Capital programmes:** Planned construction work carried out by Scottish Water to build new assets such as sewage treatment works and water mains.

**Cash flow statement:** A summary of the cash flows in and out of a company over time.

**Cash return on RCV:** The RCV approach separates the cash cost of replacing assets (depreciation) from the financing and management costs. These financing costs and management costs are the cash return on the regulatory capital value.

**Charge cap:** A limit on the charges that Scottish Water can charge to customers.

**Charge determination or determination:** In relation to Scottish Water, a determination (made by the Water Industry Commission under section 29B of the 2002 Act (as amended by the 2005 Act)) as to the maximum amounts of charges by reference to which a charges scheme is to be made.

**Charges scheme:** Sets out Scottish Water's charging policy and charge levels for each financial year. It is subject to approval by the Commission.

**Charging year:** The year commencing on 1 April.

**Codes of Practice:** Scottish Water has an obligation to produce a Code of Practice under section 26 of the Water Industry (Scotland) Act 2002. The Code of Practice provides information on the standards of service that customers can expect and on how Scottish Water will deal with customers.

**Competition Commission:** An independent public body established by the Competition Act 1998. It conducts inquiries into mergers, markets and the regulation of major regulated industries. If a regulated company disputes the regulator's price limits, it can require the regulator to refer the determination to the Commission.

**Common carriage:** An approach to competition where competing suppliers put their water into the public supply network in order to supply their customers.

**The Convenor:** The Convenor of the Customer Panels, a role established by the Water Industry (Scotland) 2002 Act. The Convenor is the head of the five Water Customer Consultation Panels.

**COPI:** Construction Output Price Index. The rate of inflation for a basket of construction prices over a period of time.

**Cost base:** A set of standard capital unit costs, designed to reflect the actual work to be carried out by Scottish Water. These can be benchmarked in order to assess a procurement efficiency gap.

**Comparative analysis:** The use of a number of different organisations' performance in a given area to assess relative performance of an individual organisation.

**Comparator company:** A company used as a benchmark, against which Scottish Water's performance is assessed.

**Core activities:** Scottish Water's primary role is to provide water and waste water services to customers. The Water Industry (Scotland) Act 2002 limits our remit to promoting the interests of customers to the core business.

**Cost-reflective pricing:** Where charges are based on the cost to the service provider of actually providing that service to a customer.

**Council Tax bands:** Bands defining the upper and lower limit for the value of a domestic property. Each property falls into a band from A to H. The band is used as a basis for setting the level of Council Tax and water charges paid by domestic customers.

**Cross-subsidy:** The subsidisation of a particular customer group by another group. The former pays less than the actual cost of providing the service and the latter pays more.

**Current cost accounting:** A method of accounting originally designed to deal with the problem of showing the effect of inflation on business profits. Instead of showing assets at their historic cost (ie their original purchase), less depreciation where appropriate, the assets are shown at their current cost (replacement cost) at the time of producing the accounts.

**Customer retained earnings:** Scottish Water generates surpluses and therefore has retained earnings, which it can invest to achieve the outputs set by Scottish Ministers. These reinvested surpluses have essentially the same properties as retained earnings in the private sector (a form of equity), except that they are reinvested for the benefit of customers, rather than with the specific aim of generating increased future profits. In considering this source of funds for Scottish Water we refer to 'customer retained earnings'.

**Debt:** Borrowings used to finance a company's functions. Scottish Water currently borrows from the Scottish Consolidated Fund at public sector borrowing rates.

**Debt premium:** The debt premium is that part of an interest rate that represents the corporate risk of the debt instrument above the risk-free rate. Investors therefore require the premium to compensate them for the additional risk of the debt instrument over government securities.

**Depreciation:** Depreciation is a measure of the consumption, use or wearing out of an asset over the period of its useful life.

**Drinking Water Quality Regulator (DWQR):** The DWQR was established by the Water Industry (Scotland) Act 2002. The DWQR provides an independent check that Scottish Water is complying with the drinking water quality regulations. These regulations reflect European Union and other statutory standards.

**Econometric modeling:** The use of regression and other statistical techniques to model the relationships that underlie economic and financial results.

**Economic level of leakage:** The level of leakage at which further leakage control activity would cost more than alternative means to bridge the gap between supply and demand.

**Economies of scale:** Means that the average cost of producing one unit of output falls as the volume of production increases. This could happen because a cost that changes very little with output, such as the cost of running an accounts department, is shared among a greater amount of output.

**Economies of scope:** Means that it is cheaper to produce two (or more) products together, rather than to produce them separately. For example, the production of timber planks also results in the production of sawdust.

**Efficiency:** Achieving the same or better outputs for lower expenditure.

**Eligible customers:** Occupiers of premises that are (or are to be) connected to the public water supply system and/or the public sewerage system, but which are not defined as a dwelling.

**Embedded debt:** Debt, due in more than one year, in company balance sheets which attracts a fixed rate of interest rather than a floating rate.

**Equity:** The net worth of a firm. Equity is usually shares, preference shares and retained earings.

**Financial model:** A computer model that uses historical financial data together with a series of assumptions and scenarios to predict the future incomes and expenditures (and hence the revenue requirement) of Scottish Water.

