Final Report for WICS

Analysis of business activity in Scottish Water

December 2004

Contents

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Private and Confidential

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09 December 2004
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Dear Sirs

Analysis of business activity in Scottish Water

In accordance with your instructions, we have performed the work set out in our engagement letter in connection with the proposed separation of the non-domestic retail activities of Scottish Water.

Scope and nature of our work

As set out in our proposal document dated 19 July 2004, the primary issues to be addressed were the identification and financial separation of:

- core/non-core activities

- wholesale/retail activities.

The key tasks that we have performed in order to address these issues are as follows:

- agree aims of wholesale and retail business

- identification of potential revenue streams

- allocation of direct costs between business areas

- allocation of assets and liabilities to business areas

- consideration of essential services and support services

- assessment of financial risks.

Our report

Our report on matters within the agreed scope comprises one volume. It is closely linked to the part of this project related to the development of the Regulatory Accounting Rules (RARs) and the M Tables and it should be considered with those documents.

The key elements of our report are:

- description of assets and operations of each component part of the business

- outline management and reporting structure

- summary of key issues to achieving accounting and operational structure

- outline work programme for achieving separation.

Purpose of our report and restrictions on its use

This report was prepared on the specific instructions of the Water Industry Commissioner for Scotland solely to assist in its consideration of the potential separation of the non-domestic retail business of Scottish Water and should not be relied upon for any other purpose. It should not be quoted, referred to or shown to any other parties unless so required by court order or a regulatory authority, without our prior consent in writing. Ernst & Young LLP assumes no responsibility whatsoever in respect of or arising out of or in connection with the contents of this report to parties other than Water Industry Commissioner for Scotland. If others choose to rely in any way on the contents of this report they do so entirely at their own risk.

Yours faithfully
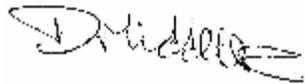
Partner
For Ernst & Young LLP

Abbreviations

The following abbreviations are used in this report:

ABM	Activity Based Management system
CA98	Competition Act 1998
DWQR	Drinking Water Quality Regulator for Scotland
GEARC	Gross Equivalent Asset Replacement Cost
GMS	Guaranteed Minimum Standards
IRC	Infrastructure Renewals Charge
IRE	Infrastructure Renewals Expenditure
MEAV	Modern Equivalent Asset Value
PPP	Public Private Partnerships
RARs	Regulatory Accounting Rules (designed specifically for the Scottish water industry)
RAGs	Regulatory Accounting Guidelines (designed by Ofwat for use in the English and Welsh industry
SEPA	Scottish Environment Protection Agency
SRC	Strategic Review of Charges
SW	Scottish Water (wholesale entity)
SWR	Scottish Water Retail
WICS	Water Industry Commissioner For Scotland

Executive Summary **Section 1**

1. Executive Summary

1.1 Project Objectives

The primary objective of the project was to deliver a set of reporting guidelines and submissions to enable effective regulation. These regulatory accounts will be used by the Water Industry Commissioner for Scotland (WICS) to inform its work as the economic and customer service regulator of the Scottish water industry, and its current near-monopoly supplier of services, Scottish Water (SW).

Regulatory accounts and their accompanying rules (or guidelines) (RARs) are commonly used by other regulators. However, in the instance of WICS, they have been specifically developed to incorporate a number of changes, both recent and proposed, to the Scottish water industry.

As such, the specific project objectives were as follows:

- identify core and non-core activities

- identify wholesale and retail business

- develop guidelines and submissions that enable effective regulation by providing clear guidance on the accounting separation of the above activities.

In this report we have set out our work on the first two objectives. This has been achieved through:

- review of legislation in both Scotland and England & Wales

- workshops attended by WICS, SW, Scottish Executive, Black and Veatch, Shepherd and Wedderburn and Ernst & Young

- individual and group meetings with personnel from WICS and SW to review specific issues

- a detailed review of the Activity Based Management (ABM) system used by SW for financial reporting

- a review of the proposed RARs and M tables to be followed and used by SW as part of the Scottish regulatory regime for water and waste water.

We have also enlisted the help of Black and Veatch, to examine the practical implications of this accounting separation.

The third objective has been addressed by a separate workstream which has prepared the RARs and M tables. It is critical that the reporting guidelines enable effective reporting of activities within SW, in particular so that meaningful comparisons, where possible, can be made across the industry. Therefore, we have worked closely with this workstream to ensure that our outputs are consistently dealt with in the regulatory accounts.

This report sets out our key findings and conclusions, documenting the conclusions of our consultations with the various relevant parties and our opinion of the appropriate allocation of activities. We considered the issues that will affect the ability of SW to accurately record the costs associated with the different activities and also the issues around separating those activities as envisaged with the future introduction of competition into the industry.

Executive Summary

1.2 Legislative Drivers of Change

There have been two important legislative changes and one proposed legislative change which will fundamentally impact both the Scottish water industry and the information WICS requires for its part in regulating it.

The first is generic, and relates to competition law in Britain:

- Competition Act 1998 – in response to European legislation, CA98 introduces two important concepts into competition law, Chapter 1 prohibition (agreements or practices which distort competition) and Chapter II prohibition (abuse of a dominant position). As a near-monopoly supplier of water and wastewater services, SW could be vulnerable to challenge under either chapter.

The second is specific to the Scottish water industry:

- Water Industry (Scotland) Act 2002 – created SW by merging the former three Scottish Water Authorities. It limited WICS' remit to the economic regulation of SW's core functions only (as described as "duties" in previous legislation and which could only be undertaken by SW). It also provided SW with discretionary powers to perform other non-core activities in competitive markets.

  It is important that SW show, through accounting separation, that no cross subsidies from the core business into the non-core business exist. Otherwise, core customers will effectively be funding non-core activities, which could be challenged under Chapter II.

The third is a proposed change to the Scottish water industry:

- Water Services etc (Scotland) Bill – introduces a framework for non-domestic retail competition. WICS' Strategic Review of

Charges 2002-06 noted that there is little economic rationale for retail services to be provided by just one company – there are not the same barriers to entry that exist in other areas of the vertically integrated supply chain.[1] As such, SW is vulnerable to challenge under Chapter II if it continues to dominate the retail market and excludes other entrants.

According to the provisions in the Bill, SW will be required to establish a subsidiary to perform retail activities for non-domestic customers (Scottish Water Retail). These activities will eventually be regarded as non-core, and fall outwith the remit of WICS' Strategic Review of Charges. However, they will be subject to a different form of regulation under a licensing regime outlined in the Bill.

The provisions of this Bill are unprecedented in the British water industry. In England and Wales, CA98 has been responded to with a different proposal for the introduction of competition. This means that there are few comparators for this separation. The closest are the Electricity and Gas industries.

In addition to the creation of a retail subsidiary, there are three other important elements to the proposed competitive market:

- § All entrants, including Scottish Water Retail (SWR), must be licensed. A new feature of WICS' remit will be to grant licences and ensure compliance;

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[1] *Strategic Review of Charges 2002-06.,*pp. 106-128

Executive Summary

§ Until the market is deemed sufficiently competitive, as part of the licence regime, WICS will set a retail price cap for the market; and

§ SW must provide wholesale water services to licence entrants. WICS will set a wholesale price cap for the market.

Given the valuable addition regulatory accounts and supporting guidelines will make to WICS' knowledge of the Scottish water industry, it is important that they take into account the above changes, and ensure WICS has sufficient information at its disposal to perform its statutory role.

In order to provide this information, the regulatory accounts required by WICS will go a step further than those of its English and Welsh counterpart Ofwat, by requiring not only a separation of core and non-core activities, but also of wholesale and retail activities.

1.3 Business activity separation

Given the current and proposed legislative situation, WICS will require SW to implement accounting separation in three ways:

- Core activities – undertaken by SW and including a further subdivision of wholesale activities and retail activities for domestic customers.
- Licensed retail activities – undertaken by SWR and other entrants.
- Non-core activities – both those activities undertaken by SW which are in addition to its statutory duties, and those undertaken by SWR which are in addition to its licence obligations.

In order to separate activities into these categories the report:

- Proposes a core/non-core separation
- Further subdivides core activities into wholesale, retail domestic and retail non-domestic activities. Beyond 2006, should the Bill receive Royal Assent, non-domestic retail activities will be regarded as non-core, and will be regulated under the remit of the licensing regime.

Our first step was to understand the activities undertaken by SW in order to supply non-domestic customers. We then isolated the core activities within this supply chain. Once core activities were identified we examined retail activities. In order to do so, we made a series of working assumptions about how the market may work . These are based on the best information available at the time and this accounting separation exercise is not intended to pre-empt how the proposed market will operate.

1.3.1 Non domestic customer supply chain
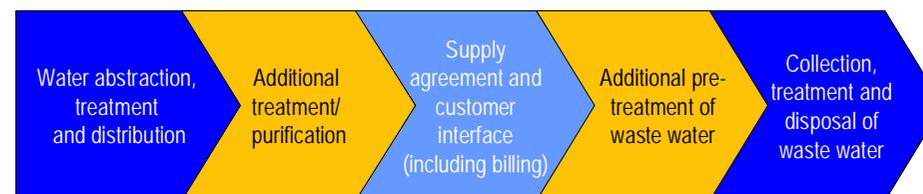
The supply chain diagram above shows the different elements that comprise activities in the water and waste water industry with regards to non-domestic customers. The parties and activities involved in each of the stages of this chain are described below. They have been divided broadly in line with how the separations required by legislation are expected to work.

Executive Summary

1.3.1.1 Core Wholesale Activities

The core activities to be carried out by the wholesaler have been identified in the diagram, in dark blue, as:

- water abstraction, treatment and distribution
- collection, treatment and disposal of waste water.

These wholesale activities are defined in statute as those that SW has a duty to undertake. They will form the basis of the wholesale price cap established by WICS.

1.3.1.2 Core Retail Activities

The core retail activities currently carried out by SW for all customer groups are identified in light blue. Broadly they comprise:

- fulfilment of the agreement to supply services; and
- the customer interface, including billing.

These primary retail functions are key activities that any participant in the proposed non-domestic market would be expected to perform such as customer relationship, billing including credit management, contact management and some metering activity around reading and query handling.

1.3.1.3 Non-Core Activities

Non-core activities carried out for non-domestic customers are identified in the diagram, in yellow. In the supply chain, they could consist of:

- additional treatment/purification; and
- additional pre-treatment of waste water.

However, there are other activities that any entrant into the retail market, or which SW as part of its discretionary power to undertake non-core activities, may wish to provide.

The report explores how we allocated activities under these categories and provide a precedent for allocating "grey areas".

1.4 Core/non-core split

The supply chain diagram broadly identifies core and non-core activities. The first stage of the process of the business activity separation was to clearly identify these core activities. That is the dark blue and light blue sections of the supply chain.

SW's core activities are primarily defined in legislation and this has been our first point of reference for the separation of core and non-core activities. However, SW carries out a wide range of activities that are not explicitly defined in legislation. Many of these activities are support activities which are required to fulfil a statutory obligation. However, others are not. In these instances of uncertainty a degree of judgement needs to be used. In order to inform this judgement, two additional sources of information have been referred to:

- In England and Wales, all water undertakers and water and wastewater undertakers are licensed to carry out Appointed activities. These Appointed activities only are reported in their regulatory accounts and are broadly analogous to the core functions that SW might be expected to carry out. They provide a useful point of reference for the activities a water and wastewater services provider might be expected to provide; and

Executive Summary

- Key stakeholders have provided their views of and rationale for which activities may be regarded as core. Key considerations made during these discussions were:

Is the activity required in support of the fulfilment of a statutory activity?

Does it involve the optional use of an asset owned by the regulated water service?

A final key consideration has been, that where any uncertainty as to the exact classification of activities exists, all costs, assets and revenues are consistently reported. However, it should be noted if "border line" activities which are, or are potentially, loss making are included in the regulatory settlement (that is, are regarded as core), it will simply have the effect of making out-performance of regulatory targets, or even the achievement of them, more challenging.

Appendix 3 of our report provides a detailed analysis of the split between regulated (the core wholesale part of SW), licensed (the non-domestic retail part of SW) and non-core (SW's other activities). At present non-domestic retail will still be classified as a core activity but after separation it will become a licensed non-core activity.

1.5 Retail/wholesale separation

Once core activities were established, it was then necessary to further subdivide these activities into wholesale and retail. In order to do so effectively we made a series of working assumptions about how the retail market might be expected to work:

- the role of licensing;

- the supplier of the last resort requirement;

- limiting the risk of challenges to the wholesale price; and

- the relationship structure in the market.

1.5.1 The role of licensing

Any entrant into the retail market must be licensed. In order to gain a licence they must apply to WICS who will employ a "fit and proper" test on any entrant to ensure non-domestic customers are protected. The content of licences will be subject to extensive consultation by WICS. They will also need to consider the role of General Market Agreements and contractual agreements for clarifying obligations within the market.

Broadly, we have assumed licences will:

- Specify the minimum service retailers must supply (essentially the light blue element of the supply chain);

- Clarify the obligations that exist between retailers and the wholesaler; and

- Provide retailers with the right, but not the obligation, to provide their customers with services beyond the minimum specified in the licence.

1.5.2 Supplier of the last resort

Under the current provisions of the Water Services etc (Scotland) Bill, SW (the wholesaler) is required to act as a supplier of the last resort for non-domestic customers. That is, should a retailer fail, SW will be required to continue to supply customers.

Executive Summary

It is likely that the licence will allow for the intervention of WICS to monitor a Licensee's activities so as to try to mitigate a potential failure event.

1.5.3 Wholesale price

WICS has consulted on the proposal that a single wholesale price should operate in the market. An important advantage of using a wholesale price is that it helps to avoid the onerous information burden that could fall on SW should a wholesale price need to be calculated on an individual basis.

General consensus seems to support this proposal. Indeed it is designed to ensure that the market operates on as pragmatic and as transparent a basis as possible. However, in order for this goal to be achieved, it is vital that this single price is defensible if challenged under the provisions of CA98.

This has significant implications for the business activity separation of SW. In particular, it is vital that any services that could be provided by a participant in the retail market are not designated as a wholesale function/cost. As such, many marginal activities, which could feasibly lie on either side of the split, should not be designated as a wholesale activity and hence not included in the wholesale price.

1.5.4 Relationship structures

Within the proposed supply chain for non domestic customers noted in section 5, there are three tiers of customer interaction at work:

- The first is between the wholesaler and its customers, the retailers who participate in the market;

- The second is between the retailers and their customers, the non-domestic "eligible" customers. It is expected that the retailer will want to "own" their customer and therefore all primary contacts with the customer will be through the retailer; and

- A third relationship could exist between retailers and third parties (or indeed SW) to whom they may wish to outsource activities to.

These tiers of interaction comprise a number of different relationships each of which vary in their scope and nature: In particular, it is necessary to distinguish these relationships in terms of:

- Who performs the physical activities?

- Who is responsible for these physical activities, and to whom those responsibilities are directed?

- Who bears the cost of performing these physical activities?

- How these relationships are governed?

It is important to note that whilst the responsibility for an act may well lie with one party and, therefore, they will also bear the cost associated with it, it does not mean that they have to perform that activity. For instance, there is potential for a retailer to choose to outsource some activities either to the wholesaler or a third party. However for simplicity, we have excluded third party arrangements from the diagram below.

Executive Summary

Diagram 1.5.4: Relationship structure
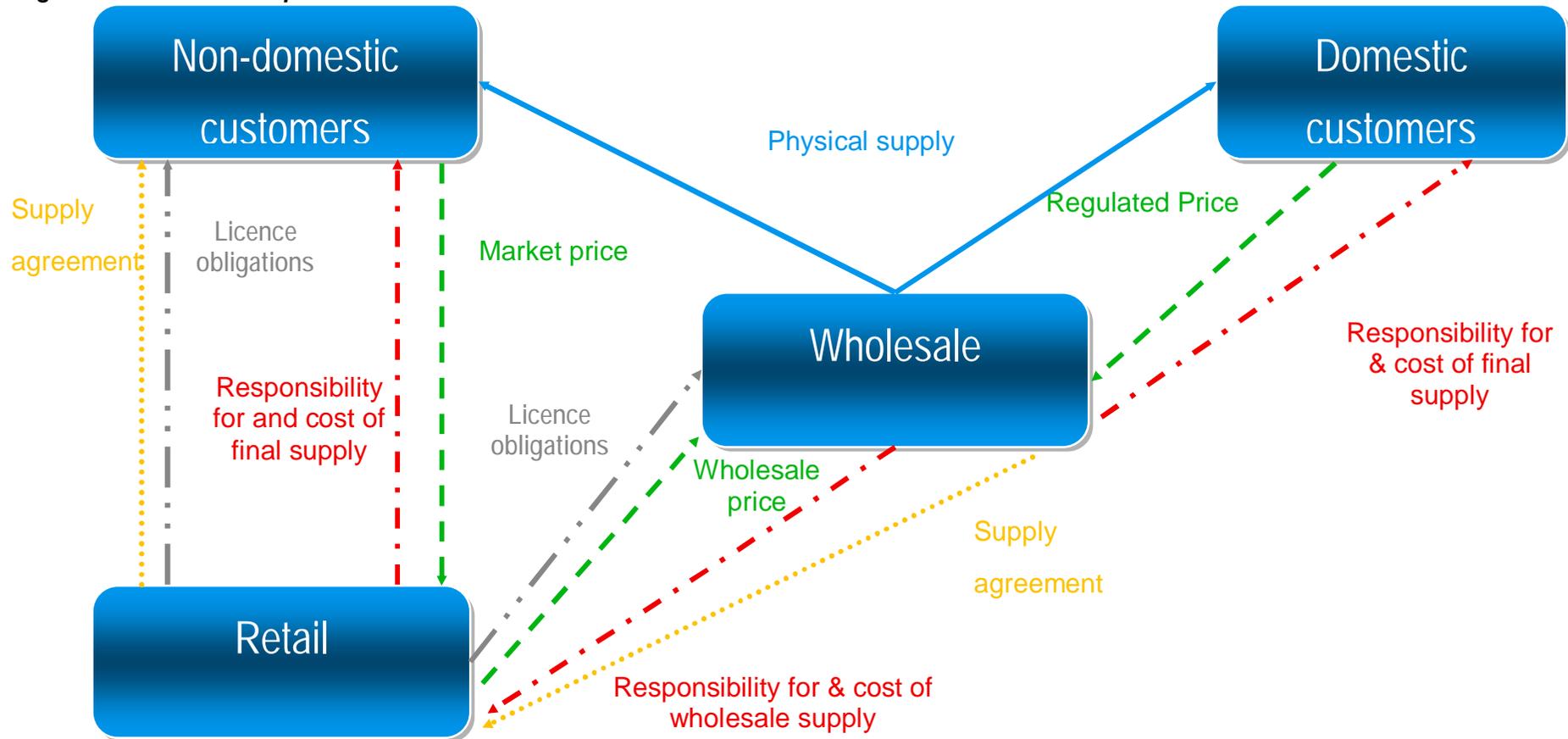
Note: *Regulated price* is the price paid by domestic customers for the wholesale and customer facing services it receives from Scottish Water, *wholesale price* is the price paid by retailers for the provision of wholesale services to their non-domestic customers, and *market price* is the price paid by non-domestic customers to retailers

Executive Summary

1.5.5 Allocation of activities

Given the above considerations as to how the retail market might operate, it was necessary to further subdivide SW's core activities into wholesale and retail. In the context of the non-domestic supply chain diagram, clarify the light blue section.

As WICS may be required to provide a retail price cap in the initial stages of the non-domestic market, the costs associated with performing these activities will be used to inform their determination. These are the activities that will likely be specific as a minimum service in licence conditions.

There is no precedent for this kind of activity separation in the water industry. Therefore, the proposed allocation of activities relied on discussions with key stakeholders and one overriding consideration:

If the activity is not designated as retail (ie, included in the wholesale price), is it likely to be contested by a retail entrant?

Appendix 3 details this allocation in full.

1.6 Reporting the business activity separation – the Annual Return M tables

WICS require SW to report on its performance in the "Annual Return", a combination of reporting tables which capture different elements of SW's business. These tables are based primarily on Ofwat's "June Return" tables which are completed annually by the English and Welsh water companies. However, where appropriate, changes have been made in the reporting structure in Scotland to reflect SW's specific circumstances and specific Scottish legislation.

SW aims to complete the M tables by using its newly developed (and still evolving) ABM. The model has been developed in order to deliver activity based costing to a high level of detail. It allocates costs across the main activities carried out by SW as part of its business. These activity categories include both non-core and retail.

Within the activities, costs can either be directly allocated using financial drivers, or for shared services, apportioned based on non-financial drivers. For instance, where operational teams divide their time between water and sewerage services they complete time sheets to indicate how their time is spent, thus allowing employment costs to be allocated. Similarly, retail activities, such as the cost of complaint handling can be allocated across a wide range of complaint categories on the basis of the number of complaints received.

This means that for a large number of activities SW are able to either directly allocate costs or use a non-financial driver to apportion them. In some instances, such as central support costs, a degree of subjectivity is used, but SW believes that costs allocated on such a basis comprise a very small proportion of total opex.

The ABM was used to complete part of the last Annual Return submission, and as such, was subject to the scrutiny of the Reporter (Black and Veatch). Whilst it is recognised that the system is still developing and are still emerging, it will provide a strong basis for reporting.

However, as the RARs emphasise, it is vital that where SW doubt the robustness of the reported number, or have used an allocation, that this is clearly documented with an appropriate confidence grade and in the commentary which accompanies submissions.

Executive Summary

1.7 Separation Issues

1.7.1 *Grey areas in both the core/non-core separation and the wholesale/retail separation*

1.7.1.1 Metering

Whilst there is the potential that retailers may wish to own their customers' meters, and hence they could prove a contestable element of the wholesale price, experience in England and Wales in the gas and electricity markets does not support this.

Indeed, meters are often regarded by undertakers as a crucial part of the infrastructure and vital for supply and demand management. Retailers may therefore regard them as a wholesale activity.

Furthermore, should meter ownership fall to the retailer, this could create a barrier to entry in the market. In particular, if meter ownership was transferred to SWR, when the market was opened to competition, conceivably other retailers would have to buy meters from them. This could leave the arrangement vulnerable to challenge under CA98.

While the ownership and maintenance of meters is defined as a wholesale function, the experience of other utilities is that it is feasible to fulfil this function in a number of ways. These include at one end of the spectrum a simple ownership model through to a fully managed service based on leasing. In the instance of the Scottish water industry, leasing would have a number of advantages, in particular:

- As not all non-domestic customers are metered, it would create an inequality if included in the wholesale price. Therefore, where a customer is measured, retailers will be obliged (potentially through a licence condition) to lease that meter;

- By leasing meters, retailers will have the flexibility to upgrade meters should they wish as part of their leasing agreement. This will enable them to tailor meter capabilities to specific customer needs; and

- SW would also be protected in this arrangement, as they would only be obliged to provide/consent to a meter upgrade (that is beyond the standard meter provided) if the retailer was prepared to bear the cost.

Regardless of where meter ownership falls, all parties in the relationship, that is non-domestic customers, retailers and the wholesaler, must be confident that the meter readings are accurately reported and verifiable. Anxiety about the reliability of meter readings could be relieved by including them as an important component of licences or some other contractual arrangement.

