

Section 4 Operating expenditure

Introduction

Section 4 collects operating expenditure relating to:

- base year
- changes (increases and reductions) attributable to capital investment set out elsewhere in the plan
- planned efficiency adjustments
- proposed improvements in Scottish Water's performance

The information is collected in three tables:

- 1 Water service - Operating expenditure
- 2 Wastewater service - Operating expenditure
- 3 Operating expenditure to achieve improved OPA

Scottish Water Guidance

The definitions have been written to be consistent, as far as is appropriate, with the annual return and regulatory accounts.

Scottish Water should ensure that no input cell is left blank. If the information is unknown or not applicable, then a zero should be entered in the cell with an appropriate explanation in the commentary.

Tables 1 and 2 are considered first, followed by Table 3.

In this Section, Scottish Water should set out (in a free-form submission) any special factors that it considers appropriate for the operating expenditure econometric models. Scottish Water should ensure that the information on special factors satisfies the criteria set out in the Commission's methodology information paper 16 (page 3).

Tables 1 and 2 Operating expenditure

Tables 1 and 2 have the following blocks:

- Base operating expenditure and adjustments
- Existing water (wastewater in Table 2) service enhancement programme (Q&S2)
- Existing water (wastewater in Table 2) service enhancement programme (Q&S3a)
- New water (wastewater in Table 2) service enhancement programme (Q&S3b)
- Total pre-efficiency
- Efficiency reported as £m
- Total post efficiency
- PPP Charges (Table 2 only)
- Memo items: operating expenditure efficiency adjustments

Base operating expenditure

Scottish Water should set out base year operating expenditure as reported in the most recent Annual Return and forecasts of changes to base operating expenditure. Explain the basis of deriving forecasts of changes to base operating expenditure in the commentary.

Adjustments to base operating expenditure

Scottish Water is to show adjustments for:

- exceptional and atypical expenditure
- changes to operating expenditure attributable to the interaction with Licensed Providers - "friction costs"
- changes to operating expenditure to deliver improvements in OPA
- other projected changes to operating expenditure

Changes in operating expenditure attributable to the investment programme

Scottish Water is to show changes to operating expenditure attributable to the Q&S2, Q&S3a and the planned Q&S3b investment programmes. The additional operating expenditure arising from each of these investment programmes is segregated into operating expenditure arising from investment in drinking water, the environment, the supply/demand balance and improving customer service.

Operating expenditure attributable to the proposed Q&S3b investment programme should show adjustments to reflect schemes which overlap between base maintenance and other functional expenditure. Scottish Water should explain its assumptions regarding overlap between base operating expenditure and that from other cost drivers. It should be noted that any resulting cost adjustments should be explicitly identified to demonstrate no double counting with operating expenditure attributable to other capital expenditure.

Scottish Water should provide an explanation of how the expenditure adjustments were derived. Where an adjustment has been made to part, but not all, of the programme or the adjustment has been calculated by applying different proportions to differing parts of the programme the relative proportions should be set out in the commentary.

Improvement profile

The assumed overall improvement profile is applicable to base operating expenditure, projected changes to base operating expenditure and the operating expenditure arising from delivering the Q&S2, Q&S3a and Q&S3b investment programme (additionally Table 2 requires the assumed overall improvement profile for new PPP charges). The means of deriving these estimates for each of these components needs to be explained in the commentary.

PPP charges

Table 2 requires Scottish Water to outline operating expenditure attributable to PPP charges, as distinct from base operating expenditure. Within this block there is the opportunity to outline any projected changes to base PPP charges and any new PPP charges arising from the Q&S3a and Q&S3b enhancement programme as well as the assumed overall improvement profile on these.

Table 3 Operating expenditure to achieve improved OPA

Table 3 collects operating expenditure changes attributable to changes in performance measures within the Overall Performance Assessment (OPA) in each of the main areas of the OPA and is sub-divided according to the following blocks:

- Water supply
- Sewerage service
- Customer service
- Environmental impact
- Total

Scottish Water is to set out the implications in terms of operating expenditure of achieving, by 2013-14, the levels of service delivered in 2007-08 by the three leading companies in England and Wales. Costs should be separately identified, using the lines of the table, for:

- changes to the number of properties experiencing
 - low pressure
 - supply interruptions
- changes in relation to:
 - security of supply
 - drinking water quality
 - sewer flooding incidents and risk of flooding
 - response to billing enquiries
 - response to written complaints
 - telephone response
 - assessed customer service measures
 - sewage treatment works compliance
 - sewage sludge disposal
 - pollution incidents (sewage)
 - pollution incidents (water)
 - leakage

In the commentary Scottish Water should distinguish between changes in operating expenditure to achieve the required improvement in the OPA and the additional operating cost of maintaining the improved level of service.

Reporter Guidance

The Reporter should challenge Scottish Water on the basis of the cost estimates and the link between the outputs it proposes to achieve, in terms of the specific improvement in performance to customers, and the investment proposed.

The Reporter should comment on the:

- clarity of supporting information
- robustness of the cost estimates

- consistency of approach

The Reporter should review the base operating expenditure reported in Tables 1 and 2 and, where the Reporter understands that the expenditure is based on the most recent Annual Return, comment on any adjustments made. Where expenditure has been based on other sources, for example zero based budgeting, the sources of information and the basis for the estimated costs should be exposed and the degree of challenge set out.

The Reporter should comment on whether the information presented in Scottish Water's free-form special factors submission is drawn from appropriate corporate records and confirm its consistency (or otherwise) with other aspects of the Plan.