**Gearing:** A company's net debt expressed as a percentage of its total capital (ie the ratio of net debt to net debt plus equity expressed as a percentage).

**Guaranteed Minimum Standards:** The minimum standards of service that Scottish Water must meet, and which customers have a right to expect. Failure to comply with any of the standards entitles the customer to financial compensation.

**Historic Cost Accounting:** The traditional form of accounting, in which assets are shown in balance sheets at their cost to the organisation (historic cost), less any appropriate depreciation.

**Household properties:** Properties used as single household dwellings (normally occupied), receiving water and/or sewerage services for domestic purposes only.

**Income and Expenditure account:** Also known as a Profit and Loss account. The accounting statement where a company records its earnings and expenses in each year and calculates its net and gross profit.

**Infrastructure assets:** Mainly underground assets, such as water mains and sewers and also lochs, dams and reservoirs. A distinction is drawn between infrastructure and non-infrastructure assets because of the way in which the assets are managed, operated and maintained.

**Infrastructure renewals charge:** An annual accounting provision for expenditure on the renewal of infrastructure assets charged to the Income and Expenditure account.

**Interest:** An annual payment on debt aimed at compensating an investor for the risk and opportunity cost of an investment.

**Interest cover:** The number of times a company's profits, before interest and tax, cover interest due on all its borrowings.

**Interim determination:** In relation to Scottish Water, a review (carried out by the Water Industry Commission under section 29F of the 2002 Act (as amended by the 2005 Act)) of the maximum amounts determined under section 29B of the 2002 Act (as so amended).

**June Return:** See Annual Return.

**Key Performance Indicators (KPIs):** A set of financial ratios used to measure financial sustainability.

**London Inter Bank Offered Rate (LIBOR):** The rate at which banks lend to each other.

**Licence holder:** A person to whom a licence has been granted.

**Licensee:** A person to whom a licence has been granted.

**Licensing authority:** A body authorised by law to grant licences.

**Load:** A measure of strength and quantity of waste water, usually expressed in Kg BOD per day.

**Logging up and down:** An adjustment that takes place at the end of the regulatory control period to reflect differences in cost from the original determination. Such differences will have an impact on prices only in the next regulatory control period.

**MEAV:** Modern equivalent asset value. The value of assets if they were replaced efficiently with the latest technology.

**Megalitre:** One million litres, or 1,000 cubic metres.

**Ministerial Guidance:** Ministers' proposals, published in February 2005, for a statement to be made under section 29D of the 2002 Act (as amended by the 2005 Act) and for a set of directions to be made under section 56A of the 2002 Act (as so amended).

**Ml/day:** One megalitre per day.

**Modified historic cost:** A basis for valuing assets by increasing the asset cost by inflation each year to represent a more realistic cost level.

**Monopoly:** When only one company sells a product that has no close substitutes, it faces no competition in the market. The customer who wants to buy the product has no choice of supplier.

**Net present value:** The economic value of a project, at today's prices, calculated by netting off its discounted cash flow from revenues and costs over its full life.

**Network:** The physical assets downstream of production and bulk storage facilities owned by Scottish Water which are essential for the supply of water to customers up to the boundary stopcock of customer premises.

**Network operator:** The company responsible for operating and maintaining a utility network.

**Non-core business:** Anything other than core business, for example consultancy services, plumbing, recreation, farming and waste management.

**Non-household properties:** Properties receiving water and/or sewerage services that are used exclusively for public, business, trade or manufacturing purposes, or household dwellings used for commercial purposes.

**Non-infrastructure assets:** Mainly above-ground surface assets, such as water and sewage treatment works, pumping stations and company laboratories, depots, workshops and equipment.

**Overall performance assessment (OPA):** Combines results for customer service measures with information about performance in drinking water quality and environmental compliance to derive an overall score for the level of service.

**Operating expenditure:** Comprises day-to-day running costs such as employment costs, electricity, materials, hired and contracted costs, local authority rates, insurance, and vehicle running costs.

**Panel data:** Performance information collected over a number of years.

**PFI:** Private Finance Initiative, precursor to Public Private Partnership.

**Population equivalent of sewage treatment works:** The capacity of sewage treatment works is measured in terms of the amount of organic material that can be treated. It is assumed that one person is equivalent to a load of 60g of BOD. This measure includes industrial waste water treated at works.

**Public Private Partnership (PPP):** The three former water authorities decided to let a total of nine concessions for the building and operation of waste water treatment plants. These concessions were for a period of 25-40 years. The concessions were usually let to joint venture companies which usually consisted of a consultant engineering and design firm, a construction contractor and an operations company.

**Quality and Standards (Q & S):** The standards set by the Scottish Executive, the Scottish Environment Protection Agency and the Drinking Water Quality Regulator to ensure that Scotland receives safer drinking water and a cleaner environment. The standards are determined largely by the policies of the Scottish Ministers, which are underpinned by standards agreed with the European Union. The Quality and Standards process sets out the environmental and drinking water standards that Scottish Water must meet and estimates the investment that is required to meet them.