By virtue of their customer facing nature, meter reading and handling meter queries are retail activities. However, it is recognised that whilst meter readings will be crucial for the retailer's billing purposes, they will also be crucial for the wholesaler to bill the retailer. As such, it is likely that a contractual or licensing arrangement would need to be established to ensure accurate meter readings are available to both parties.

Executive Summary

1.7.1.2 Customer call centres

The key function of the new retailer will be the provision of customer support and the critical activity here will be the operation of the call centre. There will need to be close liaison with the wholesaler, both in terms of personnel and IT systems, as the availability of 'real time' operational and billing information (for metered customers) is essential if the retailer is to provide a quality service too its customer

Shown overleaf is our view of how the call centre interface could operate:

Executive Summary

Diagram 1.7.1.2: Customer call centre
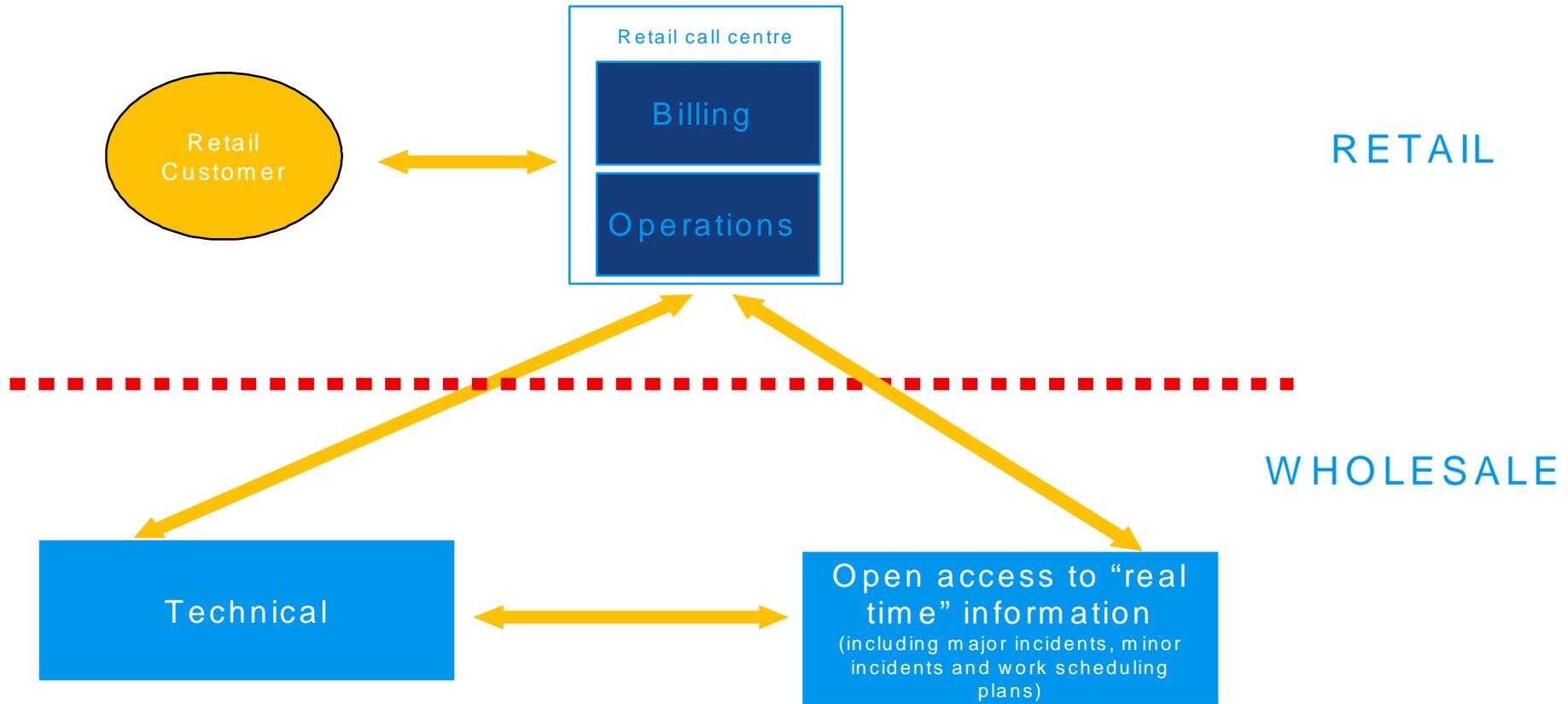
Note: In complex situations it may be necessary for the wholesale technical team to liaise directly with the retail customer

Interface

Executive Summary

Advantages of this Structure

- Customers will have a single point of contact to deal with in trying to get their problems resolved. They will also continue to enjoy the benefits of real time information.

- The single point of contact is the entity that they pay for their service supply and is therefore the entity which should be keenest to keep them satisfied. Therefore their problem will be dealt with in a timely manner and with attention to a satisfactory solution that maintains good customer relations.

- As non-domestic customers will contact the retailer should they have an issue with their supply, it will provide the retailer with much greater visibility as to the nature of the supply their customers are receiving. That is, it will prove an important check on the quality of the product the wholesaler is selling to the retailer.

- The competition requirements mean that activities that could be replicated by an alternative supplier, and thereby could give rise to competition, should not be preferentially provided by a monopoly supplier. In this case we believe that the management of the customer interface is replicable and therefore should be the responsibility of the retailer.

- It provides retailers with the knowledge of their customers' quality of supply.

Potential disadvantages:

- The success of the framework relies on the wholesale system being capable of providing open and effective access to retailers and thereby allowing retailers access to real time information on both the status of calls logged by their customers and on the state of the network infrastructure as a whole. Given that a number of retailers could be trying to interface with the wholesaler at once this raises two key issues:

  § How accessible is the wholesaler's current real time scheduling system, for instance is it based on a commercially available and widely used software system, or has it been developed specifically for SW's purposes?

  § Should the wholesaler be obliged to provide retailers with instant access to their scheduling system, and if so, with a number of retailers vying for slots how will work be prioritised?

1.7.1.3 Septic tanks

Emptying of septic tanks is an activity that other parties could enter into reasonably easily and therefore it is deemed to be competitive. We understand that non-domestic septic emptying is already competitive, as is domestic septic tank emptying. Per the legislation, retailers have the option to empty septic tanks, however, once they have chosen to accept that option, it becomes an obligation and thus it would appear to form part of their core, licensed activity. Therefore it is unclear whether it forms part of the core or non-core retail business of SW.

Executive Summary

1.7.1.4 Sewage clean up

The issue of who cleans up sewage that has leaked from the sewerage system is complex. However, there are a number of key principles that may help clarify the roles and responsibilities and thereby the impact on setting the wholesale price. These principles are best illustrated by example.

- The polluter is responsible for the remedy. The concept of the "polluter pays" is well established. In circumstances where the original leak has resulted from a failure in the network asset, SW (the wholesaler) must have the primary responsibility for clean up. As happens today it could choose to fulfil this responsibility by the use of external contractors.

- Where sewage crossed a boundary by spilling into a retail customer's premises then the responsibility for meeting the costs of clean up should remain with the primary polluter. It is of course reasonable for the premises owner to procure its own clean up function (potentially from its retailer) but these costs will be recovered as part of the claim for damages from the primary polluter.

1.7.1.5 Bottled water

In the event that water supplies are restricted or cut off, suppliers will normally provide bottled water or water tankers. There is no statutory obligation on SW to do this. However, it is feasible that as part of their wholesale agreement with retailers, provisions relating to penalties for the loss of supply will be provided. In circumstances where a retailer is obliged to use alternative sources it will seek to recover these costs from the wholesaler.

1.7.1.6 Catchment areas

Forestry management is a grey area in the separation because it is difficult to determine which side of the core/non-core boundary it sits.

If the forest is deemed to be important for catchment purposes then it could be argued that the costs incurred in maintaining the land and the trees should be part of the core business. However, if SW carries out logging in the forest then this would appear to be a non-core activity and the cost and revenue should arguably be excluded from the regulated accounts. But it could be argued that the logging is an essential part of maintenance which brings it back to a core activity.

The key principal at stake here is that water customers should not fund non-core activities undertaken by SW and therefore if the costs and revenues associated with an activity are matched in the accounts then its exact location should have little impact on the regulated cost of SW. However, if loss making or inefficiently performed activities are included in the regulatory settlement, they will only serve to make the attainment of efficiency targets more challenging.

1.7.2 Finance and Accounting

1.7.2.1 Quality of data in completing M tables

The accurate reporting of financial information by SW to WICS is a key part of the monitoring and cost setting operation of the regulator. Therefore it is essential that the data that WICS will rely on is of a sufficient quality to enable accurate conclusions to be drawn.

Executive Summary

The SW Activity Based Management (ABM) system is the tool for capturing this data. The M tables have been carefully designed to match as closely as possible the data collection format of the ABM system, however most of the data required to complete the M tables will not be produced directly by the ABM system.

The actual raw data collected will need to be manipulated by the SW finance team in order to provide the analysis required. For a number of cost categories, such as customer contact staff, this will involve reviewing quarterly activity reports and then dividing the costs of those staff in accordance with the data showing which customers they have been dealing with. These quarterly activity reports are prepared as part of the normal business reporting process and should provide a reasonable basis for apportioning costs.

For some categories of costs, such as parts of general and support costs, management will need to make a more subjective apportionment of costs and here their experience and judgement will be important.

Overall, SW is confident that they can gather and organise cost data in a way that will be meaningful for the regulator to review. However, it is important that the process for apportioning costs is monitored closely by SW, their auditors and the regulator to ensure that the M tables are completed as accurately as possible.

Scrutinising the M tables will also be included in the remit of the Reporter.

1.7.2.2 Transfer pricing – where it should be used and is it being done properly

RAR 5 provides detailed guidance to SW on the issue of Transfer Pricing. This states that SW is under a duty to trade at arm's length and to ensure that there is no cross-subsidy between the core and non-core businesses. Moreover, the onus is on SW to ensure that its activities comply with this duty and it needs to be able to demonstrate clearly that it is meeting its duty.

The primary principle is that transfer prices should be based on market price or less and that market price, wherever possible, should be determined by market testing, the principle of which are set out in RAR 5.

Where no market exists for particular supplies, works or services, the transfer price should be based on cost and the cost allocation guidelines followed. The principles of cost allocation are set out on RAR 5.

RAR 5 also stipulates that the auditors should prepare a long form report in SW's annual return, which should identify material areas of judgement and any other material circumstances which appear to the Auditor to be relevant having regard to the guidelines. Therefore WICS may require the Auditor to adopt a particular focus in examining compliance with this guideline and this would be enhanced by a pre-split review.

1.7.2.3 IFRS

The regulatory accounts will be prepared according to the RARs which will take precedence over UK GAAP and other reporting standards such

Executive Summary

as IFRS. Indeed, SW, as a public corporation, is exempt from preparing IFRS accounts before 2006 (and possibly beyond) and therefore does not expect the introduction of IFRS to have a major impact on its financial reporting.

The standard which is most likely to have a major impact is the pensions standard (IAS19) which is similar to the UK standard FRS17, which is due to be implemented shortly. This will require SW to recognise pensions liabilities through its profit and loss account and will inevitably lead to a more volatile movement in this particular balance.

From discussions with SW, we have not identified any other areas that are likely to have a significant impact before 2006. However, it is anticipated that in the future, there will be a convergence of UKGAAP with IFRS. International reporting standards that may have a significant impact (could potentially create large deferred tax issues) on the Scottish water industry beyond 2006 include:

- IAS 32 "Financial Instruments: Disclosure and Presentation"

- IAS 39 "Financial Instruments: Recognition and Measurement"

- IAS 16 "Property, plant and equipment" (particularly with regard to renewals accounting).

1.7.3 Physical Separation

The extent to which physical separation of SW will be required depends largely on the outcome of the Bill and the decision of the Scottish Executive. However, until at least 2006, SW will be required to use transfer pricing in order to complete the M tables.

Below we discuss some issues that could arise should a physical separation be required for the fulfilment of the Bill.

1.7.3.1 Customer call centre

Both SW and SWR will have a fundamental requirement for a customer contact centre after the separation of the two businesses.

It will be necessary to work out the most appropriate compromise to meet the needs of both businesses, bearing in mind the need to keep call arrangement at arms length in accordance with RAR 5.

1.7.3.2 Legal entity

The separation of SWR from SW will require careful legal planning to ensure that the new structure complies with the tax structuring requirements, the finance and reporting requirements, the licence regime requirements and the Competition Act requirements.

All shared service agreements will need to properly documented, detailing clearly the service to be provided and the fee to be paid.

A critical consideration in the short term will be the financial structure that allows SWR to compete in the retail market. The nature of the commercial risks faced by SWR, its ability to access capital for new activities, and the return appropriate for these risks must be addressed.

1.7.3.3 Personnel

SW will need to ensure that there is physical separation of the personnel involved in the two businesses, in order to minimise the possibilities of a challenge to the validity of the separation under the Competition Act.

Executive Summary

This may involve being situated on separate floors or even in separate buildings. Whilst there will still need to be close co-operation between the two part of the business this will need to be on an arms length basis and will need to be properly documented in a shared services agreement (see below).

Individual staff will need to be formally assigned to either SW or to the new retail business and they will only work for that business except under a shared services agreement. This is likely to cause particular issues in areas such as the call centre where there will be common activities between the two businesses. It will also be an issue in the support function such as HR and finance.

It is important for the establishment and success of the new entity that it is able to capitalise on the experience and skills of staff who previously performed a similar role in the original incarnation of SW. Whilst SW (wholesale) are likely to want to retain this skill base for their domestic customer contacts, some consideration should be given to the staff that will work for the new retail entity. It will be important that the establishment of their terms and conditions is managed correctly. This will include 'TUPE-ing' across staff to protect their existing terms and conditions.

1.7.3.4 Pensions

This is likely to be particularly important in respect of pensions and this may be a significant issue as the pension scheme may hold considerable current and future liabilities in respect of employees.

1.7.3.5 IT technical interfaces, including real time information and switching engines

The separation of IT (both hardware and software), together with the ongoing ability of the IT systems to interface with each other, are critical components of the separation of the two businesses. As mentioned in Section 5, the ability of the IT systems to access 'real time' information is critical to the ability of SWR to provide a high level of service to its customers.

However it also important that the IT systems are separate, in order that SWR cannot be held to have an unfair advantage over other potential retail competitors.

Thus a detailed plan of action will need to be prepared to establish an independent IT hardware and software function for SWR that meets their billing and customer contact requirements and which is able to interface on a 'real time' basis with SW's system in order to obtain up to date information on resolution of network infrastructure problems and in order to draw the data necessary to prepare bills for metered customers.

In the longer term it will be necessary for all retailers to be given open access to 'real time' information and therefore any separation plan will need to take this into account.

An additional cost that is likely to be borne by all retailers, including SWR, is the set-up and running costs of a "switching engine" to transfer customer information. There are various options available for which form a switching engine could take, varying in the degree of sophistication and cost. However, regardless of the form the engine takes, from the point of view of non-domestic customers, it is important

Executive Summary

that they are able to exercise the choice afforded to them from competition by being able to change retailer in an efficient manner.

It is likely that the switching engine will need to be operational by the time the market is option to competition. As such, development costs could be borne before the market is opened. Some consideration should be given as to how these costs can be funded before they are recovered from retailers.

Also, it is likely that a protocol for switching customers will need to be developed. This will be particularly important for customers who have debt balances. For instance, retailers may choose to refuse transfers of customers in debt; alternatively, they may allow them to transfer that debt to a new retailer.

1.7.3.6 Relationship between retail and wholesale

The relationship between SWR and wholesale will be governed by the licensing agreement, by shared services agreements and by any longer term outsourcing agreements.

The licensing agreement will define the boundaries between the two businesses. It will be expected to set out the minimum level of service to be provided by the retailer and will define the responsibilities of the wholesaler to assist the retailer in providing those services. The latter will include matters such as open access to real time information, which will be essential to enable the retailer to keep its customers informed of issues and to deal with their queries. There will also be a responsibility on the retailer to support the wholesaler in situations such as major incidents, when the retailer will be expected to help with disseminating information as required.

There will also be a direct contact with regard to GMS payments, whereby the retailer will be responsible for making the payments either directly or through a discount to the customer's bill and then they will reclaim the payment from SW in those instances when SW is responsible for the issue which led to the payment.

The shared services agreement will be the method by which both entities can formally document any joint use of services in the short term after the separation.

In the longer term, the retailer may decide that there are some services that it wishes to outsource on a permanent basis. It may choose to use a third party provider or it may decide to use SW.

1.7.3.7 Shared Services agreements

SWR will need to carry out a detailed review of activities ahead of separation in order to identify which activities they intend to operate as soon as separation occurs, which they intend to develop during the first 6 months and which they intend to outsource on a longer term basis.

For the second category, where SWR intends to develop its own function upon separation, it will want to enter into a shared services agreement with SW in order to ensure the ongoing provision of services. This might typically cover matters such as use of IT systems, use of finance and HR personnel and use of premises. The shared services agreement will set out in detail the service to be performed, the expected period and the detailed cost of providing that service. The latter will be expected to comply with RAR 5. The shared services agreement could operate both ways, ie a function that is assigned to SWR could continue

Executive Summary

to provide services to SW if required and agreed through the shared services agreement.

SW could use the ABM system as a starting point to determine the services where there is an overlap and then the basis of allocation to specify the detailed services provided.

1.7.4 Others

1.7.4.1 Single wholesale price

The operation of a single wholesale price is seen as an important principle by WICS. The grey areas noted above (and others which may come to light during the separation process) may make it difficult to maintain the concept of a single price as different retailers may wish to opt to perform certain services which may currently be expected to be provided by the wholesale business.

WICS will need to consider how it will address these issues from a pricing point of view and devise a consistent strategy to deal with these issues as they arise.

1.7.4.2 Financing of working capital

The financing structure of SWR needs to be planned and agreed ahead of separation. One proposal is that the wholesaler would be paid on demand, ie the retailer would receive no credit period. This would result in the retailer needing to establish a credit line for working capital which could see a requirement of 60 days or more depending on payment terms.

1.7.4.4 Licensing

SWR will need to apply for a licence ahead of April 2006 to cover the provision of water and waste water services to non-domestic retail customers. It will also need to decide how it intends to fulfil the conditions of the licence, ie whether it intends to provide all the services itself or whether it intends to outsource the provision of some of those services.

SWR will be monitored by the regulator who will ensure that the terms of the licence are being adhered to. SWR will need to establish appropriate internal monitoring functions to ensure that it is meeting the terms of the licence. This will be important both from the point of view of satisfying the regulator but also for ensuring that their customers are satisfied with the service they receive.

Executive Summary

1.8 Next Steps

The timetable for assessing the impact of separation issues and the implications for pricing is set out below.

Date	Action
10/12/04	Report on business activity separation sent to Scottish Water
10/12/04	RARs and accompanying M tables issued to Scottish Water
10/01/05	Scottish Water return completed tables with figures for 2003-04
20/01/05	WICS send response to Scottish Water re: completed tables
27/01/05	Workshop on regulatory accounts and issues raised
March 2005	WICS to issue RARs and accompanying tables to be completed with figures for 2004-05, for final determination

Project Overview

2. Project overview

2.1 Background to business activity separation

Recent and proposed legislative changes have had a significant impact on both the role of the Water Industry Commissioner for Scotland (WICS) and potentially, how the Scottish water industry itself could operate.

The Water Industry (Scotland) Act 2002 revised the remit of WICS to promoting the interests of customers of Scottish Water's (SW) core functions only. It also provided SW with a remit to pursue wider commercial, "non-core" activities (subject to Ministerial guidance).[2] In the next regulatory period (2006-10), WICS will be required to establish a limit on the level of charges paid by customers of SW's core functions. In order to do so, WICS must be able to establish SW's revenue requirement based on its core functions only. That is, it will need to understand the costs associated with providing a core service to customers in isolation of those costs incurred from providing non-core services. Although these core functions are defined in statute, workable interpretations of these definitions, suitable for the rigorous process of price setting, have yet to be established and agreed with the interested parties.

A second piece of proposed legislation is expected to impact further on WICS' role in the next regulatory period. The Water Services etc (Scotland) Bill introduces a framework for retail competition for non-domestic customers (essentially any customer without a council tax band). The provisions of this Bill are unprecedented in the British water industry so there are very few comparators for this separation.

A key requirement of the Bill is that SW establishes a subsidiary to perform its retail functions for non-domestic customers.[3] Doing so should preclude both the perception and reality of SW, as both the incumbent retail services supplier and wholesaler of water and wastewater services, from having an unfair advantage over potential entrants into the retail market.

Should the proposed Bill receive Royal Assent, then it is expected that this separation will take place on 1 April 2006. At this point SW will be reorganised so that it will essentially operate as two separately funded entities.[4]

The first of these, SW, will provide wholesale, core activities under the regulation of WICS and other regulators such as SEPA and the DWQR, with WICS setting a wholesale price for water and wastewater. SW will continue to be responsible for the provision of retail services to domestic customers.

The second entity will provide retail services to non-domestic customers. This entity is referred to as Scottish Water Retail (SWR) throughout this report. It is proposed in the Bill that SWR, as with other

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[2] Water Industry (Scotland) Act, Sections 25 and 56.

[3] Water Industry (Scotland) Act, Sections 12 and 13

[4] Ibid.

Project Overview

entrants in the market, will operate under a licence regime. The activities performed by the retail subsidiary will be regarded as non-core.

Once licensed, it is not expected that SWR will be immediately subject to competition. Indeed, it is likely that a period of consultation and development will be required until the market can be opened in an orderly manner. Current indicators suggest that this could happen in 2008. It is also envisaged that a further period of transition will be required until the market can be regarded as fully competitive. Until such time that the price controlling effects of market forces can be realised, WICS may be required to establish a retail price cap for the market under the remit of the licensing regime.

2.2 The regulatory accounts project

These actual and proposed legislative changes have had, and could have, a significant impact on the information requirements of WICS respectively:

- It will need to understand SW's core costs in order to establish a price cap in the next regulatory period.

- If proposed legislation receives Royal Assent, WICS will also need to differentiate between the core costs associated with performing wholesale activities and those associated with retail activities separately.

This means that SW will need to have a reporting structure in place that can accurately distinguish:

- Non-core costs

- Core wholesale costs (in order to calculate a wholesale price)

- Domestic retail costs (which combined with core wholesale costs will form the basis of the Strategic Review of Charges 2002-06.)

- Non-domestic retail costs (required as part of the Strategic Review of Charges 2006-10 and potentially to calculate a retail price for the new market).

Tables 2.2.1, 2.2.2 and 2.2.3 below summarise the impact of these legislative changes.

Project Overview

Table 2.2.1: Legislative position post 2002

STATUTE	
Activities which Scottish Water has a DUTY to undertake (referred to within this report as "core" activities.)[5]	Activities which Scottish Water has the DISCRETIONARY POWER to undertake (referred to within this report as "non-core").[6]
REGULATED	NON-REGULATED
Wholesale	For instance, consultancy, ferry
Domestic retail	
Non domestic retail	

Table 2.2.2: Proposed legislative position post 1 April 2006

STATUTE		
Activities which Scottish Water has a DUTY to undertake	Activities which Scottish Water Retail is licensed to undertake	Activities which Scottish Water has the DISCRETIONARY POWER to undertake
REGULATED	LICENSED	NON-REGULATED
Wholesale	Non-domestic retail	For instance, consultancy, ferry
Domestic retail		

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[5] As per Section 70(2) Water Industry (Scotland) Act 2002

[6] As per Section 25 Water Industry (Scotland) Act 2002

Project Overview

Table 2.2.3: Regulatory information requirements

Form of regulation	Information requirement	Output
Strategic Review of Charges 2006-10	Wholesale costs, domestic retail costs, non-domestic retail costs	Price cap for domestic customers Initial wholesale price
Licensing regime	Non-domestic retail costs[7]	Initial retail price

It is also important for SW that it will be able to "ring-fence" its core activities and provide clear accounting separation from its "non-core" activities. This should enable it to understand better the costs associated with providing core functions, but should also help prevent any cross subsidisation between the two types of activities. This is important for SW's core customers as it will ensure that the costs of non-core activities are not taken into account during price setting.

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[7] WICS, as overseer of the licensing regime, will set a price cap on an interim basis until the market is deemed to be fully competitive.

Not only is the avoidance of cross-subsidisation important for SW's customers, but also SW itself. The Competition Act 1998 (CA98) prohibits anti-competitive behaviour by companies through their entering agreements that distort, restrict or prevent competition. It also prohibits a company abusing its dominant position. As SW is a near-monopoly supplier of water and waste water services in the Scottish market, it is vulnerable to challenge under this legislation. As such, it must be able to demonstrate that charges reflect costs which have been appropriately allocated.

The CA98 also has important implications for the proposed introduction of non-domestic retail competition which is itself, in part, a response to this legislation. When setting a wholesale price, WICS must ensure that it does not reflect clear inefficiency or misallocated costs on the part of the wholesaler, otherwise it will be open to challenge by incoming retailers.

Clearly, there is an increased risk of a challenge through the CA98 if there is no audited accounting regime that differentiates wholesale and retail costs, revenues, assets and liabilities. It is important that transfer pricing (the price paid by one party in a group to another for goods or services provided by them) is a key feature of any accounting system. Where goods and services transfer either between the ringfenced core and non-core elements of SW, or potentially between SW and SWR, they must be accounted for either through market testing, or where appropriate, cost. Should a competitive market be introduced, SW must demonstrate that SWR is treated in the same way as any other third party retailer, that is, at arms length.

Project Overview

Given the degree of scrutiny that wholesale and initially retail prices are likely to receive it is important that they can be comprehensively justified. Whilst statutory accounts have previously provided WICS (together with supporting information from the Annual Return) with sufficient information to calculate a revenue cap for SW, they will be unable to subject wholesale and retail price determinations to a sufficient degree of rigour. WICS therefore intends to use a set of regulatory accounts designed specifically to meet the demands of price determination.

The introduction of a set of parallel, regulatory accounts will provide more information than statutory accounts and will reveal more about the underlying costs of the business. This is essential for effective regulation. Accounting separation of key discrete activities (core and non-core, wholesale and retail) means that core customers will only pay for the core services they receive. It should also lead to a robust allocation of costs, thus enabling prices to be less vulnerable to challenge under competition law.

It will also provide a number of additional benefits:

- Benchmarking and comparability –WICS currently forms a view of how efficiently SW should operate based on comparisons with the water and wastewater companies in England and Wales. In order to do so, adjustments to the information reported in SW's statutory accounts are made to ensure that they are comparing like for like. As regulatory accounts are used in England and Wales, their implementation in Scotland should help to reduce the necessity of such adjustments; and

- Monitoring - WICS also monitors SW's performance in part by using statutory accounts. However, as these accounts are primarily designed to comply with the Companies Act, their content can change as these statutory reporting conventions change. This makes monitoring over longer periods difficult, and again requires adjustments to the statutory accounts to be made. As regulatory accounts will be designed entirely for the purpose of regulation, they will not be subject to such statutory changes.

In order to realise these benefits, the regulatory accounts project will provide:

- The separation of accounts for core and non-core activities;

- The further separation of accounts for core into retail and wholesale activities;

- Accompanying reporting tables (M tables) capable of capturing this separation;

- Appropriate rules for the completion of accounts, including clear rules for transfer pricing; and

- Guidance for auditors.

Methodology and Approach

3. Approach to business activity separation

One of the key requirements of the project is to provide an accounting structure which allows a separation of activities. In order to do so, activities have been separated on the basis of:

- Understanding the difference between core and non-core activities; and

- Further subdividing core activities into wholesale and retail activities.

Core activities are defined in legislation and are broadly understood. However, an interpretation of core activities prescriptive enough for the purposes of regulatory accounts needs to be established. It is recognised that some activities may not be universally core or non-core, and a degree of judgement needs to be applied. Where appropriate, this judgement has been informed by definitions of Appointed activities used in England and Wales.

Having identified core activities, we then go on to further subdivide them into retail and wholesale activities. As we shall discuss, the way in which the proposed market could operate will influence how this activity separation is initially made. As such, we have made a number of working assumptions throughout the process to better inform the separation, particularly:

- the relationship structure within the competitive framework;

- the requirement for a single wholesale price; and

- the potential role of licensing.

However, the initially agreed accounting separation is not intended to pre-empt the way in which the market will operate. Instead, it is intended to identify the activities which could be regarded as retail, and subdivide them in a way which provides sufficient flexibility should the provisional boundary need to be finessed as the framework for competition is developed.

In order to gain this initial understanding, activities have been identified from SW's activity based costing accounting model, and discussed with key stakeholders.

The provisional findings are discussed in the following sections.

Methodology and Approach

3.1 Non-Domestic Customer Supply Chain

In order to understand better the effect of both the core/non-core and wholesale/retail activity separation, it is useful to examine how the supply chain to non-domestic customers will be affected by the proposed changes.

The supply chain diagram 3.1 below shows the different elements that comprise activities in the water industry with regards to non-domestic customers. The parties and activities involved in each of the stages of this chain are described below. They have been divided broadly in line with how the separations required by legislation are expected work.

3.1.1 Core Wholesale Activities

The core activities to be carried out by the wholesaler have been identified in the diagram, in dark blue, as:

- Water abstraction, treatment and distribution; and

- Collection, treatment and disposal of waste water.

These activities are defined in statute as those that SW has a duty to undertake. They will form the basis of the wholesale price. SW will retain sole responsibility for treatment and distribution on the public networks.

In the event of retail competition being introduced, SW will treat water and waste water for a third party retailer and distribute it to and from that retailer's customers. All such relationships with retailers would be at arm's length in accordance with RAR 5 and this would be reflected in the wholesale price.

3.1.2 Core Retail Activities

The core activities to be carried out by a retailer have been identified, in light blue, as comprising:

- Fulfilment of the agreement to supply services; and

- The customer interface, including billing.

These primary retail functions are key activities that any participant in the non-domestic market would be expected to perform such as customer relationship, billing including credit management, contact management and some metering activity around reading and query handling.

3.1.3 Non-Core Activities

Non-core activities that could be carried out for non-domestic customers either by a retailer or SW are identified in the diagram, in yellow, as:

- Additional treatment/purification; and

- Additional pre-treatment of waste water.

However, there are activities that any participant in the retail market, or SW as part of its discretionary power to undertake non-core activities, may wish to provide.

Methodology and Approach

The remainder of this report explores:

- How we allocated activities into the core sections of the supply chain, and by default how activities were designated as non-core;

- How we allocated these core activities between retail and wholesale, including the working assumptions we have made, and the role licensing will take; and

- How the regulatory returns required to report this separation have been developed.

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Methodology and Approach

Diagram 3.1: Supply chain for non-domestic customers

| Water abstraction, treatment and distribution | Additional treatment/ purification | Supply agreement and customer interface (including billing) | Additional pre - treatment of waste water | Collection, treatment and disposal of waste water |

Statutory activities

Licensed activities

Statutory activities
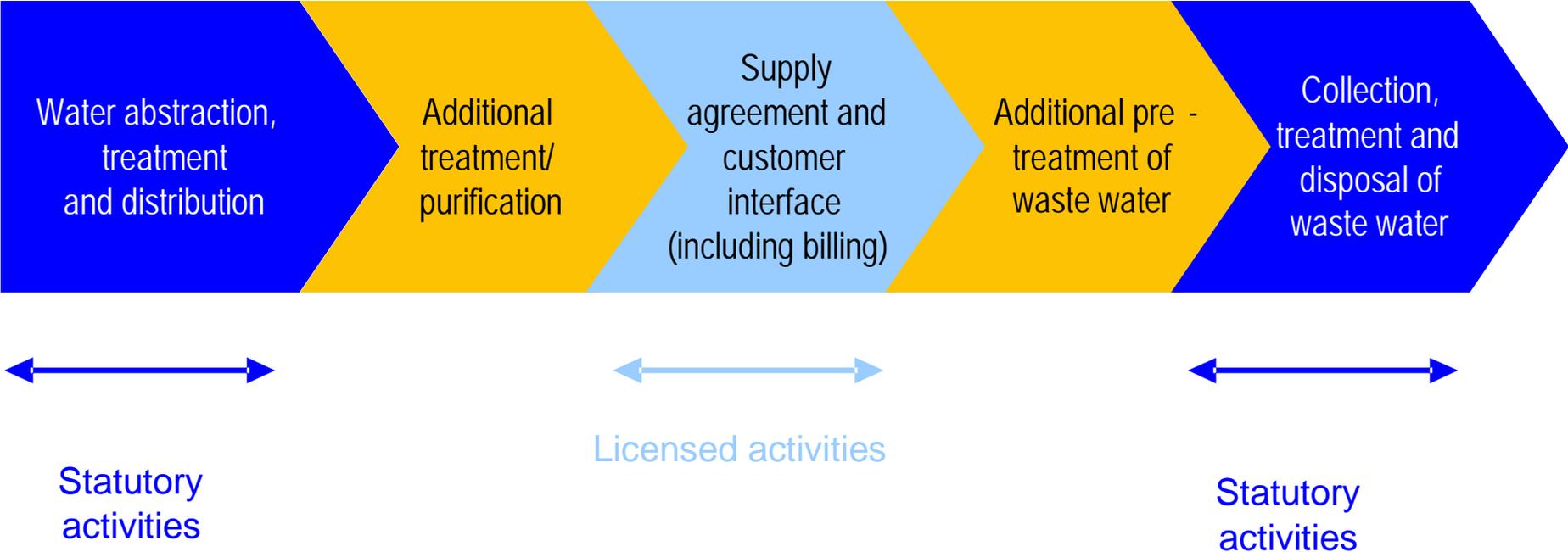
Core/Non Core Separation

4. Core and non core activity separation

SW's core activities are primarily defined in legislation and this has been our first point of reference for the separation of core and non-core activities. However, SW carries out a wide range of activities that are not explicitly defined in legislation. Many of these activities are support activities which are required to fulfil a statutory obligation. However, others are not. In these instances of uncertainty a degree of judgement has been used. In order to inform this judgement, two additional sources of information have been referred to:

- In England and Wales, all water undertakers and water and wastewater undertakers are licensed to carry out Appointed activities. These Appointed activities only are reported in their regulatory accounts and are broadly analogous to the core functions that SW might be expected to carry out. They provide a useful point of reference for the activities a water and wastewater services provider might be expected to provide; and

- Key stakeholders have provided their views of and rationale for which activities may be regarded as core.

4.1.1 Statutory definition of core activities

The Water Industry (Scotland) Act 2002 established SW and clarified the role of WICS in regulating the entity. Specifically:

- Section 1 revised the WICS' remit to protecting the interests of SW's core customers only;

- Section 25 provided SW with the remit to engage in non-core commercial activities subject to Ministerial guidance (these are described as SW's discretionary powers); and

- Section 70(2) defines these core activities with reference to the Sewerage (Scotland) Act 1968 and Water (Scotland) Act 1980 and any other enactment (taken to include later legislation).

The general and widely understood definition of SW's core functions is the provision of water and wastewater services for domestic and non-domestic customers. This understanding is consistent with the obligations (duties) placed under SW in the above two Acts.

Within these Acts, core functions have been taken as those functions which the Act notes are either requested or required by the Minister (then the Secretary of State) or those functions that "Scottish Water shall" or "Scottish Water must" perform as opposed to those that they have the discretionary power to perform under section 25[8]

The key features of each Act are:

Sewerage (Scotland) Act 1968:

- Provide the necessary public sewers and treatment works, or other means, for the effective drainage and treatment of domestic sewage, surface water and trade effluent (unless not practicable at reasonable cost);

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[8] 2002 Act amended both the 1968 Act and 1980 Act by replacing the term "Authority" with "Scottish Water"

Core/Non Core Separation

- Take the public sewers to a point that will enable owners of premises to be served by them to connect their drains or private sewers at a reasonable cost (unless not practicable at reasonable cost);

- Inspect, maintain, repair, cleanse, empty, ventilate and renew where necessary, all sewers and sewage treatment works;

- The closure, alteration, replacement or removal of any sewer or sewage treatment works but only once an equally effective sewer or sewage treatment works has been provided and the affected parties, at no cost to them, connected to these;

- Maintain maps showing, as far as is practicable, their area of supply and of all sewers (indicating the purposes of each if there are sewers reserved for foul water or surface water only), drains, sewage treatment works, making these freely available for inspection and copying by any person;

- The water authority may pass a resolution to elect to empty all septic tanks serving premises in a designated area and if approved by the Minister, they would be required to do this at reasonable intervals and convenient times; and

- If required to do so by the Minister: conduct surveys of existing consumption of, and demand for, water supplies and the water resources in or available in their area, prepare an estimate of the future water supply requirements of that area, formulate proposals for meeting existing or future water supply requirements, and submit a report on any of these matters to the Secretary of State in the timeframe he specifies.

Water (Scotland) Act 1980

- Provide a supply of wholesome[9] water in pipes to each part of their area where a supply is required for domestic purposes[10] and can be provided at reasonable cost, and take the pipes to a point where they can be connected, at a reasonable cost, to the buildings required; and

- Provide a supply of water on reasonable terms and conditions to those non-domestic users who request it, subject to practicability, reasonable cost and the non-jeopardising of existing services.

In addition to existing legislation, the Water Services etc (Scotland) Bill has the potential to influence the statutory definition of core activities in two ways:

- Trade effluent - Under the 2002 Act, WICS do not have the power to advise Ministers as to the appropriate level of charging for trade effluent. That is, it is excluded from SW's annually devised Scheme of Charges and is determined at its discretion to that extent that charges do not allow SW to exceed its revenue cap.

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[9] The level of wholesomeness that Scottish Water must provide water to is prescribed in the Water Supply (Water Quality) (Scotland) Regulations 1990 and Water Supply (Water Quality) (Scotland) Regulations 2001, see www. DWQR.org.uk

[10] Drinking, washing, cooking, central heating and sanitary purposes, including supply for business purposes (except laundries and food/beverage businesses) where most of the premises are used as a house

Core/Non Core Separation

Under the new Bill, section 29(3)(j) of the Sewerage (Scotland) Act 1968 will be repealed, removing SW's power to set trade effluent charges separately.

Consistent with the Ministers' advice that the next review should be carried out on the basis that the Bill has been passed, trade effluent prices will be determined by WICS.

- The activities performed by SWR for non-domestic customers will be defined as non-core. However, until that point at which the market is deemed fully contestable, they will remain regulated activities under the remit of licensing.[11]

4.1.2 Ofwat definition of Appointed business

In England and Wales, the "Appointed" activities of water and water and wastewater undertakers are defined in legislation and their licence conditions. This gives the English and Welsh water companies a high degree of clarity of what are appointed and non-appointed activities.

However, further references to appointed activities are made also made in Ofwat's RAGs. In particular, appendix 3 of RAG 4 provides very clear descriptions of the activities a water and wastewater undertaker is likely to undertake as part of their appointed business. Essentially, they provide a very clear indication of Ofwat's view of Appointed activities.

It is recognised that differences in circumstances and legislation mean that these definitions can not be directly applied to the Scottish water industry and used to define core activities. However, they do provide a useful precedent.

As part of the process of implementing legislative definitions of core activities, the activities currently undertaken by SW (as indicated by their Activity Based Management System (ABM)) were compared with those defined in RAG 4. The majority of activities listed were either clearly recognisable a being a core activity required to fulfil a statutory duty or matched Ofwat's view of Appointed activities. However, some activities could not be directly reconciled. These were referred to key stakeholders for discussion.

(Appendix 2 of the new Scottish RAR 4 contains a series of definitions similar to those used by Ofwat, but written specifically for the Scottish water industry.)

4.1.3 Allocation of activities

In the non-domestic supply chain diagram, there are a number of activities which lie on the boundary of the core and non-core sections of the supply chain, and could possibly fall into either section. These activities may not be clearly identified in either legislation, or may not be appropriate to apply Ofwat's definition of "Appointed" to.

These activities are listed below, and are taken largely from SW's ABM. In order to allocate these activities to either core or non-core, a number of considerations have been made:

- *Is the activity required in support of the fulfilment of a statutory duty?*

- *Does it involve the optional use of an asset owned by the regulated water service?*

- *Is Scottish Water the monopoly supplier of that activity?*

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[11] The potential role of licensing is discussed more extensively in section 5

Core/Non Core Separation

However, the overriding consideration of any allocation is that regardless of whether an activity or cost is regarded as non-core or core, it is vital that any associated revenue streams follow that cost.

Below we detail where some of the most borderline or prominently discussed activities have been allocated, and the rationale for that allocation. Appendix 3 features a more detailed allocation of all activities.

4.1.3.1 Market and sell non-core products

	Non-core	Core
Commercial marketing & intelligence	Yes	
Sell products and services	Yes	

Rationale for allocation:

- The development of a product strategy, price and advertising for SW's commercial activities. Where the activity is carried out for commercial services unrelated to the provision of water and wastewater services, it is non-core.

4.1.3.2 Provide non-core services

	Non-core	Core
Provide third party PPP consultancy	Yes	
Perform third party environmental audits	Yes	
Provide external consultancy	Yes	
Provide third party sampling & lab services	Yes	
Operate & maintain third party assets	Yes	

Rationale for allocation:

- These are generally activities which involve the incidental use of assets normally required for the provision of water and wastewater services, but are carried out for third parties.

Core/Non Core Separation

4.1.3.3 Value added activities

	Non-core	Core
Additional water treatment	Yes	
Pre-treatment of trade effluent	Yes	
On-site water storage	Yes	
Multi-utility billing etc	Yes	

Rationale for allocation:

- These are activities which are similar in nature to the provision of water and wastewater services, but provide a level of service or treatment beyond that prescribed in legislation.

- Some activities may become particularly pertinent should retail competition develop. For instance, multi-utility billing will not be a service required by licence, but may be offered by some retailers in order to add value to a service they are already providing for water customers.

4.1.3.4 Other

	Non-core	Core
Film location services	Yes	
Forestry	Yes	
Plumbing insurance	Yes	
Ferries	Yes	
Telecomms masts and towers	Yes	
Windfarms	Yes	
Advertising boards	Yes	

Rationale for allocation:

- These are activities which generally use unregulated assets, such as ferries in conjunction with assets required for water supply such as lochs/reservoirs, catchment areas etc. As they are not vital for the fulfilment of statutory obligations, they are non-core.

Wholesale and Retail Separation

5. Wholesale and retail activity separation

The Water Industry (Scotland) Act 2002 signalled that the next Strategic Review of Charges should be carried out on the basis of SW's core functions only. The analysis above clarifies what these core activities are.

However, the proposals within the Water Services etc (Scotland) Bill require a further subdivision of these core activities into wholesale and retail. In particular, how the proposed non-domestic retail market is expected to operate will influence how this separation is made, for instance:

- The role of licensing;

- The supplier of the last resort requirement;

- The wholesale price and limiting the risk of challenge;

- How the relationship structures within the market could operate; and

- What this could mean in practice using the customer contact centre as an example.

In order to provide a structure for the accounting separation of the retail and wholesale roles, it has been necessary to make some working assumptions about how the proposed non-domestic retail market could operate in the future. However, these assumptions are not intended to pre-empt how the market will operate.

5.1 The role of licensing

Section 6 of the Water Services etc (Scotland) Bill notes that any entrant into the non-domestic retail market must possess either a water services retail licence or a wastewater services retail licence. Only those in the possession of a licence will be entitled to become wholesale customers of SW. A retailer may hold either one or both of the licences.

Licences are seen as a key device to control the proposed market and protect its participants – the wholesaler, retailer and non-domestic customers. They are intended to provide clarity as to obligations in the market and a monitoring regime will be in place to ensure they are complied with.

However, as noted above, the existence of licence requirements does not necessarily mean that a retailer has to physically carry out all of the activities themselves. Instead they could sub-contract any number of elements to a third party or even to the wholesaler. The responsibility to fulfil the licence requirements would still lie with the retailer.

The content of licences will be subject to extensive consultation by WICS. They will also need to consider the role of General Market Agreements and contractual agreements for clarifying obligations in the market. (Section 5.4 outlines where we believe these obligations may exist).

Broadly, we have assumed licences will:

- Specify the minimum service retailers must supply (essentially the light blue element of the supply chain)

- Clarify the obligations that exist between retailers and the wholesaler

- Provide retailers with the right, but not the necessity, to provide its customers with services beyond the minimum specified in the licence.

Wholesale and Retail Separation

5.2 The supplier of the last resort requirement

Under the current provisions of the Water Services etc (Scotland) Bill, SW (the wholesaler) is required to act as a supplier of the last resort for non-domestic customers.[12] That is, should a retailer fail, SW will be required to continue to supply customers.

It is likely that the licence will allow for the intervention of WICS to monitor a licensee's activities so as to try to mitigate a potential failure event.

5.3 Setting a wholesale price

In order for non-domestic retail competition to be successfully introduced into the Scottish water industry, it is important that the wholesale price charged to retailers meets a number of criteria:

- It should allow SW (the wholesaler) to recover the cost of wholesale supply;

- It should be fair, and not unduly advantage or disadvantage any one retailer; and

- It must be defensible, and in particular, be able to withstand challenge from retailers.

WICS are proposing to produce a single price for wholesale water services and a single price for wholesale wastewater services. Doing so will be key to ensuring a simple and pragmatic charging relationship between retailers and SW.

WICS' preference for calculating a single wholesale price is designed to ensure that the market operates on as pragmatic and as transparent a basis as possible. However, in order for this goal to be achieved, it is vital that this single price is defensible if challenged.

Challenges are likely to come from retailers who wish to provide a service already included in the wholesale price. Should they successfully challenge the single wholesale price, then it is likely that they would be offered a tailored wholesale price reduced to reflect the fact that they, and not SW (the wholesaler), were providing that service. Should all retailers successfully challenge a single wholesale price, then it is foreseeable that a series of wholesale prices would have to be offered depending on the collection services included within that price. This "pick and mix" approach to wholesale prices would both increase regulatory burden and place onerous information demands on SW (the wholesaler).