**Rate of Return:** The annual income and capital growth from an investment, expressed as a percentage of the original investment.

**Regulatory accounts:** A set of accounting statements produced by a regulated company to rules set by the regulator. These ensure that costs and revenues from regulated activites are properly recognised.

**Regulatory capital value (RCV):** The capital base used in setting charge limits. The value of the regulated business on which Scottish Water can earn a return.

**Regulatory information:** Financial, customer and engineering data collected by the regulator for monitoring, benchmarking and financial analysis.

**Reporter:** The Reporter is an independent auditor who reviews most aspects of Scottish Water's information submissions. This includes auditing both Scottish Water's Annual Return and its business plan submissions, as well as scrutinising the costing, scope and content of the proposed investment programme.

**Retail activities:** Retail is the selling of goods or services directly to consumers.

**Retail price index (RPI):** The rate of inflation for a basket of retail prices over a period of time.

**RPI-X regulation:** A form of regulation that involves setting price caps that are measured relative to the RPI. All of the UK economic regulators have used price cap (RPI-X) regulation to limit the prices that companies are allowed to charge their customers.

**Retail subsidiary of Scottish Water:** The undertaking that will be established by Scottish Water in compliance with section 12 of the Water Services etc. (Scotland) Act 2005, to perform the activities of a licensed retail entity.

**Revenue:** The total amount of money that Scottish Water collects (from customers) in a year.

**Scottish Executive:** The devolved Government in Scotland and their civil service support.

**Scottish Environment Protection Agency (SEPA):** SEPA is responsible for a range of activities, including regulating discharges to rivers, lochs, estuaries and coastal waters and for protecting and improving the water environment, including River Basin Management Planning under the Water Environment and Water Services Act 2003.

**Section 29D statement:** A statement of policy regarding charges made by Ministers under new section 29D of the 2002 Act (as inserted by the 2005 Act).

**Section 56A directions:** Directions given to Scottish Water by Ministers by reference to new section 56A of the 2002 Act (as inserted by the 2005 Act).

**Special factors:** Factors taken into account when setting Scottish Water's operating expenditure targets.

**Spend to save:** Spend to save expenditure is spending now to save money later, for example redundancy payments now to reduce wage bills in the future.

**Standard customers:** A set of representative 'typical customers' who are defined by aspects such as their consumption, connection size and rateable value. We can calculate the impact of tariff changes on the bills for each of these 'typical customers'. Customers can then match the service they receive with the standard customer who is most similar to themselves, allowing them to understand the likely impact on their bills of changes in tariffs.

**Supply/demand balance:** The balance between the amount of a company's available water resource and the demand for water by customers. Any imbalance between supply and demand can be met via resource enhancement or demand management strategies (eg selective metering and leakage control).

**Surface water drainage charge:** The part of the waste water charge that covers the cost of removing and cleaning impurities and pollution from rainwater from roofs and private lands, as well as from roads and other public areas.

**Tariff basket:** Includes all of the tariffs that impact on customers who receive a particular service. For example, if measured non-household water customers were considered as a group, all of the tariffs that impact on them would be included.

**Ten principles:** These principles were agreed between Scottish Water, the Scottish Executive and this Office in 2003. The principles set out a range of measures to improve information flows and clarify both Scottish Water's efficiency targets and the nature and scope of any adjustments that are made for the purposes of comparison.

**Trade effluent:** Industrial waste water other than that produced through normal domestic systems such as sinks and toilets.

**Unsatisfactory intermittent discharges (UIDs):** At times of heavy storms, some sewers are designed to overflow into water courses, as are storm water retention tanks at sewage treatment works. Where this results in unacceptable levels of discharge into water courses, these discharges are deemed by SEPA to be unsatisfactory.

**Value chain:** The different activities that occur one after another, and which must be carried out in order to provide customers with water and waste water services.

**Water Customer Consultation Panels:** Established by the Water Industry (Scotland) Act 2002, to represent the views and interests of customers served by the public sector water industry in Scotland.

**The Water Industry Commission:** A body established by the Water Services etc. (Scotland) Act 2005 to replace the Commissioner as the party responsible for economic and customer service regulation of the public sector water industry in Scotland.

**The Water Industry Commissioner for Scotland (WICS):** A role established by the Water Services Act 1999 to carry out economic and customer service regulation for the public sector water industry in Scotland. The Commissioner has now been replaced by the Commission.

**Water Industry (Scotland) Act (2002)** or the **2002 Act:** The Water Industry (Scotland) Act 2002 (2002 asp 3).

**Water Services etc. (Scotland) Act (2005)** or the **2005 Act:** The Water Services etc. (Scotland) Act 2005 (2005 asp 3).

**Weighted average cost of capital (WACC):** The weighted average cost of capital combines the rate of return from debt and from equity relative to the share of each in the market value of the firm.

**Wholesale activities:** Wholesale is the selling of goods or services to merchants, usually in large quantities and for resale to consumers.

**Wholesale services agreement:** An agreement between Scottish Water and a licensed retailer, setting out the terms and conditions for the supply of wholesale services, as required by section 14 of the Water Services etc. (Scotland) Act 2005.