This has significant implications for the business activity separation of SW. In particular, it is vital that any services that could be provided by a participant in the retail market are not designated as a wholesale function/cost. As such, many marginal activities, which could feasibly lie on either side of the split, should not be designated as a wholesale activity and hence not included in the wholesale price.

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[12] Water Services etc (Scotland) Bill, Sections 14-17

Wholesale and Retail Separation

5.4 Relationship structures within the framework for competition

In order to effectively separate SW's wholesale and retail functions as described above it is useful to identify the customers who will exist in the proposed competitive framework, and how they might be expected to interact

5.4.1 Defining customers

Within the proposed supply chain framework, there are three tiers of customer interaction at work:

- The first is between the wholesaler (SW) and its customers, the retailers who participate in the market;

- The second is between the retailers and their customers, the non-domestic "eligible" customers; and

- A third relationship could exist between retailers and third parties (or indeed SW) to whom they may wish to outsource activities to.

It should also be recognised that there could be a fourth tier of customer interaction in this model between the wholesaler and the non-domestic customers served by the retailer. However, as we shall discuss, it is envisaged that the scope of this interaction will be limited and will essentially be the act of physically supplying water and responding to emergencies and repairs that are reported through the retailers.

5.4.2 Defining relationships

The three tiers of customer interaction that exist within the framework comprise a number of different relationships each of which varies in their scope and nature. In particular, it is necessary to distinguish these relationships in terms of:

- Who performs the physical activities?

- Who is responsible for these physical activities, and to whom those responsibilities are directed?

- Who bears the cost of performing these physical activities?

- How these relationships are governed?

It is important to note that whilst the responsibility for an act may well lie with one party and, therefore, they will also bear the cost associated with it, it does not mean that they have to perform that activity. For instance, there is potential for a retailer to choose to outsource some activities either to the wholesaler or a third party. However for simplicity, we have excluded third party arrangements from the diagram below.

Diagram 5.4 below illustrates how these relationships are expected to work.

Wholesale and Retail Separation

Diagram 5.4: Relationship structure
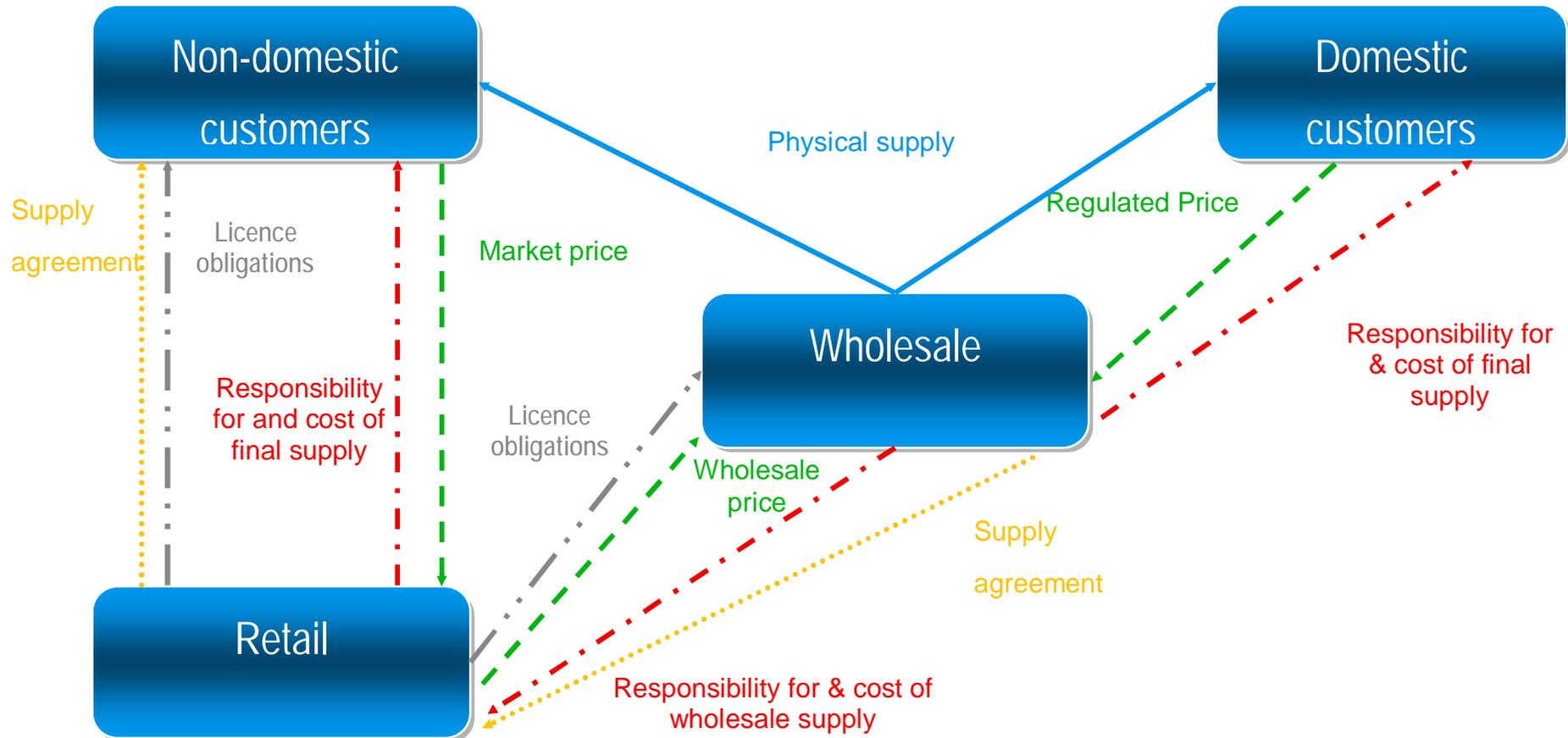
Note: *Regulated price* is the price paid by domestic customers for the wholesale and customer facing services it receives from Scottish Water, *wholesale price* is the price paid by retailers for the provision of wholesale services to their non-domestic customers, and *market price* is the price paid by non-domestic customers to retailers

Wholesale and Retail Separation

5.4.3 Physical supply of water and removal of wastewater (denoted by blue (____) arrows)

The physical act of supplying treated water to the boundary of a customer's property, and the removal of wastewater from that property for treatment and disposal (where necessary). This is essentially the physical manifestation of SW's) core function (as highlighted in dark blue in the supply chain diagram.) It is proposed that the only direct connection between SW (the wholesaler) and non-domestic customers will be a physical supply connection, emergencies and dealing with repairs reported through the retailer.

5.4.4 Licence obligations (denoted by grey (____) arrows)

SWR and subsequent participants in the market will be subject to licence conditions. These licence conditions will govern the nature of the relationship the retailer has with both its non-domestic customers and SW (the wholesaler). Licence conditions are likely to be used to specify the minimum standard of service a retailer must provide. In the instance of SWR, it is envisaged that these will be used to define the activities which will be included in the initial regulated retail price.

5.4.5 Supply agreement (denoted by yellow (____) arrows)

In addition to licence conditions which retailers will be subject to, they will wish to formally agree their obligations to their non-domestic customers on a contractual basis. New retailers will be obliged to enter into agreements with customers. SWR will inherit deemed contracts. These contracts may cover not only their licence obligations, but also further service offerings which they may wish to provide. As such, it is envisaged that a supply agreement will exist between retailers and their non-domestic customers. Under the legislation retailers will also need to enter into agreements with SW (the wholesaler) and this includes SWR. This agreement could cover, amongst

other things, payment terms, guaranteed standards, invoice auditing and disputes procedures.

5.4.6 Responsibility for supply (denoted by red (____) arrows)

Whilst the physical act of supplying non-domestic customers with water and wastewater services will be performed by SW (the wholesaler), the ultimate responsibility for this function will, from the perspective of the non-domestic customer, fall to the retailer.

However, there are in effect two stages of interaction underlying this relationship. The first is between SW (the wholesaler) and the retailer. SW (the wholesaler) will be required to supply the retailer with water and wastewater services (in fact, the physical supply will go directly to non-domestic customers). Essentially this means that SW (the wholesaler) will bear the responsibility and cost of providing a wholesale supply. Retailers will pay SW (the wholesaler) a wholesale price in return for that wholesale supply.

Retailers will then sell this service, with the addition of the retail element of the supply chain, to non-domestic customers. This has been termed "final supply" in the diagram.

5.4.7 Price (denoted by green (____) arrows)

In return for the services provided to them, both retailers and non-domestic customers will be expected to pay a price.

Retailers will pay a wholesale price to SW (the wholesaler) which will be determined by WICS.

Wholesale and Retail Separation

Once the market is fully opened to competition, which is expected to be some time after April 2008, non-domestic customers will pay a market price to retailers.

5.4.8 Implications for business activity separation

Clarifying these relationships is important for how some activities will be designated in the final retail/wholesale activity separation. In particular, it is envisaged that non-domestic customers will have one primary interface, that is, with their retailer. As customers will be paying the retailer for services, it is at this interface where they will have greatest leverage. As such, it should be the same interface that they complain to when this service fails.

In practice, this will mean that regardless as to whether the service failure is operational (for instance low pressure) or customer service related (for instance a billing issue), the non-domestic customer will refer their complaint or enquiry to the retailer. That is, the responsibility for, and cost of, all customer relationship management will fall to the retailer. It will be their responsibility to refer customer complaints on operational issues to SW (the wholesaler) for resolution (where appropriate).

It is therefore envisaged that the retailer will be responsible for ensuring all non-domestic customer contacts are received, logged and actioned. The final resolution of these complaints may well rely on action from the wholesaler, however, the onus will be placed on the retailer to ensure that this action is taken in a satisfactory and timely manner.

5.5 Customer Call Centre Split Illustration

5.5.1 Interfaces

The arrowed lines between each box within the diagram represent an interface. The various types of interface have been identified as retail customer, retailer call centre (billing and operations) and wholesale technical and real time information, and these are discussed below:

5.5.1.1 Retail Customer Interfaces

From a retail customer's point of view they may have an issue relating to either billing or operations and they will phone the call centre where the call will be routed to either the billing or operations operator.

5.5.1.2 Call Centre Interfaces

The call centre will need to have a customer management system which enables them to access up to date billing and operational information concerning an individual customer.

If the query is regarding billing, then the availability of up to date information should enable the problem to be isolated and a solution identified.

If the query is of an operational nature, the call centre will gather information through a guided menu of questions. This will enable the operator to ascertain the urgency of the call and whether or not it requires on site intervention. The operator should have access to real time information regarding the status of the network, so that they can provide information in event of a major incident or a localised issue which is affecting a small number of customers. This may include conveying their awareness of the cause already and the status of the work being carried out to resolve it.

The call centre operators will need to have real time access to work scheduling plans so that they can advise customers as to when a problem will be worked on. They will also need access to 'job information' so that they can convey such information updates to customers as and when required.

Wholesale and Retail Separation

5.5.1.3 Technical Function Interfaces and open access to 'real time' information

As noted above, the interface between the technical function and the retailer call centre will allow notification to be given when a job has been completed allowing the call centre staff to notify the relevant customer of the resolution if required. Thus once the technical function has resolved an issue it will be immediately logged on the system and this information made available to retailers.

The wholesaler should also provide open access to real time information on network monitoring of major incidents that would affect a large number of customers. If that is the case then they shall be able to provide information on the potential severity of these incidents. This will enable the retailer to support the wholesaler in dealing with the incident and in providing information to the public.

The staff physically resolving the problems will be able to feed back into this network monitoring system to keep the status of any incident up to date.

This system can also be used to log minor network incidents or planned network intervention so that customers can receive timely and accurate information on problems with their service.

It should be noted that, in complex situations, it may be necessary for the wholesale technical team to liaise directly with a retail customer. Such liaison will be logged and details made available to the retailer on a 'real time' basis.

Wholesale and Retail Separation

Diagram 5.5 Customer call centre
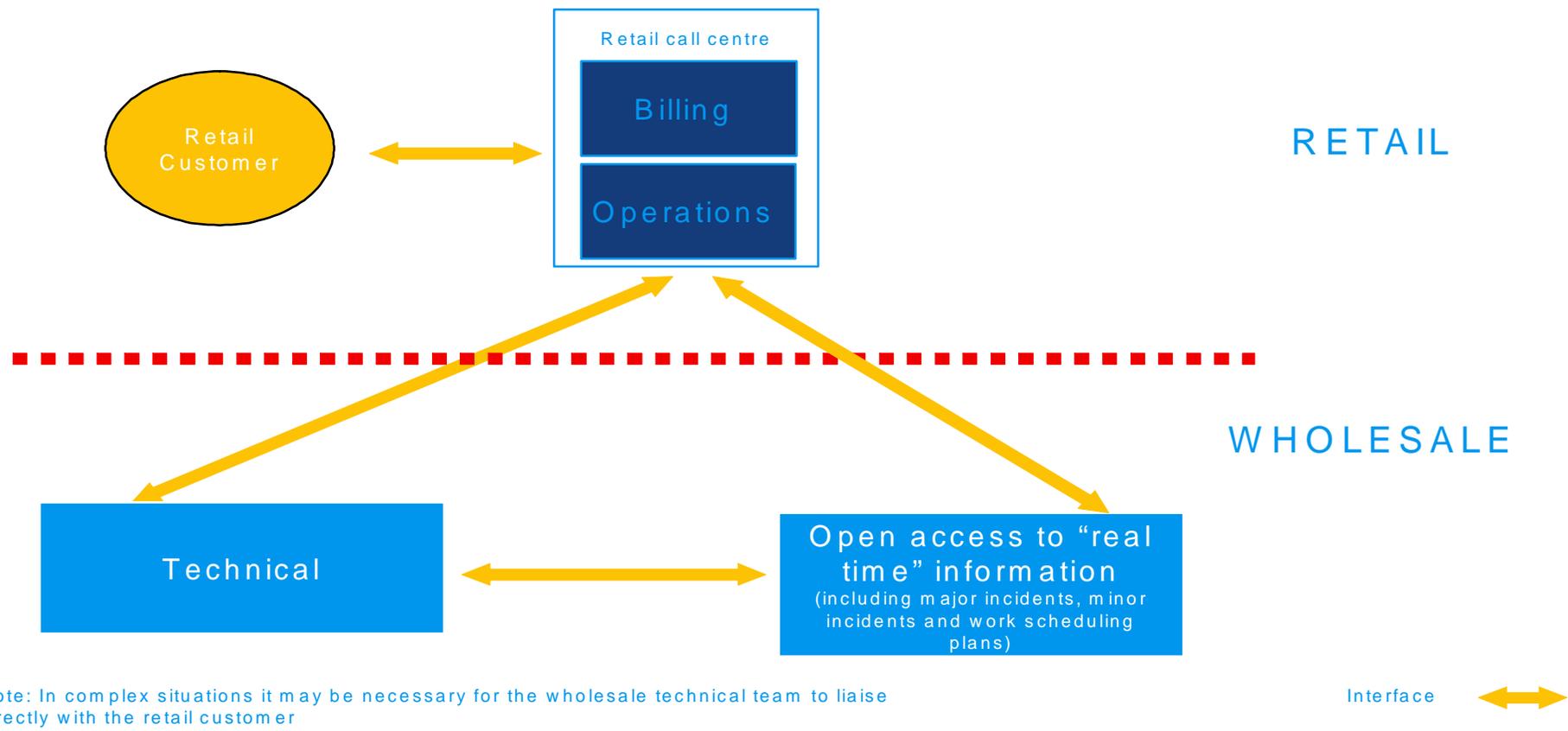
Retail call centre

Billing

Operations

Retail Customer

RETAIL

WHOLESALE

Technical

Open access to "real time" information
(including major incidents, minor incidents and work scheduling plans)

Note: In complex situations it may be necessary for the wholesale technical team to liaise directly with the retail customer

Interface

Wholesale and Retail Separation

5.5.2.1 Advantages of this format

- Customers will have a single point of contact to deal with in trying to get their problems resolved;

- The single point of contact is the entity that they pay for their service supply and is therefore the entity which should be keenest to keep them satisfied. Therefore their problem will be dealt with in a timely manner and with attention to a satisfactory solution that maintains good customer relations;

- As non-domestic customers will contact the retailer should they have an issue with their supply, it will provide the retailer with much greater visibility as to the nature of the supply their customers are receiving. That is, it will prove an important check on the quality of the product the wholesaler is selling to the retailer;

- The competition requirements mean that activities that could be replicated by an alternative supplier, and thereby could give rise to competition, should not be preferentially provided by a monopoly supplier. In this case we believe that the management of the customer interface is replicable and therefore should be the responsibility of the retailer; and

- It provides retailers with the knowledge of their customers' quality of supply, which, given the dispersed nature of the customer and supply networks may in fact be the only source of such information.

5.5.2.2 Potential disadvantages

- The success of the framework relies on the wholesale system being capable of providing open and effective access to retailers and thereby allowing retailers access to real time information on both the status of calls logged by their customers and on the state of the network infrastructure as a whole. Given that a number of retailers could be trying to interface with the wholesaler at once this raises two key issues:

  o How accessible is the wholesaler's current real time scheduling system, for instance is it based on a commercially available and widely used software system, or has it been developed specifically for SW's purposes?

  o Should the wholesaler be obliged to provide retailers with instant access to their scheduling system, and if so, with a number of retailers vying for slots how will work be prioritised?

Wholesale and Retail Separation **Section 5**

5.6 Allocation of activities

The non-domestic supply chain diagram in section 3 identified three different types of activity:

- SW core activities

- Retail "core" activities (the primary retail function)

- Additional services.

Within each of these groups there are a number of activities which need to be identified and allocated. Core activities were identified in section 4, and "additional services" were designated as non-core. Within the core activities identified in section 4 it is necessary to make a further subdivision for retail activities. That is, to identify the primary retail function, which, for non-domestic customers, will (if the Bill receives Royal Assent) be eventually regarded as non-core.

Again, the activities have been identified in part from SW's activity based costing model. They are assumed to be representative of SW's current retail function, and therefore are assumed to be indicative of how the retail subsidiary, and later participants in the market, could be expected to perform.

This section explores core functions in more detail, and, based on discussions with key stakeholders and policy requirements, identifies non-domestic retail activities.

In designating activities, there have been two overriding considerations:

- *Could they be contestable if included in the wholesale price?*

- *How the expected relationship structure of the market will function?*

The primary purpose of this section is to identify the roles a retailer could be expected to perform. As such, they should fall outside of SW's core wholesale activities.

References to retail in the tables below are primarily with regard to non-domestic customers; they could also be termed "licensed".

Wholesale and Retail Separation

5.6.1 Core (licensed) retail function:

5.6.1.1 Customer metering

	Retail	Wholesale
Meter reading	Yes	
Meter queries	Yes	
Meter installation		Yes
Meter ownership		Yes
Meter maintenance		Yes

Rationale for allocation:

- Whilst there is the potential that retailers may wish to own their customers' meters, and hence they could prove a contestable element of the wholesale price, experience in England and Wales in the gas and electricity markets do not support this.

- Indeed, meters are often regarded by undertakers as a crucial part of the infrastructure and vital for supply and demand management. Retailers may therefore regard them as a wholesale activity.

- Furthermore, should meter ownership fall to the retailer, this could create a barrier to entry in the market. In particular, if meter ownership was transferred to SWR, when the market was opened to competition, conceivably other retailers would have to buy meters from them. This could leave the arrangement vulnerable to challenge under CA98.

While the ownership and maintenance of meters is defined as a wholesale function, the experience of other utilities is that it is feasible to fulfil this function in a number of ways. These include at one end of the spectrum a simple ownership model through to a fully managed service based on leasing. In the instance of the Scottish water industry, leasing would have a number of advantages, in particular:

- As not all non-domestic customers are metered, it would create an inequality if included in the wholesale price. Therefore, where a customer supply is measured, retailers will be obliged (potentially through a licence condition) to lease that meter.

- By leasing meters, retailers will have the flexibility to upgrade meters should they wish as part of their leasing agreement. This will enable them to tailor meter capabilities to specific customer needs.

- SW would also be protected in this arrangement, as they would only be obliged to provide/consent to a meter upgrade (that is beyond the standard meter provided) if the retailer was prepared to bare the cost.

- By virtue of their customer facing nature, meter reading and handling meter queries are retail activities. However, it is recognised that whilst meter readings will be crucial for the retailer's billing purposes, they will also be crucial for the wholesaler to bill the retailer. As such, it is likely that a contractual or licensing arrangement would need to be established to ensure accurate meter readings are available to both parties.

Wholesale and Retail Separation

5.6.1.2 Business customer accounting

	Retail	Wholesale
Manage customer contact data	Yes	
Manage billing & contact data	Yes	
Manage billing exceptions	Yes	
Generate and issue bills	Yes	
Tariff negotiations	Yes	

Rationale for allocation:

- Both the retailer and the wholesaler will need some degree of access to customer contact data. In the case of the wholesaler, this information will be primarily for emergency planning.

- However, it is recognised that some transfer of billing data from SW to SWR will be required upon separation. This relationship should be clarified by the arrangements for the transfer of customer information outlined in the Water Services etc (Scotland) Bill.

5.6.1.3 Credit management

	Retail	Wholesale
Remittance and cash processing	Yes	
Manage direct debits	Yes	
Debt management	Yes	
Manage disconnection/connection process	Yes	
Physical disconnection/connection		Yes
Manage debt collection	Yes	
Handle payment enquiries/plans	Yes	

Rationale for allocation:

- Credit management is a complementary action to the billing function, and as such is a retail activity.

- However, some interaction with SW will be required. For instance, should a retailer wish to disconnect a non-domestic customer for continued non-payment, then the costs associated with this disconnection, both the administrative costs of notifying the customer, and the physical act of disconnection, should lie with the retailer. However, it is envisaged that in order to protect the supply network, SW will carry out the disconnection at the retailer's request. As the retailer will bear the cost of the disconnection, it is

Wholesale and Retail Separation

likely to be regarded as a rechargeable activity for a third party in SW's regulatory accounts.

- One of the key benefits expected to be delivered from competition is the level of choice that non-domestic customers will have. It is therefore likely that non-domestic customers will wish to change retailer, many of whom may well be in debt. A method for transferring debt and an agreed protocol for it will be required.

5.6.1.4 Customer relationship management

	Retail	Wholesale
Manage customer calls	Yes	
Manage written customer contacts	Yes	
Handle complaints re:		
Metering	Yes	
Billing	Yes	
Water quality	Yes	
Pressure	Yes	
Sewer flooding	Yes	
Supply (incl. Interruptions)	Yes	
Water rising	Yes	
Fire hydrant misuse	Yes	
Infrastructure safety complaints	Yes	
Odour	Yes	
Infrastructure repairs	Yes	

Wholesale and Retail Separation

	Retail	Wholesale
GMS payments:		
Complaints	Yes	
Change of payment method	Yes	
Billing and charging enquiries	Yes	
Pressure	Yes	
Unplanned interruptions	Yes	
Planned interruptions	Yes	
Sewer flooding	Yes	
Proactive key customer management	Yes	
Customer marketing & intelligence	Yes	

Rationale for allocation:

- In line with the model for retail activities presented in diagram 5.5, all customer contacts both billing and operational, have been regarded as retail activities. If implemented in practice, this would mean that non-domestic customers would contact their retailer regardless of the nature of their complaint or enquiry. The retailer would receive, log and action this contact, and resolve it either themselves or by directing it to SW.

- A similar rationale has been applied to GMS payments, where it is assumed all payments will be made by the retailer. GMS payments have a dual role of compensating customers for poor service and acting as an incentive for the retailer and/or wholesaler to provide better performance. The retailer should make the payment as a range of payment options, either through a discount on their bill or through a direct payment.

- As such, they should be placed where the incentive to avoid poor performance, either for billing or operational matters will be stronger. Arguably for operational matters, given the relatively small financial impact of GMS payments on SW, the incentive would be stronger if retailers were expected to make the payment, and then seek reimbursement from SW themselves.

- Where SW expects to interrupt supply for maintenance etc, notification should be sent to the retailer who will then inform their customers who will be affected.

Wholesale and Retail Separation

5.6.1.5 Emergency planning

	Retail	Wholesale
Emergency planning and security		Yes
Manage and coordinate response		Yes
Support and cooperate with planning and response	Yes	

Rationale for allocation:

- Responsibility for providing a wholesome supply of water will lie with SW. In the event that this water supply becomes unsafe, then SW is expected to plan and coordinate the emergency response.

- However, it is recognised that the non-domestic customer's primary point of contact will be with their retailer. As such, retailers will be expected to support SW's emergency planning and responses.

5.6.1.6 New primary retail functions

	Retail	W/sale
Relationship management	Yes	Yes
Retail contract management	Yes	Yes
Interaction with market mechanisms ie, data registry and switching	Yes	
Licensing, compliance and reporting	Yes	
Verifying meter readings and invoices from Scottish Water (the wholesaler)		Yes

Rationale for allocation:

- The introduction of retailers, essentially a third party in the supply relationship, will require greater relationship/contract management between SW (the wholesaler) and its customers (the retailers) and retailers and their customers (non-domestic customers).

- Section 9 of the Water Services etc (Scotland) Bill requires that water services providers and wastewater services providers must provide the proposed Commission with such information as it requires to ensure licensees are complying with licence conditions. Licensing compliance will be a new activity previously not undertaken.

Allocation of Costs Between Business Areas

6. Allocation of costs between business areas

6.1 Development of reporting tables – M tables

WICS require SW to report on its performance in the "Annual Return", a combination of reporting tables which capture different elements of SW's business. These tables are based primarily on Ofwat's "June Return" tables which are completed annually by the English and Welsh water companies. However, where appropriate, changes have been made in the reporting structure in Scotland to reflect SW's specific circumstances and specific Scottish legislation.

The E-tables of the Annual Return report SW's operating costs and are broadly equivalent to Ofwat's reporting tables 20 and 21, and introduce an element of activity based costing to the Annual Return. However, unlike the English and Welsh tables which are only completed for the appointed business, SW currently complete the E tables on the basis of the whole organisation, that is, both core and non-core.

Also, the E tables only introduce activity based costing at a very high level, requiring SW to allocate costs between *Water resources and treatment, water distribution, sewage treatment, sludge treatment and disposal.* They do not provide the detailed allocation of costs between core and non-core and retail and wholesale activities that will be required in the next regulatory period.

In response to the challenges faced in the next regulatory period, WICS has developed a new set of tables (M tables) in conjunction with SW, based predominantly on the E tables. These M tables capture both SW's core and non-core operating costs and breakdown retail costs into a high level of detail.

Also, additional M tables have been developed; the complete suite of M tables is:

- M1: Activity Based Costing – Water Service

- M2: Activity Based Costing – Sewerage Service

- M1A: Analysis of Turnover – Water Service

- M2A: Analysis of Turnover – Sewerage Service

- M1B: Analysis of fixed assets – Water Service

- M2B: Analysis of fixed assets – Sewerage Service

6.2 Rationale for the development of the M tables

The M tables have been developed largely following the same logic that has been applied to the business activity separation process outlined in sections 5 and 6 – they initially separate out non-core costs and then analyse core costs, particularly retail costs, in a higher degree of detail.

Rationale for columns:

- The first 3 columns of each the M1 tables aim to separate non-core costs from core costs. otal non-core costs are separated into *Retail non-domestic* and *other non-core*. This allows the tables to capture the non-core and unregulated activities that may be carried out by both SW and SWR and should be excluded from any price cap.

- The remaining columns detail core costs. These are further subdivided into *water resources and treatment, water distribution, retail domestic* and *retail non-domestic* for the water service and

Allocation of Costs Between Business Areas

Sewerage, sewage treatment, sludge treatment and disposal, retail domestic and *retail non-domestic.*

The inclusion of separate columns for both retail non-domestic and retail domestic columns is important as:

- It allows WICS to view wholesale costs separately from retail costs, and hence calculate a wholesale price;

- Retail domestic costs can be added to wholesale costs to establish the retail requirement of SW; and

- Retail non-domestic costs can be excluded from both these calculations, and be used to inform a retail price cap for the licensed market.

Where the retail subsidiary undertakes activities beyond those reflected in the retail price cap, the associated costs can be reported in *Retail non-domestic non-core.*

Rationale for rows:

The majority of rows remain the same as those used by Ofwat in tables 20 and 21, and the existing E tables used by WICS.

Some modifications to previously reported information have been made to reflect WICS' future information requirements. For instance, in order to roll forward the proposed RCV at price setting, WICS will require not only Infrastructure Renewals Expenditure (IRE) to be reported, but also Infrastructure Renewals Charge (IRC). Therefore, Infrastructure Renewals accrual or prepayment has been included in order to allow the IRC to be deduced from the reported IRE.

The most significant addition to the M tables has been the breakdown of retail costs into a much higher degree of detail than was previously reported in the E tables under *customer services.* Retail costs are required to be reported in such detail as:

- It aids WICS' benchmarking with Ofwat, particularly in areas where there are significant differences in opex between Scotland and England and Wales, for instance, metering.

- It provides a degree of granularity around the boundary of wholesale and retail. This means that should a wholesale price be challenged, there is scope for it to be recalculated. For this reason it is important that the retail element is and detailed enough, to allow flexibility in the retail/wholesale boundary.

The activities listed within the retail component are largely derived from SW's Activity Based Management System (ABM), and have been separated in such a way as to aid SW in completing them. Section 6.4 provides an overview of how this system works.

It is accepted that a degree of judgement and apportionment may need to take place. Section 6.4 outlines where we believe this may need to happen, and the drivers that are available to do so.

6.3 How Scottish Water will complete the M tables – the Activity Based Management System)

SW aims to complete the M tables by using its newly developed (and still evolving) ABM. The model has been developed in order to deliver activity based costing to a high level of detail. It allocates costs across the main activities carried out by SW as part of its business. These activity categories include both non-core and retail.

Allocation of Costs Between Business Areas

Within the activities costs, can either be directly allocated using financial drivers, or for shared services, apportioned based on non-financial drivers. For instance, where operational teams divide their time between water and sewerage services they complete time sheets to indicate how there time is spent, thus allowing employment costs to be allocated. Similarly, retail activities, such as the cost of complaint handling can be allocated across a wide range of complaint categories on the basis of the number of complaints received.

This means that for a large number of activities SW are able to either directly allocate costs or use a non-financial driver to apportion them. In some instances, such as central support costs, a degree of subjectivity is used, but SW believes that costs allocated on such a basis comprise a very proportion of total opex.

Appendix 1 describes on a line by line basis both the content of the M tables, and how we believe SW will complete them.

6.4 Overview of tables M1 and M2

- *Rows M1.2 to M1.13 and M2.2 to M2.13*

These rows were previously reported as part of the E tables and are ostensibly the same as those featured in the equivalent Ofwat tables. Significant changes between the E and M tables include the amendment of lines previously used to capture PPP costs. These are now subdivided between the payments made to external parties for running PPP schemes and internal management costs of PPP. No figure is expected to be reported in tables M1 for these rows, as PPP relate exclusively to sewerage projects.

Other additions include "Contract Management". This row is expected to capture the additional administrative costs associated with liaising with retailers such as contract negotiation.

The significant change to the E tables is the requirement that costs are allocated between core and non-core. SW does not envisage this being a significant problem. The ABM identifies key resource drivers for core and non-core activities as such costs can be accurately allocated.

- *Rows M1.22 to M1.49 and M2.22 and M2.49*

The inclusion of these rows marks the most significant change to the M tables from their existing incarnation of the E tables. They are designed to capture retail activities in a sufficient degree of granularity for WICS' wholesale price setting.

Both the subdivision of the rows and the accompanying definitions are designed to match those of the ABM as closely as possible.

A line for "contract management" complementing that included in wholesale costs has been included to reflect new administrative retail costs from contract negotiations with the wholesaler and other contacts such as over disconnections or GMS payments.

Allocation of Costs Between Business Areas

SW notes that the ABM drivers allow the direct the allocation and where necessary, apportionment, of costs between:

- Water and sewerage
- Core and non-core
- Domestic and non-domestic
- Non-domestic measured and unmeasured non-domestic.

This section also includes memo lines which detail direct employment costs and IT costs (excluding employment). This serves two functions:

- It indicates the extent to which direct IT costs are captured under IT activities and not "general and support activities" – hence avoiding the contention that some retail costs are being disguised elsewhere in the table.
- Reporting employment costs will help to provide a point of reconciliation with the statutory accounts.

Within table M2 these costs will also be expected to capture the cost of trade effluent billing and enquiries.

- *Rows M1.52 and M2.52*

These rows are designed to capture "general and support costs" across the column headings for both water and sewerage. That is, SW will be expected to allocate/apportion them across 16 columns.

SW notes that whilst the majority will need to be apportioned, the ABM includes sufficient "resource drivers" for them to do so accurately. For instance, support IT costs can be apportioned according to number of helpdesk calls or number of users per application. Similarly HR costs can be apportioned on the basis of Full Time Equivalent employees used.

- *Rows M1.61 to M1.82 and M2.61 to M2.82*

These lines are ostensibly the same as the E tables; however, some changes in the nature of the figures reported will take place. For instance, costs associated with licensing compliance will be reported in "costs of regulation" for non-domestic customers. Also, in the E tables "Third party services" had been used by SW to capture non-core costs. In the M tables, this row will only be used to capture "core" third party services under the appropriate columns.

- *Rows M1.83 to M1.96 and M2.83 to M2.96*

These rows capture capital maintenance costs and in order to reflect WICS' proposed RCV based method of price setting, include the IRE and IRE accruals and prepayments. Both pieces of information are important components in the process of rolling forward the RCV.

6.5 Overview of tables M1A, M2A and M1B, M2B

Tables M1A, M2A and M1B and M2B are new additions to the M tables. Tables M1A and M2A simply provide an analysis of turnover (being amounts billed, less credits issued and an adjustment for the movement in the unbilled income accrual) under the same column headings as tables M1 and M2. As such, we do not anticipate any problems with their completion.

Allocation of Costs Between Business Areas

Tables M1B and M2B provide an analysis of fixed assets, again under the same column headings as tables M1 and M2. RAR 4 specifies that these tables must be completed on a current cost basis using Modern Equivalent Asset Valuations (MEAV). SW does not currently use current cost accounting extensively, and as such may have difficulties completing this table initially. Also, SW currently uses a Gross Equivalent Asset Replacement Cost (GEARC) method of valuing its assets. Whilst this method of valuing assets is not directly comparable to MEAV, we understand that it is broadly equivalent to the principles underlying MEAV outlined in RAR 1. As such, we do not anticipate SW will experience major difficulties revaluing their assets in MEAV form.

Outline of planned management and reporting structure

7. Outline of planned management and reporting structure

7.1 Expected evolution of the management and reporting structure

7.1.1 Current reporting and management structure

SW currently operates within a Group structure. The business which manages the provision of water and waste water services to domestic and non-domestic customers currently operates as a single business with a single management structure and a single reporting structure. It produces audited statutory accounts which are currently used by WICS to order to help determine whether or not SW is operating in an efficient manner. However, in order to do so on a consistent basis. WICS has to make adjustments where reporting standards (UKGAAP) have changed.

SW produced an activity based costing method of accounting (ABM) in 2003. This will enable it to record in detail the costs associated with each of its key activities and functions in its water and waste water business and this will allow management and the regulator much clearer visibility of the costs and thus the efficiency of its regulated activities

The ABM was used to complete part of the last Annual Return submission, and as such, was subject to the scrutiny of the Reporter (Black and Veatch). Whilst it is recognised that the system is still developing and anomalies are still emerging, it will provide a strong basis for reporting.

However, as the RARs emphasise, it is vital that where SW doubt the robustness of the reported number, or have used an allocation, that this is clearly documented with an appropriate confidence grade and in the commentary which accompanies submissions.

At present, the management of the company continues to reflect a single organisation covering the provision of water and waste water services to all customers in Scotland.

7.1.2 Introduction of RARs and the M tables

At present, SW completes E tables which are based on the regulatory system in England and Wales. This enables costs from the ABM system to be categorised in a way which allows the regulator to analyse costs within different parts of the business in order to be able to prepare pricing and cost targets.

As part of this project, Regulatory Accounting Rules are being prepared which are specific to Scotland and thus SW. These guidelines will be used to complete M tables.

M tables M1 and M2 are based on the E tables but have been adapted to take account of the SW ABM system and the Scottish strategy in respect of water and waste water. M1A (analysis of turnover) and M1B (analysis of fixed costs) have been developed specifically for this project.

Thus they will analyse costs for the water and waste water business between core and non-core and between domestic and non-domestic in such a way that the completed M tables will enable a cost base to be established for the core business of SW and for that part of the business that is due to be opened up to competition (ie non-domestic retail).

Outline of Planned Management and Reporting Structure

SW will start completing the M tables in 2005. Therefore the first full year of completed M tables will be 2005/06, although it may be necessary for SW to attempt to retrospectively complete the tables for 2003/04 and 2004/05 to provide comparative information. However, the accuracy of this information is likely to be less than that for later years because more subjective judgement will need to be used where data was not historically captured in the same format as the M tables.

7.1.3 Establishment of non-domestic retail as a separate, licensed entity

In order to prepare SWR for the new competitive environment and in order to establish a structure that will not be subject to challenge under CA98, it will be necessary to establish SW as a separate, licensed, legal entity. This is expected to happen by April 2006.

SWR will need to be established with its own management and financial reporting structure. Whilst it may still continue to make use of SW facilities and services, this will need to be defined by a shared services agreement.

RAR 5 sets out the guidance for Transfer Pricing in the Scottish water industry and this will need to be followed by both parties. This should ensure that there is no cross-subsidy between the SW core business and its non-core business, which will include SWR.

Initially there will be no competition in the non-domestic retail sector. Therefore, in order to prevent any abuse of monopoly position, WICS will impose a price cap on this business, by reference to the data available from the M tables, prepared in accordance with the RARs.

7.1.4 Establishment of non-domestic retail as a separate, licensed legal entity that is open to competition

The non-domestic retail market is expected to be opened up to competition from April 2008, although the exact details have not yet been finalised. It is possible that, if the regulator does not deem the market to be immediately fully competitive, then it will continue to impose a price cap until such time as the market is deemed to be competitive.

In advance of that date it will be necessary to establish non-domestic retail as a separate legal entity ring fenced from SW. This will be necessary to enable it to operate as a separate commercial entity, with clear arms length transfer pricing for all transactions with SW.

Thus it will need to have its own management board independent from SW and its finance function will also need to be independent.

This entity will also need to have its own funding structure, which will probably be a mix of equity and debt. It has been proposed that SW will require retailers to pay on demand for services provided, which could lead to a considerable requirement for working capital for the retailers. This will need to be taken into account in devising any funding structure.

Outline of Work Programme for Achieving Separation

8. Outline of work programme for achieving separation

The separation of the SW's non-domestic retail business from the rest of SW will require a clear, well managed programme. WICS has commenced the process of establishing that programme with the current detailed review of the activities of SW and the establishment of a clear regulatory structure including M tables and RARs. It is not yet clear whether the outcome of the Water Services etc (Scotland) Bill require the physical separation of SW. However, if it does, the following issues will need to be considered.

8.1 Separation planning

8.1.1 Organisation structure

It has been established that the separation will be between the non-domestic retail business and the remainder of the business. In order to establish the boundary between these two parts of the business, it has been necessary to identify the split between the core and non-core and between the retail and wholesale parts of the business.

Whilst most business activities can be established fairly easily, there are a number of 'grey' areas where it is difficult to identify the exact boundary. Examples of this that have been identified so far on this project include:

- Septic tanks. Emptying of septic tanks is an activity that other parties could enter into reasonably easily and therefore it is deemed to be competitive. We understand that non-domestic septic emptying is already competitive, as is domestic septic tank emptying. Per the legislation, retailers have the option to empty septic tanks, however, once they have chosen to accept that option,

it becomes an obligation and thus it would appear to form part of their core, licensed activity. Therefore it is unclear whether it forms part of the core or non-core retail business.

- Sewage clean up. The issue of who cleans up sewage that has leaked from the sewerage system is complex. However, there are a number of key principles that may help clarify the roles and responsibilities and thereby the impact on setting the wholesale price. These principles are best illustrated by example:

  - The polluter is responsible for the remedy. The concept of the "polluter pays" is well established. In circumstances where the original leak has resulted from a failure in the network asset, SW (the wholesaler) must have the primary responsibility for clean up. As happens today it could choose to fulfil this responsibility by the use of external contractors; and

  - Where sewage crosses a boundary by spilling into a retail customer's premises then the responsibility for meeting the costs of clean up should remain with the primary polluter. It is of course reasonable for the premises owner to procure its own clean up function (potentially from its retailer) but these costs will be recovered as part of the claim for damages from the primary polluter.

- Bottled water. In the event that water supplies are restricted or cut off, suppliers will normally provide bottled water or water tankers. There is no statutory obligation on SW to do this. However, it is feasible that as part of their wholesale agreement with retailers, provisions relating to penalties for the loss of supply will be provided. In circumstances where a retailer is obliged to use

Outline of Work Programme for Achieving Separation

alternative sources it will seek to recover these costs from the wholesaler.

- Catchment areas. Forestry management is a grey area in the separation because it is difficult to determine which side of the core/non-core boundary it sits.

  If the forest is deemed to be important for catchment purposes then it could be argued that the costs incurred in maintaining the land and the trees should be part of the core business. However, if SW carries out logging in the forest then this would appear to be a non-core activity and the cost and revenue should arguably be excluded from the regulated accounts. But it could be argued that the logging is an essential part of maintenance which brings it back to a core activity.

The key principal at stake here is that water customers should not fund non-core activities undertaken by SW and therefore if the costs and revenues associated with an activity are matched in the accounts then its exact location should have little impact on the regulated cost of SW.

However, if "border line" activities which are, or are potentially, loss making are included in the regulatory settlement, it will simply have the effect of making outperformance of regulatory targets, or even the achievement of them, more challenging.

Clearly it is important that these issues, and others like them that may come to light as the project progresses, are addressed and resolved before the physical and accounting separation is finalised and the wholesale price agreed.

Another issue relating to the organisation structure is the legal structure that is to be used for SWR. It has not yet been agreed whether this will be a division of SW or a subsidiary of SW or a separate entity entirely. There will be implications for financing and taxation, as well as perceptions of independence from SW amongst other potential retail competitors,

8.1.2 Senior management

Linked in with the legal structure above will be the identification of the appropriate management structure to develop the business. Again, in order to convey the correct impression of independence from SW, it will be necessary to develop an independent senior management team, although this may, initially, have to rely heavily on support from SW through shared services agreements.

8.1.3 Staffing and HR policies and approach

As with senior management above, it will be necessary to identify the personnel required to operate within the new business entity. The establishment and success of the new entity will rely on the staff chosen to work within that entity and it will be important that the establishment of their terms and conditions is managed correctly. This will include 'TUPE-ing' across staff to protect their existing terms and conditions.

This is likely to be particularly important in respect of pensions and this may be a significant issue as the pension scheme may hold considerable current and future liabilities in respect of employees.

Outline of Work Programme for Achieving Separation

8.1.4 Marketing, corporate identity and brand guidelines

The business will need to establish a new commercial identity for itself and prepare itself for operating in a competitive environment.

8.1.5 Financial policies and approach

The financial accounting for the retail business in the short term will be driven in part by the existing accounting policies used by SW to prepare its statutory accounts and by the RARs which will be used to complete the M tables.

It is uncertain as to how long the retail business will need to complete the M tables and this will be directly linked to how quickly a competitive market is established, as the regulator will continue to impose a price cap on the retailer or retailers for as long as the market is not deemed competitive.

The retail business will wish to demonstrate through its financial policies and approach, particularly in respect to RAR 5 and transfer pricing, that it is independent from SW.

8.1.6 Initial financial baseline

The key issues here for the retail business will be the split of assets and liabilities and the establishment of a suitable funding structure.

The business will need to be assigned suitable assets to enable it to perform its planned activities but without being deemed to have received an unfair advantage over its potential competitors. One specific issue here is likely to be the ownership and operation of the call centre and of the associated IT hardware and software, especially as SW will need to

retain a call centre function to handle calls from its domestic customers. A suitable compromise solution will need to be reached.

On the liabilities side, key issues are likely to include opening working capital balances, together with the assumption of provisions or future liabilities for pensions in respect of those staff transferring across to the separate retail business.

The funding of the new business is linked to the legal structure of the new business and its ability to raise its own finance. This is important because it is likely that the retail business will need to have a significant working capital capacity

8.2 Separation actions

We set out below the key areas in which SW will need to take action in order to ensure that the separation is effective.

8.2.1 Physical Separation

SW will need to ensure that there is physical separation of the personnel involved in the two businesses, in order to minimise the possibilities of a challenge to the validity of the separation under the Competition Act. This may involve being situated on separate floors or even in separate buildings. Whilst there will still need to be close co-operation between the two part of the business this will need to be on an arms length basis and will need to be properly documented in a shared services agreement (see below).

Individual staff will need to be formally assigned to either SW or to the new retail business and they will only work for that business except under a shared services agreement. This is likely to cause particular

Outline of Work Programme for Achieving Separation

issues in areas such as the call centre where there will be common activities between the two businesses. It will also be an issue in the support function such as HR and finance.

8.2.2 Relationship between SWR and wholesale

The relationship between SWR and wholesale will be governed by the licensing agreement, by shared services agreements and by any longer term outsourcing agreements.

The licensing agreement will define the boundaries between the two businesses. It will be expected to set out the minimum level of service to be provided by the retailer and will define the responsibilities of the wholesaler to assist the retailer in providing those services. The latter will include matters such as open access to real time information, which will be essential to enable the retailer to keep its customers informed of issues and to deal with their queries. There will also be a responsibility on the retailer to support the wholesaler in situations such as major incidents, when the retailer will be expected to help with disseminating information as required.

There will also be a direct contact with regard to GMS payments, whereby the retailer will be responsible for making the payments either directly or through a discount to the customer's bill and then they will reclaim the payment from SW in those instances when SW is responsible for the issue which led to the payment.

The shared services agreement will be the method by which both entities can formally document any joint use of services in the short term after the separation.

In the longer term, the retailer may decide that there are some services that it wishes to outsource on a permanent basis. It may choose to use a third party provider or it may decide to use SW.

8.2.3 Licensing and regulation

SWR will need to apply for a licence ahead of April 2006 to cover the provision of water and waste water services to non-domestic retail customers. It will also need to decide how it intends to fulfil the conditions of the licence, ie whether it intends to provide all the services itself or whether it intends to outsource the provision of some of those services.

SWR will be monitored by the regulator who will ensure that the terms of the licence are being adhered to. SWR will need to establish appropriate internal monitoring functions to ensure that it is meeting the terms of the licence. This will be important both from the point of view of satisfying the regulator but also for ensuring that their customers are satisfied with the service they receive.

8.2.4 Shared Services agreements

SWR will need to carry out a detailed review of activities ahead of separation in order to identify which activities they intend to operate as soon as separation occurs, which they intend to develop during the first 6 months and which they intend to outsource on a longer term basis.

For the second category, where SWR intends to develop its own function upon separation, it will want to enter into a shared services agreement with SW in order to ensure the ongoing provision of services. This might typically cover matters such as use of IT systems, use of finance and HR personnel and use of premises. The shared services

agreement will set out in detail the service to be performed, the expected period and the detailed cost of providing that service. The latter will be expected to comply with RAR 5. The shared services agreement could operate both ways, ie a function that is assigned to SWR could continue to provide services to SW if required and agreed through the shared services agreement.

SW could use the ABM system as a starting point to determine the services where there is an overlap and then the basis of allocation to specify the detailed services provided.

8.2.5 IT – hardware and software

The separation of IT (both hardware and software), together with the ongoing ability of the IT systems to interface with each other, are critical components of the separation of the two businesses. As mentioned in Section 5, the ability of the IT systems to access 'real time' information is critical to the ability of SWR to provide a high level of service to its customers.

However it also important that the IT systems are separate, in order that SWR cannot be held to have an unfair advantage over other potential retail competitors.

Thus a detailed plan of action will need to be prepared to establish an independent IT hardware and software function for SWR that meets their billing and customer contact requirements and which is able to interface on a 'real time' basis with SW's system in order to obtain up to date information on resolution of network infrastructure problems and in order to draw the data necessary to prepare bills for metered customers.

In the longer term it will be necessary for all retailers to be given open access to 'real time' information and therefore any separation plan will need to take this into account.

An additional cost that is likely to be borne by all retailers, including SWR, is the set-up and running costs of a "switching engine" to transfer customer information. There are various options available for which form a switching engine could take, varying in the degree of sophistication and cost. However, regardless of the form the engine takes, from the point of view of non-domestic customers, it is important that they are able to exercise the choice afforded to them from competition by being able to change retailer in an efficient manner.

It is likely that the switching engine will need to be operational by the time the market is option to competition. As such, development costs could be borne before the market is opened. Some consideration should be given as to how these costs can be funded before they are recovered from retailers.

Also, it is likely that a protocol for switching customers will need to be developed. This will be particularly important for customers who have debt balances. For instance, retailers may choose to refuse transfers of customers in debt; alternatively, they may allow them to transfer that debt to a new retailer.

8.2.6 Finance and reporting

SWR will need to establish its own finance and reporting systems to meet its own business needs. In the short term it will need to gather information to enable it to complete M tables as its prices will be subject

Outline of Work Programme for Achieving Separation

to a cap by the regulator and it will need to provide standard cost information to enable the regulator to establish a suitable cap.

The SWR finance team will need to be independent from the SW management team although they may need assistance from SW through a shared services agreement in the short term whilst it establishes its own systems and controls.

The regulatory accounts will be prepared according to the RARs which will take precedence over UK GAAP and other reporting standards such as IFRS. Indeed, SW, as a public corporation company is exempt from preparing IFRS accounts before 2006 (and possibly beyond) and therefore does not expect the introduction of IFRS to have a major impact on its financial reporting.

The standard which is most likely to have a major impact is the pensions standard (IAS19) which is similar to the UK standard FRS17, which is due to be implemented shortly. This will require SW to recognise pensions liabilities through its profit and loss account and will inevitably lead to a more volatile movement in this particular balance.

From discussions with SW, we have not identified any other areas that are likely to have a significant impact before 2006. However, it is anticipated that in the future, there will be a convergence of UKGAAP with IFRS. International reporting standards that may have a significant impact (could potentially create large deferred tax issues) on the Scottish water industry beyond 2006 include:

- IAS 32 "Financial Instruments: Disclosure and Presentation"

- IAS 39 "Financial Instruments: Recognition and Measurement"

- IAS 16 "Property, plant and equipment" (particularly with regard to renewals accounting.)

8.2.7 Tax

SWR will need to become a separate tax entity and will need to manage its own tax affairs. The exact nature of the split will be determined by what sort of legal entity SWR becomes and the timing of the transformation to a separate entity. It is important that the planning of this is agreed with a view to the most efficient tax structure from the point of view of SW as a whole.

8.2.8 Legal

The separation of SWR from SW will require careful legal planning to ensure that the new structure complies with the tax structuring requirements, the finance and reporting requirements, the licence regime requirements and the Competition Act requirements

All shared service agreements will need to properly documented, detailing clearly the service to be provided and the fee to be paid.

A critical consideration in the short term will be the financial structure that allows SWR to compete in the retail market. The nature of the commercial risks faced by SWR, its ability to access capital for new activities, and the return appropriate for these risks must be addressed.

8.2.9 Funding

A critical consideration in the short term will be the financial structure that allows SWR to compete in the retail market. The nature of the commercial risks faced by SWR, its ability to access capital for new activities, and the return appropriate for these risks must be addressed.

Outline of Work Programme for Achieving Separation **Section 8**

8.2.10 Property

The physical location of the new SWR business will need to be agreed with SW. It may be that a section of the existing location can be segregated for the new business or new premises may be required. The requirements of the new business will depend on the exact asset split, but it will be expected that the main requirement will be for accommodation for customer support staff which may lead to a formal sharing of the existing customer call centre facility or relocation to an alternative

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

Detailed analysis of M tables

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.2 Employment Costs	E1.1	The sum of the total costs of "non-manual and manual manpower" which are directly attributable to each of the individually identified activities within: *Water Resources and Treatment, Water Distribution* and *Non core* activities. To be included are the gross salaries and wages of all employees within the relevant activity, including payments resulting from bonus and profit-related payment schemes, employer's National Insurance contributions, superannuation, unfunded pension liabilities, sick pay, sickness benefits, private health insurance, retirement awards, death in service benefits, paid leave, subsistence, travel, entertaining and conference expenses.	Specific	Allocate employment costs that are directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution).
M1.3 Power	E1.2	All energy costs other than energy used for transport and energy costs associated with the provision of depots and offices – which are included in *General and support activities* – which are directly attributable to each of the individually identified activities within: *Water Resources and Treatment*, *Water Distribution* and *Non core* activities.	Specific	Allocate appropriate energy costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution).

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.4 Hired and contracted services	E1.3	All hired and contracted equipment and services, which are directly attributable to each of the individually identified activities within: *Water Resources and Treatment, Water Distribution* and *Non core* activities. (Hired services excludes the hire of vehicles and plant, which is included in *General and support activities*). Contracted services includes all contracted labour; professional advice (such as lawyers and consultants); and computer software.	Specific	Allocate appropriate hired and contracted costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution).
M1.5 Annual charge for PPP schemes	E1.37 Total annual charge for PPP schemes	The annual charge paid to external parties for PPP schemes.	Specific	Allocate appropriate PPP annual charges directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution).

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.6 Internal costs of PPP schemes	E1.4 Estimated running cost of PPP schemes	The internal costs (excluding the annual PPP charge) of managing the PPP schemes.	Specific/for mulaic	Allocate appropriate internal costs of PPP schemes directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution). Sewerage costs can also be split between sewerage, sewage treatment and sludge treatment. Apportion any remaining costs on the basis of the proportion of: • schemes relating to each different category • staff time spent on schemes relating to each category • costs that have been directly allocated to each category
M1.7 Materials and consumables	E1.5	All materials and consumables that are not in *Hired and contracted services* which are directly attributable to each of the individually identified service activities within: *Water Resources and treatment*, *Water Distribution* and *Non core activities*. This category of cost includes equipment (such as small tools and clothing), provisions, tarmac and backfill materials, but excludes all items capitalised or included within infrastructure renewals expenditure. Most if not all stock items fall into this category.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution). Apportion any remaining costs on the basis of the proportion of: • costs that have been directly allocated to each category
M1.8 Service	E1.6	Total cost of service charges by SEPA (Scottish	Specific	Allocate appropriate costs directly attributable to non-core

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

Appendix 1

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
charges SEPA		Environment Protection Agency) for water abstraction and discharge which are directly attributable to individually identified service activities within: *Water Resources and Treatment*, *Water Distribution* and *Non core* activities.		(split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution). No costs will be entered for non-core.
M1.9 Bulk supply imports	E1.7	Total payments for imported bulk supplies which are directly attributable to individually identified service activities within *Water Resources and Treatment*, *Water Distribution* and *Non core* activities.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution).
M1.10 Contract Management	Not previously used	The cost of negotiating and administering contracts for the supply and carriage of water with the Scottish Water Retail – Non domestic activity and other third parties carrying out this activity for non-domestic water customers.	Likely to be specific with some formulaic	Allocate appropriate costs directly attributable to the core wholesale business as a whole. Apportion any remaining costs on the basis of the proportion of: • Support staff time spent on contract management • costs that have been directly allocated Costs not currently captured by ABM, but can be adapted to do so.
M1.11 Meter maintenance and installation	Previously covered	Installation, repair and exchange of customer meters, including planning and scheduling of work, pre installation survey, design of work and valuation.		Allocate appropriate costs directly attributable to the core water distribution category. Apportion any remaining costs on the basis of the

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
	under E1.13			proportion of: • staff time spent on meter maintenance and installation compared to other activities that they do
M1.13 Other direct costs	E1.8	Any other operating costs, but excluding interest and taxation, on an aggregated basis, including costs associated with the provision of depots and offices, and insurance premiums (where such costs exceed 5% of total operating costs, an analysis should be provided) also include fines and penalties, which can be directly attributable to individually identified service activities within: *Water Resources and Treatment, Water Distribution* and *Non core activities*.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water abstraction, water treatment and water distribution). Apportion any remaining costs on the basis of the proportion of: • costs that have been allocated directly to each category
M1.22 Contract management	Not previously used	The costs for negotiating and administering contracts for the supply and carriage of water within the *Water Resources and Treatment* and *Water Distribution* activities.	Specific but likely to be some formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Likely to depend on whether Scottish Water have a dedicated team for this new function. Possible apportionment of costs could be on the basis of the proportion of: • staff time spent on contracts relating to each different category compared to other activities • costs that have been directly allocated

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.24 Manage billing data	Previously covered under E1.13	Update billing system for change in occupancy, splits/mergers, vacant properties, new properties, service changes, rateable value change, meter exchange/removal, meter reads or burst reductions. Update billing system for sundry bills, generate and issue bill.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • Number of bills issued
M1.25 Generate and issue bills	Previously covered under E1.13	Audit cyclic billing data, generate and issue bill, including planning and scheduling of billing cycles. Include management costs and fees of local authority contracts for collection of household charges.	Specific/formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). • Costs for domestic customers can be directly allocated according to number of billed domestic properties.
M1.26 Handle billing enquiries	Previously covered under E1.13	Investigate and respond to billing enquiries. Include the costs of handling customer calls and written customer contacts.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Majority of domestic billing enquiries likely to be handled by Local Authorities Apportion any remaining costs by the proportion of: • number of billing enquiries

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.27 Handle billing exceptions	Previously covered under E1.13	Investigate billing exception reports and identify action required.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by: • number of billing exceptions
M1.28 Handle billing com-plaints	Previously covered under E1.13	Investigate and respond to billing complaints. Include cost of monitoring complaint resolution.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic. Apportion any remaining costs by the proportion of: • number of billing complaints per service and customer type. Some subjective allocation maybe required between water and sewerage
M1.30 Meter reading	Previously covered under E1.13	Read and record customer meter readings. (Include reading of meters for third parties as a non-core activity).	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic. Apportion any remaining costs by the proportion of: • number of meter readings per customer group (likely to be negligible for domestic customers)

Comparison of existing tables and proposed M Tables, together with basis for allocating costs   **Appendix 1**

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.31	Not previously covered in E tables	Any costs incurred by the Retail activity for meter maintenance and installation.	Specific	Likely to be a leasing charge for meters
M1.32 Handle metering enquiries	Previously covered under E1.13	Investigate and respond to metering queries. Include cost of managing customer calls and written contacts.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of meter enquiries (again return expected to be zero or negligible for domestic customers)
M1.33 Handle metering com-plaints	Previously covered under E1.13	Investigate and respond to metering complaints eg wrong meter reading. Includes monitoring of complaints resolution.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of metering complaints
M1.35 Remittance and cash pro-	Previously covered under	Reconcile and allocate payments to customer accounts. Includes banking of cash and cheques. Includes set up and monitoring of direct debit payments.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-

Comparison of existing tables and proposed M Tables, together with basis for allocating costs   **Appendix 1**

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
cessing	E1.13			domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • total number of bills • figure for domestic customers may not be included as a flat rate fee is paid to Local Authorities. Any allocation would therefore be subjective.
M1.36 Debt management (excl bad debt charge)	Previously covered under E1.13	Monitoring of outstanding debt, including issue of reminders and follow up telephone calls. Include management and monitoring of field recovery of debt, including costs of customer visits.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of reminders
M1.37 External debt recovery	Previously covered under E1.13	Manage and monitor external debt collection routes including debt collection agencies, and legal. Includes legal fees, court costs and debt collection fees.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of external recoveries
M1.38 Disconnections	Previously covered under E1.13	Costs of disconnecting customer supplies.	Specific/formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic).

Comparison of existing tables and proposed M Tables, together with basis for allocating costs **Appendix 1**

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
				Domestic customers cannot be disconnected. Wholesaler will perform disconnection on behalf of retailer; therefore will recharge cost to retailer. Apportion costs between measured and non-measured by the proportion of: • number of disconnections
M1.39 Handle payment enquiries/ plans	Previously covered under E1.13	Investigate and resolve payment enquiries, including set up and monitoring of payment plans.	Formulaic/ subjective	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of payment enquiries Where payments for water and sewerage services are combined, apportionment could be subjective.
M1.41 Advertising / Marketing	Previously covered under E1.13	Production and distribution of customer sales literature and awareness campaigns etc. Include costs of customer satisfaction surveys/research.	Formulaic/ subjective	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • customer marketing initiatives Not likely to be any costs for domestic.

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
				Retail non-domestic may need to be subjectively split between customer type and water and sewerage. Non-core costs may also have to be subjectively allocated
M1.43 Account management	Previously covered under E1.13	Additional costs for liaising with and managing larger users such as key accounts. This includes the costs of services not provided to other customers e.g. account managers. Includes management of additional customer data.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • number of planned key accounts customer visits This is predominantly a non-domestic customer service.
M1.45 Manage GSS payments	Previously covered under E1.13	Costs of handling GSS payments including GSS payments relating to operational activities. Include value of payment.	Specific/formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). GSS payments currently captured as part of complaint handling costs however, ABM can be adapted to split them out. Apportion any remaining costs on basis of: • number of payments made

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
				Value of payments can be directly split between water and sewerage depending on nature of GSS.
M1.46 Handle operational customer contacts	Previously covered under E1.13	Costs of receiving and handling customer contacts (telephone and written) concerning the wholesale activity of water supply.	Formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Not currently collected separately, but sufficient customer service information should exist to allow apportionment. Costs of resolution should be reported under wholesale. Not currently captured separately, but again should be possible to do so. Apportion any remaining costs by the proportion of: • number of operational contacts Water/sewerage can be allocated according to nature of operational call.
M1.47 Other direct costs	E1.8	Any other operating costs, but excluding interest and taxation, on an aggregated basis, including costs associated with the provision of offices, and insurance premiums (where such costs exceed 5% of total operating costs, an analysis should be provided) which are directly attributable to Retail activities.	Formulaic/ subjective	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). • depends on nature of cost. Likely to be apportioned according to the same proportions as the rest of direct costs.

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
M1.48 Direct employment costs	Previously would have been included in E1.1 Employment costs.	Employment costs are the sum of the total costs of manpower which are directly attributable to the retail activity. To be included are the gross salaries and wages of all employees within the relevant activity, including payments resulting from bonus and profit-related payment schemes, employer's National Insurance contributions, superannuation, unfunded pension liabilities, sick pay, sickness benefits, private health insurance, retirement awards, death in service benefits, paid leave, subsistence, travel, entertaining and conference expenses.	Specific	Allocate appropriate costs directly attributable to core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion any remaining costs by the proportion of: • costs that have been allocated to each category in the lines above
M1.49 IT (excl employment)	Previously included in General & Support Other costs.	Costs of IT support, hardware, software, licence payments and any other costs associated with the provision of IT with the exception of employment costs.	Subjective	Allocate appropriate costs directly attributable to core retail (split between domestic, measured non-domestic and non-measured non-domestic).
M1.52 General and support costs	E.10 and E1.11	General and support activities include all centrally provided services except for any items specifically covered under the individually identified activities. For further detail on General & Support Activities see WICS	Formulaic/ subjective	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between water source, water treatment and water distribution) and core retail (split

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
		RAR 4. The direct costs of *General and support activities* must be allocated across individually identified service activities within: *Water Resources and Treatment, Water Distribution, Retail – Domestic, Retail –Non domestic* and also *Non core activities*. Costs should be allocated in relation to the way that resources are consumed. Allocations based entirely on turnover, volume or direct labour rates should not be used as they are unlikely to reflect the activities involved. Scottish Water should include detail of the cost drivers used to allocate costs in its Commentary. See RAR 5 for further detail on allocation of costs.		between domestic, measured non-domestic and non-measured non-domestic). Majority can be done on a formulaic basis. Small proportion may need to be apportioned by the proportion of: • costs that have been allocated to each category in the lines above
M1.61 Scientific services	E1.14	Total costs directly associated with scientific services except for depreciation. Include the costs of scientific and laboratory services, and of the monitoring of quality. The cost of such services purchased should be included but the costs of services provided for third parties excluded. The costs of services to third parties should be included in line M1.73 as *Services provided to third parties* or in the appropriate column as *Non core* costs.	formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between retail domestic and total retail non-domestic). Apportion any remaining costs by the proportion of: • number of sample visits • number of samples transported • number of lab tests

Comparison of existing tables and proposed M Tables, together with basis for allocating costs
Appendix 1

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
		See WICS Regulatory Accounting Guideline 4 for further description of activities.		
M1.62 Cost of regulation	E1.15 Other business activities	This should include the cost of regulation (except depreciation), including all incremental managerial costs of regulation associated with a Strategic Review of Charges, licence fees payable to WICS and the Scottish Executive in respect of regulation; and staff and associated costs incurred in the preparation of submissions to, and liaison with, regulators. (Note: SEPA charges are included under the operational activities.)	Likely to be formulaic with some subjective	Apportion costs according to: • staff time spent on each area. Possible need for 50/50 split between water and sewerage especially WICS and Scottish Executive.
M1.65 Local authority rates	E1.17	The cost of Local Authority rates. This should include both the Uniform Business Rate and the National Non-Domestic Rate (if appropriate), including cumulo rates for water supply.	Specific/formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between domestic and total retail domestic. Rates for wastewater operational assets can be allocated directly. Remainder eg, for support buildings require apportionment It is not possible to directly allocate cumuli rates to water operational assets. Other options may need to be considered.

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
				Apportion any remaining costs on the basis of the proportion of: • rates by property?
M1.66 Bad debt charge	E1.18 Doubtful debts	The charge/credit to the income and expenditure account for bad and doubtful debts.	Specific/formulaic	Allocate appropriate costs directly attributable to non-core (split between retail non domestic and other non core), wholesale core total and core retail (split between retail domestic, retail non-domestic measured and retail non-domestic non-measured).
M1.71 Total exceptional items	E1.23	*Exceptional items* are defined in FRS3 *Reporting Financial Performance*. Scottish Water should provide full details of its exceptional items in the accompanying commentary.	Formulaic/ subjective?	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between domestic, and total retail domestic. Majority of exceptional items currently "spend to save" used on staff severance – possible to apportion on basis of employee role? Or allocate in proportion to total opex for each category?
M1.73 Third party services – opex	E1.25	The operating costs of providing water services to third parties, to include: • rechargeable works • bulk supplies of raw or treated water • non-potable water	Specific	Allocate appropriate costs directly attributable to core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between retail domestic and total retail non-domestic). Should capture a charge for each rechargeable work.

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
		• water main diversions		
M1.81 Reactive and planned maintenance infra-structure	E1.27	The reactive and planned maintenance expenditure on water infrastructure assets, for each of the individually identified service activities, *Water Resources and Treatment*, *Water Distribution* and *Non core* activities included in operating expenditure. This should include expenditure on: • burst repairs; • flushing, scrubbing and air scouring; • leakage control activities and leak repairs; • valve, hydrant maintenance/replacement; • communication pipe and stop tap replacement; • reactive and planned maintenance on aqueducts and dams.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between water source, water treatment and water distribution). Apportion remaining costs on the basis of the proportion of: • staff time spent on each category informed by timesheets
M1.82 Reactive and planned maintenance non-infrastructure	E1.28	The reactive and planned maintenance expenditure on water non-infrastructure assets, for each of the individually identified service activities within *Water Resources and Treatment, Water Distribution* and *Non core* activities included in operating expenditure. This should include expenditure on: • planned routine and reactive servicing of pumping plant; • planned routine and reactive maintenance of treatment works and instrumentation;	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between water source, water treatment and water distribution) and core retail (split between domestic, measured non-domestic and non-measured non-domestic). Apportion remaining costs on the basis of the proportion of: • staff time spent on each category informed by timesheets

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
		• service reservoir dosing; • buildings and ground maintenance; and • contracts for maintenance of computer equipment.		
M1.83 Infra-structure renewals expenditure	E1.29 is being replaced by M1.83 and M1.84	IRE is the net planned maintenance expenditure on the infrastructure network i.e., net of any grants or contributions for each of the individually identified service activities, *Water Resources and Treatment, Water Distribution* and *Non core* activities. See WICS RAR 3 for further detail.	Specific/for mulaic	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between total water resources and treatment, and water distribution).
M1.84 Infra-structure renewals accrual/ pre-payment	As above	The difference between the Infrastructure Renewals Charge and the Infrastructure Renewals Expenditure for each of the individually identified service activities, *Water Resources and Treatment, Water Distribution* and *Non core activities*. See WICS RAR 3 for further detail.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between total water resources and treatment, and water distribution).
M1.85 Non-infrastructure depreciation charge	E1.30	Non infrastructure depreciation charge on tangible fixed assets, for each of the individually identified service activities, *Water Resources and Treatment, Water Distribution* and *Non core* activities. Note that this figure is not net of the amortisation of deferred credits and intangible assets, which are shown	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between domestic, measured non-domestic and non-measured non-domestic).

Comparison of existing tables and proposed M Tables, together with basis for allocating costs

Appendix 1

M Table Ref	E Table Ref	M Table Definition	Basis for allocating costs	Description of basis of allocation
		separately on lines M1.86 and M1.87.		
M1.86 Amortisation of deferred credits	E1.31	The amortisation of deferred credits arising from third party contributions on non-infrastructure assets. These are amortised over the life of the related asset.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core) and core wholesale (split between total water resources and treatment, and water distribution).
M1.87 Amortisation of intangible assets	E1.32	Any amortisation or other reduction in the balance sheet valuation of intangible assets, such as goodwill.	Specific	Allocate appropriate costs directly attributable to non-core (split between retail non-domestic and other non-core), core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between retail domestic and total retail non-domestic). Scottish Water do not expect to report on intangible assets
M1.88 Business activities depreciation charge	E1.33	The asset depreciation at the aggregate level for each service, attributable to the assets used in the business activities: *Retail-Domestic, Retail Non-domestic,* Scientific services and Cost of Regulation and *Non core* (where related to these business activities).	Specific	Allocate appropriate costs directly attributable core wholesale (split between total water resources and treatment, and water distribution).
M1.90 Third party services – depreciation	E1.35	Asset depreciation on assets relating to third party services, together with any infrastructure depreciation charge for infrastructure assets relating to third party services.	Specific	Allocate appropriate costs directly attributable to core wholesale (split between total water resources and treatment, and water distribution) and core retail (split between retail domestic and total retail non-domestic).

M Tables

SECTION M : OPERATING COSTS AND EFFICIENCY
Table M1: Activity Based Costing - Water Service

M Tables

M Tables

SECTION M : OPERATING COSTS AND EFFICIENCY
Table M2: Activity Based Costing - Waste Water

M Tables

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Provide Water Services	Collect to provide to customer					
Source Water	Collect water and transport to treatment works					
Collect & Impound	Operation, maintenance and control of dams and impounding reservoirs	CORE			RAR 4	**1.1.1 Water Supply - Source water**
Borehole Extraction	Operation, maintenance and control of boreholes and impounding reservoirs	CORE			RAR 4	**1.1.1 Water Supply - Source water**
River & Surface Water Intake	Operation, maintenance and control of river and surface water intakes	CORE			RAR 4	**1.1.1 Water Supply - Source water**
Bulk purchase of raw water	The cost of bulk supplies of raw water from third parties	CORE			RAR 4	**1.1.1 Water Supply - Source water**
Raw water pumping	Operation, maintenance and control of raw water pumping to treatment. Excludes boosting to the distribution system. Where pumps serve dual purpose costs of pumping to distribution system should be estimated based on relative pumping head and charged to distribution	CORE			RAR 4	**1.1.1 Water Supply - source water**
Raw water conveyance	Conveyance of raw water to the treatment works, including operation, maintenance and control of aqueducts, valves etc.	CORE			RAR 4	**1.1.1 Water Supply - source water**
Treat Water	Treatment of raw water					
Operate and maintain large WTW's	All activities associated with the treatment of water at large water treatment works, including cost of chemicals, sludge and wastewater disposal, management,	CORE			RAR 4	**1.1.2 Water supply - treat water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	administration, depreciation and interest on capital. Large works have capacity to treat more than 25Ml/day				
Operate and maintain small WTW's	All activities associated with the treatment of water at small water treatment works, including cost of chemicals, sludge and wastewater disposal, administration, management, depreciation and interest on capital. Small works have capacity to treat up to 25ML/day	CORE		RAR 4	**1.1.2 Water supply - treat water**
Bulk purchase of treated water	The cost of bulk supplies of treated water from 3rd parties	CORE		RAR 4	**1.1.1 Water Supply – treat water**
<mark>Distribute Water</mark>	Transport treated water to the customer service pipes				
<mark>Bulk Transportation</mark>	Transport of treated water within high capacity element of network				
Bulk distribution pumping of water	All costs associated with the pumping of treated water to service reservoirs or for boosting within the bulk distribution system (pipe lines 300mm and above). Includes operation maintenance and control of pumps including cost of power, management, administration, depreciation and interest on capital	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Bulk transportation of treated water (incl PRV's)	All costs associated with the conveyance of treated water within the trunk distribution system (pipelines 300mm and above), includes operation, maintenance, control, management, administration,	CORE		RAR 4	**1.2 Water supply - distribution of treated water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	infrastructure maintenance and interest on capital				
<mark>Local Distribution</mark>	Deliver water from high capacity element of network to customer service pipes				
Local distribution pumping of water	All costs associated with the pumping of treated water to service reservoirs or for boosting within the local distribution system (pipe lines <300mm). Includes operation, maintenance and control of pumps and associated equipment, management, administration, depreciation and interest on capital	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Local transportation of treated water	All costs associated with the conveyance of treated water within the local distribution system (pipelines <300mm). Includes operation, maintenance, control of aqueducts and mains, valves, bulk meters, etc investigation of complaints and enquiries, byelaw inspections, management, administration, infrastructure maintenance and interest on capital	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Local distribution storage of water	All costs associated with the storage of treated water within the bulk distribution system (pipe lines<300mm). Includes management, administration, depreciation and interest on capital	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
<mark>Provide Wastewater</mark>	Sewage and storm water collection to				

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Services	final disposal				
Collect Wastewater	Sewage and storm water reception and conveyance				
Pump wastewater	All pumping costs associated with the collection of sewage and storm water, excluding terminal pumping costs (costs of pumping to treatment works). Includes operation, maintenance and control of pumps including cost of power	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Storm overflow and outfall	Operation, maintenance and control of storm overflows/outfalls. Includes SEPA consents	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Transport wastewater	Operation, maintenance and control of the sewer network	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Treat Wastewater	Wastewater treatment including crude sewage pumping to treatment works				
Operate and maintain large WWTW's	Operate size band 6 WWTW's (capacity >1500kg BOD/Day)				
Treat wastewater at large secondary WWTW's	Operation, control and maintenance of large secondary WWTW's. (Works whose highest processes include biological filtration processes or activated sludge processes). Includes terminal pumping costs	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**
Treat wastewater at large tertiary WWTW's	Operation, control and maintenance of large tertiary WWTW's (Works whose highest processes include tertiary processes and nitrifying filters including sand filters, microstrainers, upward flow	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	clarifiers etc)				
Operate and maintain small WWTW's	Operate WWTW's with capacity up to 1500kg BOD/Day				
Operate and maintain SW septic tanks & outfalls	Operation, maintenance and control of SW septic tanks including the cost of desludging, and outfalls	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**
Treat wastewater at primary WWTW's	Operation control and maintenance of primary WWTW's works. Includes primary sedimentation process, includes desludging by direct pumping or any other means to the first stage of the sludge treatment process and terminal pumping	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**
Treat wastewater at small secondary WWTW's	Operation, control and maintenance of small secondary WWTW's. (Works whose highest processes include biological filtration processes or activated sludge processes). Includes terminal pumping	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**
Treat wastewater at small tertiary WWTW's	Operation, control and maintenance of small tertiary WWTW's (Works whose highest processes include tertiary processes and nitrifying filters including sand filters, microstrainers, upward flow clarifiers etc)	CORE		RAR 4	**1.4 Sewerage services -sewage treatment**
Sludge Treatment & Disposal					

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Sludge treatment & disposal to landfill	Operation, maintenance and control of sludge treatment facilities (sludge screening, treatment (chemical, biological, thermal), dewatering, storage). Includes transportation to point of disposal, disposal cost and landfill tax.	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Sludge treatment & disposal to land reclamation	Operation, maintenance and control of sludge treatment facilities (sludge screening, treatment (chemical, biological, thermal), dewatering, storage). Includes transportation to point of disposal and disposal costs	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Sludge treatment & disposal to agriculture	Operation, maintenance and control of sludge treatment facilities (sludge screening, treatment (chemical, biological, thermal), dewatering, storage). Includes transportation to point of disposal and disposal costs	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Sludge treatment & disposal to coppising	Operation, maintenance and control of sludge treatment facilities (sludge screening, treatment (chemical, biological, thermal), dewatering, storage). Includes transportation to point of disposal and disposal costs	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Sludge treatment & disposal to power generation	Operation, maintenance and control of sludge treatment facilities (sludge screening, treatment (chemical, biological, thermal), dewatering, storage). Includes transportation to point of	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**

Detailed Allocation of Activities

Appendix 3

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	disposal and disposal costs				
Market & Sell Non Core Products	Develop non core product strategy, price, market & sell				
Commercial Marketing & Intelligence	Market products and services for SW Commercial services and Trading units, compile competitor intelligence, and establish SW commercial brand.	NON-CORE		RAR 4	**3.0 Non-core activities**
Sell Products & Services	Identify the needs of new and existing customer and potential business opportunities (external/capital only), prepare proposals and tender/bid for work	NON-CORE		RAR 4	**3.0 Non-core activities**
Provide Non Core Services					
Provide 3rd party PPP consultancy	Provide consultancy for design, build, finance and operate contracts outwith Scottish Water. Includes planning and scheduling and preparation of billing data	NON-CORE		RAR 4	**3.0 Non-core activities**
Perform 3rd party environmental audits	Perform environmental audits, including leak detection, smart metering etc. Includes planning and scheduling and update of billing data	NON-CORE		RAR 4	**3.0 Non-core activities**
Provide external consultancy	Provide consultancy and advisory services to third parties other than PPP consultancy, and asset design & build consultancy. Includes planning and scheduling and update of billing data	NON-CORE		RAR 4	**3.0 Non-core activities**

Detailed Allocation of Activities

Appendix 3

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Provide 3rd party sampling & laboratory services	Sampling, testing and reporting results of third party water and wastewater. Includes scheduling, and preparation of billing data	NON-CORE			RAR 4	**3.0 Non-core activities**
Operate and maintain 3rd party assets	Operation and maintenance of third party assets	NON-CORE			RAR 4	**3.0 Non-core activities**
Provide Customer Services	Customer contact to monitoring of closure					
Customer Accounting		CUSTOMER TYPE				
Customer Metering		DOMESTIC	NON-DOMESTIC			
Meter Reading	Read & record customer meter readings, and meters for third party customers eg BAA	CORE	LICENSED		RAR 4	**1.6 Retail activities/3.0 Non-core for 3rd parties**
Meter maintenance and installations	Installation, repair and exchange of customer meters, including planning and scheduling of work, pre installation survey, design of work and valuation	CORE	LICENSED		RAR 4	**1.2 Water supply - distribution of treated water/1.3 Sewerage services - sewerage**
Handle Metering Queries	Investigate and respond to metering queries	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Business Customer Accounting						
Manage Cyclic Billing Data	Update billing system for change in occupancy, splits/mergers, vacant properties, new properties, service changes, rateable value change, meter exchange/removal, meter reads or burst reductions	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Manage Sundry Billing	Update billing system for sundry bills,	N/A	LICENSED		RAR 4	**1.6 Retail activities**

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Detailed Allocation of Activities

Appendix 3

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
	generate and issue bill					
Manage Billing Exceptions	Investigate billing exception reports and identify action required	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Generate and Issue Cyclic Bills	Audit billing data, generate and issue bill, including planning and scheduling of billing cycles	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Handle Billing Enquiries	Investigate and respond to billing enquiries	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Tariff negotiations	Develop and negotiate non standard tariff agreements.	N/A	CORE/LICENSED		RAR 4	**1.6 Retail activities**
Credit Management						
Remittance & Cash Processing	Reconcile and allocate payments to customer accounts. Includes banking of cash and cheques	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Manage direct debits	Set up and monitor direct debit payments	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Handle payment enquiries/plans	Investigate and resolve payment enquiries, including set up and monitoring of payment plans	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Debt management	Monitoring of outstanding debt, including issue of reminders and follow up telephone calls	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Manage field recovery of debt	Manage and monitor field recovery of debt, includes costs of customer visits	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Disconnections	Disconnect customer supplies	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Manage external debt collection	Manage and monitor external debt collection routes including debt collection agencies, and legal. Includes legal fees and debt collection fees	CORE	LICENSED		RAR 4	**1.6 Retail activities**

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Provide for Business Debt	Provision for domestic bad debt charged to the P&L account	N/A	LICENSED		RAR 4	**1.6 Retail activities**
<mark>Domestic Customer Accounting</mark>						
Household Billing & Collection	Management costs and fees of local authority contracts for collection of household charges	CORE	N/A		RAR 4	**1.6 Retail activities**
Provide for Domestic Debt	Provision for domestic bad debt charged to the P&L account	CORE	N/A		RAR 4	**1.6 Retail activities**
<mark>Customer Relationship Management</mark>						
<mark>Manage Customer Contacts</mark>						
Manage Customer Calls	Receive and log customer call. Either resolve, raise service request, assign complaints to customer relations or complex billing issues to billing & credit management	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Manage Written Customer Contacts	Receive and log customer letters, emails and faxes. Either resolve and respond to customer, raise service request, assign complaints to customer relations or billing and metering enquiries to billing & credit management	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Handle metering complaints	Investigate and respond to metering complaints eg wrong meter reading. Includes monitoring of complaints resolution	CORE	LICENSED		RAR 4	**1.6 Retail activities**

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Handle billing complaints	Investigate and respond to billing complaints, includes inspecting for surface water connections, void properties etc. Includes cost of monitoring complaints resolution	CORE	LICENSED		RAR 4	**1.6 Retail activities**
Investigate Water Quality Complaints	Investigate water quality complaints relating to colour, taste, smell, presence of foreign bodies or illness due to water. Includes any sampling costs as a result of complaint.	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Investigate Water Pressure Complaints	Investigate complaints of high or low water pressure	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Investigate Water Rising Complaints	Investigate complaints of rising water levels	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Investigate Fire Hydrant Misuse	Investigate and remedy complaints relating to vandalism of fire hydrants	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Investigate Other Water Supply Complaints	Investigate other water supply complaints including lack of supply, intermittent supply, overflow running, airlock, noise in pipe, lack of notification of shutdown and water in gas pipes.	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Investigate Water Infrastructure Safety Complaints	Investigate water infrastructure safety complaints including dangerous reinstatements, and dangerous, missing, broken noisy or damaged manhole covers.	CORE	CORE		RAR 4	**1.2 Water supply - distribution of treated water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Investigate Sewer Flooding Complaints	Investigate complaints relating to sewer flooding/surcharging and sewer backing up.	CORE	CORE		RAR 4	**1.3 Sewerage services – sewerage**
Investigate Odour Complaints	Investigate complaints relating to odour	CORE	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Proactive key customer management	Meet key customers on a proactive basis to build relationships, keep them informed, identify potential problems or business opportunities, and provide advice. Includes management of key customer data	N/A	LICENSED		RAR 4	**1.6 Retail activities**
Customer Marketing & Intelligence	Production of customer literature including charges scheme leaflets, what water services, customer awareness campaigns and conducting customer satisfaction surveys/research	CORE	LICENSED		RAR 4	**1.6 Retail activities**
<mark>Emergency Planning</mark>						
Emergency planning & security	Improve/maintain plans, develop/draft procedures, contact information, zonal contingency plans, customer plans, intranet content, document control, audit of plans and procedures, risk assessment, liaison requirements. Train and emergency exercise programs. Manage emergency equipment and supplies. Develop, implement and maintain security policies and procedures, monitor effectiveness of security, liaise with security officers etc	CORE	SOME LICENSED COOPERATION REQUIRED		RAR 4	**1.7 Business activities -general and support (Emergency planning)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Manage and coordinate incident response and communication	Implementation of emergency planning procedures during an incident, including provision of staff, equipment etc Includes communicating with customers, holding hospital plan, managing and advising key stakeholders including key customers, media, DWQR, SEPA, public health bodies, Scottish Executive etc.	CORE	SOME LICENSED COOPERATION REQUIRED		RAR 4	**1.7 Business activities -general and support (Emergency planning)**
Manage the Assets	Develop strategy to implementation & monitoring					
Define Asset Management Targets						
Monitor strategic asset management performance	Understand future regulatory performance requirements and future demand. Understand service level/cost performance risk balance and set targets. Produce and monitor strategic performance reports eg KPI's	CORE			RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Develop Integrated Strategic Asset Plan						
Deliver Functional and Area Operating Strategy	Develop and deliver functional, cross-functional and geographic strategies funded from operating expenditure	CORE			RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Deliver Functional and Area Capital Investment Strategy	Develop and deliver functional, cross-functional and geographic strategies funded from capital expenditure	CORE			RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Manage Whole Life Asset Plan						

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Generate, review and monitor capital investment plans	Capex needs identification, prioritisation, approval and development of outputs	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Generate, review and monitor operational asset plans	Generate and maintain operational optimisation opportunity and risk of failure plans	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Generate, monitor and review maintenance asset plans	Generate, update and maintain risk based maintenance plans	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
<mark>Manage AM Standards & Policies</mark>					
Maintain SW works manuals	Maintain & update SW works manuals and policies	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Maintain SW asset specifications & standards	Maintenance & update of SW asset specifications & standards to represent the optimal balance between cost, risk, performance and sustainability	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
<mark>Manage Asset Information</mark>					
Manage Infrastructure Asset Data	Manage and update infrastructure asset data including maintenance	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Manage Non Infrastructure Asset Data	Manage and update non infrastructure asset data	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Provide developer information	Deal with questions from Scottish Exec and developers, where physical aspects of infrastructure are required to change, investigate and advise on implications	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Capital Programme Management					
Manage Capital Programme	Investment Appraisal and Approval of capital projects. Includes update of fixed asset register for acquisitions and disposal	CORE		RAR 4	**1.7 Business activities -general and support (Manage the assets)**
Scottish Water Solutions	Scottish Water Solutions setup	NON CORE		RAG 4	**3.0 Non-core activities**
Deliver Approved Capital Programme					
Manage Capital Projects	Manage delivery of capital investment projects (Project Sponsors, Project Planners and Project Managers) and monitor and report on project delivery by area or element of programme (Area Programme Leaders).	CORE		RAR 4	**1.7 Business activities - general and support (Manage the assets)**
Design & build assets					
Mains Rehabilitations	Rehabilitate water mains, including design of work and valuation	CORE		**RAR 1, RAR 2**	**N/A**
Main Laying	Construction of mains or sewers, including planning, design, inspection and valuation of works. Includes work performed by framework contractors	CORE		**RAR 1, RAR 2**	**N/A**
Sewer Laying	Construction of mains or sewers, including planning, design, inspection and	CORE		**RAR 1, RAR 2**	**N/A**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	valuation of works. Includes work performed by framework contractors.				
Non-standard water connections	Design, Construct, Audit and Accept Non-standard water connections (>32mm). Includes planning, scheduling, and production of billing data	CORE		**RAR 1, RAR 2**	**N/A**
Standard water connections	Design, Construct, Audit and Accept standard water connections (<32mm), including one off connections. Includes planning, scheduling and production of billing data	CORE		**RAR 1, RAR 2**	**N/A**
Sewer connections	Approve, Audit and Accept sewer connections. Includes scheduling and preparation of billing data	CORE		**RAR 1, RAR 2**	**N/A**
Leakage detection & repair	Leakage detection and repair of mains including planning and design of work	CORE		RAR 4	**1.1.1 Water Supply - Source water/1.12 Distribution of treated water**
Design & build 3rd party assets	All costs relating to the design & build of assets on behalf of third parties	NON-CORE			**3.0 Non-core activities**
Operate & maintain the assets					
Workflow Support & Admin					
Capacity Planning	Manage NSO and choke squad diaries,	CORE		RAR 4	**1.7 Business activities - general and support (Workflow support and administration)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Plan, schedule & allocate tasks	Plan, prioritise & schedule planned and reactive tasks, and obtain commitment to perform work. Includes raising of work orders/work requests in Promise & WAMs	CORE		RAR 4	**1.7 Business activities - general and support (Workflow support and administration)**
Produce & Issue Work Packs	Collate and issue work packs for planned maintenance work	CORE		RAR 4	**1.7 Business activities - general and support (Workflow support and administration)**
Works notification	Issue notification to roads authority on works maintenance. Provide utility information	CORE		RAR 4	**1.7 activities - general and support (Workflow support and administration)**
Input timesheets	Input networks staff timesheets to system	CORE		RAR 4	**1.7 activities - general and support (Workflow support and administration)**
Routine operation & maintenance of water production and wastewater treatment assets					
Catchment Management	Routine inspections and investigation of pollution incidents	CORE		RAR 4	**1.1.1 Water Supply - Source water**
Operation & routine maintenance of water resources	Operation and routine maintenance of water resources including reservoir monitoring, control & maintenance, intake monitoring control and maintenance, operation, maintenance & regulation of raw water aqueducts and operation,	CORE		RAR 4	**1.1.1 Water Supply - Source water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	maintenance and monitoring of raw water pumping stations				
Process checks	Process operation and cleaning includes samples, checking dosing levels, process optimisation and validating instrumentation	CORE		RAR 4	**1.1.2 Treat water**
Deal with chemical deliveries	Taking delivery of chemicals on site including loading into storage	CORE		RAR 4	**1.1.2 Treat water**
Perform health & safety checks	Perform health & safety checks including issue of permits to work, control of contactors, risk assessments, equipment checks	CORE		RAR 4	**1.7 Business activities - manage Human Resources**
General routine maintenance	General routine maintenance and checks at sites, including quality checks, SCADA checks, security checks, instrument calibration, data recording, maintenance of asset records, and general housekeeping duties.	CORE		RAR 4	**1.1.2 Treat water**
Provide water process advice & support	Provide technical advice on day to day water operational problems with processes including management of operational problems eg supply v demand. Advise on treatment optimisation and conduct audits and investigations. (Opex only advise relating to capital should be allocated to manage the capital programme)	CORE		RAR 4	**1.1.2 Treat water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation		Potentially a shared service?	Covered by	RAR 4 Activity
Provide wastewater process advice & support	Provide technical advice on day to day wastewater operational problems with processes including management of operational problems eg supply v demand. Advise on treatment optimisation and conduct audits and investigations. (Opex only advise relating to capital should be allocated to manage the capital programme)	CORE			RAR 4	**1.4 Sewerage services -sewage treatment**
Sludge production and conditioning	Manual and mechanical desludging of processes, sludge dewatering and thickening.	CORE			RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Treatment operatives intersite travel	Travel time between works for operatives performing routine operation and maintenance of water production and wastewater treatment assets. Excludes travel time for reactive maintenance and electrical/mechanical maintenance which should be charged to the activity.	CORE			RAR 4	**1.4 Sewerage services -sewage treatment/1.1.2 Treat water**
		CUSTOMER TYPE				
Waste management		DOMESTIC	NON-DOMESTIC			
Schedule septic tank emptying	Plan & schedule septic tank emptying	CORE	NON-CORE		RAR 4	**1.6 Retail activities/ 3.0 Non-core activities/**
Septic Tanks emptying	Desludging of septic tanks and transportation of waste to sludge treatment centre or WWTW's for treatment	CORE	NON-CORE		RAR 4	**1.6 Retail activities/3.0 Non-core activities**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Third Party Waste Transportation	Transport of third party waste to sludge treatment centre, or WWTW's for treatment	NON-CORE		RAR 4	**3.0 Non-core activities**
Intersite sludge tankering	Tankering of sludge from works to sludge conditioning centre or sludge treatment centre (SW owned or PFI). Includes desludging of SW septic tanks, liaison with PFI when take to PFI plant eg sample sludge disposing/density etc, admin, vehicle checks, tacographs, defect reports etc	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Bulk internal sludge movement from works to final disposal	Tankering of sludge from sludge treatment works to final disposal point, excludes sludge tankering by external contractors, and intersite sludge transportation	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Manage contract waste transportation & disposal	Manage external contracts for removal of sludge and other waste from works to final disposal point. Excludes intersite sludge transportation	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Monitor waste management compliance	Monitor waste management compliance ensuring adherence to the waste management licensing requirements	CORE		RAR 4	**1.5 Sewerage services - sludge treatment and disposal**
Monitor Network Performance					
Monitor water distribution system performance (planned)	Routine monitoring of water networks operations including services reservoirs and pumping stations using telemetry system & INMS. Includes pressure	CORE		RAR 4	**1.2 Water supply - distribution of treated water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	recording, flow measurement and reservoir level reading. Alert Network operations of problems. Report and generate work requests.				
Reactive monitoring of water distribution system performance	Reactive monitoring of water network operations as a result of a complaint or known problem, using telemetry system and INMS. Alert network operations of problems, report and generate work requests	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Monitor wastewater collection system performance (planned)	Routine monitoring of wastewater network operations using telemetry system and alert network operations of problems	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Reactive monitoring of wastewater collection system performance	Reactive monitoring of wastewater network operations using telemetry system and alert network operations of problems, report and generate work requests.	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Maintain INMS Model Integrity	Review INMS model integrity and request physical investigation to be carried out by NPO's (below)	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Maintain INMS Model Physical Integrity	Boundary valve management, and maintenance of loggers, meters and other collection devices	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Leakage Detection	Leakage sounding and repair	CORE		RAR 4	**1.2 Water supply - distribution of treated water**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Health & Safety Coordination	Coordinate health & safety inspections , identify and ensure health & safety remedial works take place	CORE		RAR 4	**1.7 Business activities - Manage Human Resources**
Planned Network Operations	<A> Added by Metify ABM				
Mains Flushing & Scouring	Flushing and scouring of water mains to remove debris.	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Planned Interruptions	Valve operations to facilitate repairs or additions	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Secondary Chlorination	Addition of chlorine to water supply within the network to maintain water quality	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Perform Water Infrastructure Investigations	Investigate water network performance issues	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Perform WW Infrastructure Investigations	Investigate WW network performance issues eg sewer backing up	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Provide shipping water	Supply of potable water to ships at dock.	NON-CORE		RAR 4	**3.0 Non-core activities**
Byelaw Inspections	Carry out plumbing inspections for byelaw compliance and advise where necessary	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Customer assistance	Provide assistance to customers including turning water supply on and off, issuing bottled water etc.	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Network Repairs & Maintenance					

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Mains Repairs	Repair burst water mains	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Remove Chokes	Clearance of choked sewers including any rodding, jetting or flushing involved in clearing the blockage	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Sewer Repairs	Repair to sewers	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Sewer Maintenance	Sewer maintenance including CCTV maintenance examinations, man entry surveys, flushing, jetting and rootcutting to clear debris or silting	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Maintain Street Furniture	Maintenance, replacement and installation of manhole covers	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Repair of service connections	Repair of sewer connection pipes and water connection pipes	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Repair & maintain PRV's, valves etc	Repair, maintenance, install, replace and remove water main fittings eg PRV's, valves	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Service reservoir cleaning	Cleaning & remedial work to service reservoirs	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Risk based maintenance inspections	Risk based maintenance inspections of CSO's and wastewater pumping stations	CORE		RAR 4	**1.3 Sewerage services - sewerage**
Mains diversions	All costs associated to the diversion of mains. Includes planning, scheduling and	CORE		RAR 4	**2.0 Services for a third party**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	preparing billing data				
Lead Pipe Renewals	All costs associated with replacement of lead pipes	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Installation & repair of Fire Hydrant	Installation and repair of fire hydrants. Including preparation of billing data	CORE		RAR 4	**1.2 Water supply - distribution of treated water**
Electrical & Mechanical Maintenance					
Reactive Electrical & Mechanical Repairs	All urgent electrical and mechanical repairs to assets. Includes management of external contractors	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**
Planned Electrical & Mechanical Repairs	All planned (High & Low priority) electrical and mechanical repairs to assets, including any specialist upfront technical input eg investigations, design etc. Includes management of external contractors	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**
Cyclic Electrical & Mechanical Maintenance	Cyclic risk based electrical and mechanical maintenance on assets including gas monitors, breathing apparatus and statutory inspections	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**
Minor Electrical and Mechanical Installations	Minor E&M installations to assets, includes specialist upfront technical input eg investigations, design etc and management of external contractors	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Maintain Telemetry	Maintenance of telemetry servers at outstations, plus checking of priority signals	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**
Manage minor telemetry installations	Minor telemetry installations to assets, includes specialist upfront technical input eg investigations, design etc and management of external contractors	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Electrical Mechanical repairs)**
<mark>Manage PFI Assets</mark>					
Manage PFI contracts	Day to management of PFI contracts, including relationship with supplier and asset operations, monitoring contract compliance/performance, dealing with contractual disputes, contract variations and compensation claims. Includes contract fees and SW costs incurred as a result of PFI assets.	CORE		RAR 4	**Allocate costs according to cost definitions - Appendix 3**
<mark>Manage Human Resources</mark>	Recruitment to exit				
Manage HR strategy	Communicate HR initiatives to the business, understand business issues, what business units want to achieve and how HR can impact, and develop into HR solutions. Develop and maintain HR policies	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
<mark>Staff Deployment</mark>					

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Staff recruitment	Staff recruitment including production of job specifications, advertisements, recruitment agency fees, short listing, and interview costs.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Manage excess staff	The cost of managing the business support unit, including staff costs of excess staff transferred to the BSU. Excludes costs of BSU staff utilised within the business, whose costs should be charged to the appropriate activity. Excludes costs of VSS which are chargeable to transformation	CORE	**P**	RAR 4, RAR 5	**Allocate costs according to cost definitions - Appendix 3**
Manage employee data	Update and maintain employee records including contractual details, personal data etc. Includes amendments to payroll standing data eg employee addresses, pay scale etc	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Deliver Staff Training	Develop training and development strategy, assess training needs and decide how best to meet needs. Includes internal cost of training design. Schedule training events, issue training schedule, collate and verify bookings, and evaluate and update training records. Includes course fees, materials and cost of staff on training course. Supplier contact, negotiation and purchase order preparation will be required as part of this activity.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Manage employee performance, reward & recognition					
Manage Employee Performance Measurement	Develop and coordinate the Corporate Performance Measurement process	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Develop staff compensation & benefits package	Develop terms and conditions package for SW staff, communicate to staff, and obtain staff acceptance.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Manage team performance	Manage and monitor team performance including attendance management, downtime monitoring etc	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Manage payroll	Ensure all employee payments and payments to third parties eg inland revenue are accurate and on time, and all payroll transactions comply with legislation. Ensure compliance with SW policies and offer advise to employees. Monitor and process claims ensuring appropriate authorisation and absence payments. Issue payslips	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Manage Health & Safety	<A> Added by Metify ABM				

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Develop, maintain and monitor health & safety policy	Review current legislation for any changes and new legislation, internalise impact and implement policy. Training for SW business including delivery philosophy and cost/benefit analysis. Best Practice analysis partnering with other utilities. Input to projects and initiatives. Includes accident reporting and investigation, reportable misses and risk assessment.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Implement health & safety policy	Support managers and advise on health & safety issues. Implement SW health & safety policies, including development of a health & safety management system	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Formulate, deliver and monitor occupational health scheme	Policy development, implementation, 3rd party service delivery, monitor effectiveness including cost benefit analysis.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
<mark>Manage employee & industrial relations</mark>					
Manage employee relations	Manage employee relations issues including, visiting employees absent on long term sick, coaching and counselling, and dealing with disciplinary issues	CORE		RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
Manage industrial relations	Manage trade union relations and joint consultative committees. Includes cost of SW council and business unit councils	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Human resources)**
<mark>Manage Information</mark>	Data capture to storage + access				

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Manage IT Demand					
Manage IT strategy	Develop IT strategy. Conduct market research, and benchmarking to identify opportunities for performance improvement. Assess feasibility of business requirements including financial justification and benefits realisation, prior to entering design and build phase. Includes capex forecasting.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Manage customer expectation	Manage IT customer performance, including meeting with GM's and managers to identify & resolve issues and identify future IT requirements	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Develop IT Solutions					
Realise IT solutions	Design, implement and build IT solutions, including the design and implementation of small systems by applications support, technical and comms infrastructure by technical and comms infrastructure teams that is chargeable to capital.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Deploy IT solutions					
Support Business Applications					
Provide applications support	Operate and maintain software applications eg LIMS, Billing, tranman, peoplesoft system including report writing, changes and user advice, and supporting tactical applications (eg access database).	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Software maintenance contracts	Fixed fee software maintenance contracts with software supplier for continued support of application, usually fixed proportion of purchase price.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
IT Service Support					
Provide IT Helpdesk	Provision of IT helpdesk service including logging calls, passing problem to appropriate personnel, and monitoring resolution of request.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Provide Desktop Support	Provide support to desktop users eg computer setup, software installation, fault diagnosis, repair printers etc. Excludes costs of office moves and changes, which should be captured under the individual activity.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Provide Communications Infrastructure					
Provide Data Communications	Operate and maintain the wide area network including line rentals and usage. This includes the main office network and the secondary network to works(BT Line Rental) (i.e. ISDN)	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Provide Telemetry	Operate and maintain the telemetry networks including line rentals and usage	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Provide Voice Communications	Operate and maintain the internal (featurenet) telephone system, and the exchange lines. Includes line rentals and	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	usage.				
Provide Mobile Communications	Mobile phone rental and	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Provide Call Centre Telephone System	Operate and maintain the call centre telephone system, including line rentals & usage	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Manage availability of Infrastructure				RAR 4, RAR 5	
Manage IT Infrastructure Availability	Provide server configuration, user setup, backup, disaster recovery and restore services. Includes database administration, maintaining email/ internet gateways and managing diskspace. Includes fixed external maintenance contract costs with supplier	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage Information)**
Manage Property & Facilities	Acquisition to disposal				
Manage Estate					
Property Acquisitions	Acquisition of property for the capital programme. Disposal of surplus assets once decommissioned, cleared and audited for health & safety and decontamination	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Property Disposals	Acquisition of property for the capital programme. Disposal of surplus assets once decommissioned, cleared and	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	audited for health & safety and decontamination				facilities)
Manage land compensation claims	Act as agent for SW in settlement of land compensation claims	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Manage rent, rates & council tax	Manage receipt and payment of all rent, rates and council tax, including minimising rates liability	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Manage operational property maintenance	Establish and manage a maintenance programme for operational property to ensure SW complies with health & safety requirements, key operational maintenance, statutory and contractual legal compliance	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Manage central building maintenance	Establish and manage a maintenance programme for central buildings to ensure SW complies with health & safety requirements, key operational maintenance, statutory and contractual legal compliance	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Manage Non Core Property Services	Provide commercial property services to increase contribution generation from our core assets eg telecomms masts & towers, windfarms, advertising boards etc. Includes management & running of Loch Katrine Tourist Complex (shop,	NON-CORE		RAR 4, RAR 5	**3.0 Non-core activities**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	cycle hire steamer, land management), farming, forestry and fishing activities.				
<mark>Manage Facilities</mark>					
Provides central building services	Provision of office facilities including reception, post room, printing & photocopying, utilities, R&M, furniture & fittings and other property services eg security and cleaning. Includes managing office demand. Includes provision of electronic library e, and travel desk	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
Manage Office moves	Coordinate and manage office moves, including management of contractors associated with moving furniture, files, workstations. Includes IT costs associated with setup of workstations, printers etc	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage property and facilities)**
<mark>Provide Scientific Services</mark>	Interpretation of legislation, set policy, monitor & report				
<mark>Sampling</mark>					
Define, schedule and monitor sampling programme	Interpret new legislation and the impact of new assets in order to define the regulatory sampling regime. Define operational sampling requirements, schedule sampling to meet planned sampling requirements. Track regulatory sampling and interpret results.	CORE		RAR 4	**1.7 Business activities - scientific services**

Detailed Allocation of Activities   **Appendix 3**

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Take samples	Take samples and return them to the local depot	CORE		RAR 4	**1.7 Business activities - scientific services**
Transport samples	Transport of samples from local depots to the appropriate laboratory for testing. Transport sample bottles etc to local depots for next days sampling	CORE		RAR 4	**1.7 Business activities - scientific services**
Provide Laboratory services	<A> Added by Metify ABM				
Sample reception	Log in samples, split samples where required and take samples to labs for analysis.	CORE		RAR 4	**1.7 Business activities - scientific services**
Analyse samples & record results	Perform laboratory analysis on samples. Includes the cost of hire and maintenance of any laboratory equipment used. Record results	CORE		RAR 4	**1.7 Business activities - scientific services**
Prepare & issue analytical reports	Preparation and issue of laboratory analytical reports	CORE		RAR 4	**1.7 Business activities - scientific services**
Audit Laboratory Processes	Audit laboratory processes to ensure UCAS ISO 1725 standards are adhered to.	CORE		RAR 4	**1.7 Business activities - scientific services**
Manage Water Quality					
Manage PCV Breaches	Inform asset ops/customer services and understand reason. Complete event notice form and submit to DWQR, and inform public health officers. Ensure key stakeholders are managed and kept informed, to minimise the no. of event escalations	CORE		RAR 4	**1.7 Business activities - scientific services**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Manage Environmental Quality					
Production & implementation of environmental & sustainability policies	Translate legislation and develop environmental and sustainability policies for Scottish water. Provide advice to business on impact of new legislation	CORE		RAR 4	**1.7 Business activities - scientific services**
Manage Wastewater Quality Failures	Liaison with SEPA following wastewater quality failure, investigate, report and ensure correct procedures followed	CORE		RAR 4	**1.7 Business activities - scientific services**
Manage Trade Effluent Customers					
Manage Trade Effluent Consents	Set consent conditions for discharges to sewer to ensure that treatment works operation, health & safety or the environment is not compromised. Monitor discharges on a risk based basis to protect the environment. Provide advice to prevent accidental discharges. Investigate and recover the cost of incidents related to non consented discharges	CORE		RAR 4	**1.6 Retail activities**
Trade Effluent Billing & Enquiries	Provision and maintenance of trade effluent data for billing. including customer liaison and correspondence in response to billing enquiries	LICENSED		RAR 4	**1.6 Retail activities**
Research & Development					

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Coordinate Research & Development	Assessment of research & development projects, monitoring and direction of UKWIR projects, payments to UKWIR to carry out projects, reporting and promoting R&D results	CORE		RAR 4	**1.7 Business activities - general and support (Research & Development)**
Provide Fleet Services	Acquisition to disposal				
Procurement of vehicles	Advice and commercial input to specification and supply of all fleet assets	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**
Provision of vehicles & plant	Provision of vehicles and plant including lease costs and depreciation on owned assets	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**
Vehicle and plant hire	Provision of a central hire desk, including all vehicle and plant hire costs.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**
Vehicle & plant maintenance	Maintenance inspection of vehicles & plant in line with maintenance schedules including routine maintenance to comply with legislation; MOT plating and testing in line with statutory conditions of operating licences. Includes spares and external maintenance costs, cost of replacement vehicle and administration of tax.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Fuel management	Purchase of fuel and administration of fuel card contracts	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**
Accident management	Provision of common reporting procedures to understand and support all accidents. Including cost of insurance claims	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Provide fleet services)**
Procurement	Identify supplier, raise requisition, generate and despatch purchase order and receipt goods when received				
Strategic Sourcing	Develop procurement category strategy, evaluate and select suppliers, implement procurement category strategy and monitor contract performance	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Procurement)**
Procure Goods & Services	Identify supplier, raise requisition, generate and despatch order and receipt goods when received	CORE	**P**	RAR 4, RAR 6	**1.7 Business activities - general and support (Procurement)**
Pay suppliers					
Collate & process supplier correspondence	Process vendor mail and prepare for processing including invoices, credit notes, returned cheques etc	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Procurement)**
Invoice checking and authorisation	Includes costs of checking and authorising supplier invoices for payment	CORE	**P**	RAR 4, RAR 6	**1.7 Business activities - general and support (Procurement)**
Vendor maintenance and liaison	Add and maintain vendors. Reconcile vendor statements. Action and prioritise vendor requests - eg non-payment stops	CORE	**P**	RAR 4, RAR 7	**1.7 Business activities - general and support (Procurement)**

Detailed Allocation of Activities   **Appendix 3**

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	and legal action, investigations etc. Other reporting for business.				
Manage self billing	Self billing agreements, raise self bill, maintain self billing spreadsheets and submit to the inland revenue.	CORE	**P**	RAR 4, RAR 8	**1.7 Business activities - general and support (Procurement)**
<mark>Store & Issue Materials</mark>					
Store Materials	Materials storage and control, includes stock specification, management and catalogue maintenance and management of inventory	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Store & issue materials)**
Replenish Materials	Internal stock replenishment order management, including satellite stores replenishment and transport of materials between stores.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Store & issue materials)**
Issue Stock	Distribution of stock to internal customers	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Store & issue materials)**
Material take offs	Assess material requirements, internal & external order management, materials storage, control, distribution and associated management reporting	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Store & issue materials)**
Standpipe Management	Storage, distribution, recovery and refurbishment of standpipes	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Store & issue materials)**
<mark>Manage Finance &</mark>					

Detailed Allocation of Activities

Appendix 3

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Business Strategy					
Manage business strategy & risk					
Develop business plan	Coordination of functional business plan process and development of the strategic business plan	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage business strategy)**
Manage Business Risk	Manage and monitor business risk including development of a corporate risk register	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage business strategy)**
Provide Internal Audit	Plan audit work on a risk basis, respond to adhoc requests for reviews, perform audits, report findings & recommendations to management and audit committee. Review and follow up on implementation of recommendations	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage business strategy)**
Manage Financial Resources					
Budgeting & Forecasting	Preparation, consolidation and approval of departmental budgets, and forecasts. Including budget management, financial advise and support, reporting and variance analysis	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Provide employee related Insurance Cover	Purchase insurance cover including preparation of employee data. Monitor cover terms and conditions. Provide insurance cover advice	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Provide vehicle and plant Insurance Cover	Purchase insurance cover including preparation of asset details. Monitor cover terms and conditions. Provide insurance cover advice	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Provide asset related Insurance Cover	Purchase insurance cover including preparation of claims history, asset details. Monitor cover terms and conditions. Provide insurance cover advice	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Provide Insurance Claims Service	Manage and monitor insurance claims. Provide claims information, advice and cost to the business. Provide adequate financial recording of outstanding claims liability	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Pensions Administration	Strategic overview of existing 3 funds. Execution and sign off of non payroll payments into the funds	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Manage Cash flow & debt	Provide daily, weekly & monthly cashflow analysis. Ensure adequate liquidity and manage debt profile. Manage bank relationships. Execute all non AP/payroll payments and reconcile/service bank accounts.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Financial transaction processing	Processing of journals, including accruals, prepayments and recharges including provision of supporting documentation. Production of control account reconciliations and trial balance output	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Manage tax	Monitor statutory tax compliance, including production and maintenance of procedures, training staff on VAT, SIC coding, checking tax returns, and auditing tax sensitive ledger accounts.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage finance)**
Manage External Relationships					
Manage public relations	Manage relations with the media	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
Manage political stakeholders	Liaison with political bodies eg MSP's, MP's, MEP's and the Scottish Executive. Monitor Scottish parliament, Westminster and EU activity to ensure SW fully informed on matters which could affect the organisation.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
External communication of capital programme	Proactive communication of the SW capital programme to local communities, media etc	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
Manage business & community relations	Provide a management service for business & community representative bodies including community forums, community councils, local councillors, federation of small businesses, trade associations etc. Includes interfacing with WICS at community relations meetings and face to face communication with	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - regulation**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	representative groups				
Regulatory reporting & liaison with WIC office	Coordination of reporting, liaison and negotiation with the WIC office, including WIC office fees. Includes the annual return, quarterly and monthly submissions eg WIC 1, 5,22 etc, adhoc information requests, annual scheme of charges, strategic review of charges including Q&S III development , efficiency analysis and special factor claims	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - regulation**
Manage water quality regulation	Liaison, coordination of submissions, and submission to the DWQR and other regulatory bodies on matters relating to water quality and abstraction levels including production of the annual water quality report, annual cryptosporidium report and management undertakings & relaxations. Includes provision of input to regulatory directives and policy to ensure they are in the best interest of SW.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - regulation**
Manage wastewater quality regulation	Liaison and coordination of submissions to SEPA and other regulatory bodies on matters relating to wastewater quality including effluent quality and consent standards. Includes management of consent issues, and input to	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - regulation**

Detailed Allocation of Activities

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	environmental regulation directives and SEPA policies to ensure they are in the best interest of SW				
Statutory reporting	Provision of statutory reports and returns including the statutory accounts, interim accounts, VAT returns, corporation tax returns, annual environmental sustainability report, statutory fleet list, vehicle defect sheets and DGSA.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
Provide corporate governance	All costs associated with the corporate governance of SW, including costs of the board of directors and chief executive	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
External Reporting &	Liaison and reporting to external stakeholders including department of health, food standards agencies, medics, pressure groups etc.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage external relationships)**
Manage Improvement and change					
Internal performance measurement & reporting	Develop internal performance targets eg KPI's, reporting and monitoring performance against these targets. Includes board reporting, comparative analysis reporting and internal management reporting excluding budget reporting.	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage improvement and change)**

Detailed Allocation of Activities   **Appendix 3**

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Performance Improvement	Review SW processes, identify opportunities to rationalise and achieve savings, and develop action plans	CORE	**P**	RAR 4, RAR 5	**1.7 Business activities - general and support (Manage improvement and change)**
<mark>Manage transformation</mark>					
Deliver Asset Management Transformation Projects	All costs associated with deliverance and monitoring of asset management transformation projects funded from transformation. Projects include asset data improvement, asset delivery, asset planning, strategy for developer services, engineering services, investment programme review, performance improvement, performance improvement implementation, risk management and specifications and standards	CORE	**P**	RAR 4, RAR 5	**The following activities were grouped to avoid detailed disclosures in RAG4**
Deliver Business Services Transformation Projects	All costs associated with deliverance and monitoring of business services transformation projects funded from transformation. Projects include business continuity, data cleansing, dealing with the Euro, fleet vehicle utilisation, information strategy, labs rationalisation, MIS-Business Intelligence, property rationalisation, and rationalisation to a single platform	CORE	**P**	RAR 4, RAR 5	
Deliver Commercial Transformation Projects	All costs associated with deliverance and monitoring of commercial services transformation projects funded from	CORE	**P**	RAR 4, RAR 5	

Detailed Allocation of Activities   **Appendix 3**

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
	transformation. Projects include broadband initiative and develop waste services management business				
Deliver Customer Services Transformation Projects	All costs associated with deliverance and monitoring of customer services transformation projects funded from transformation. Projects include business billing rationalisation, debt management & collection, SW customer database, customer management centre, cs organisational design, household billing & collection, SW code of practice, rationalisation of customer information for emergencies, retail partnering, revenue maximisation and web development	CORE	**P**	RAR 4, RAR 5	
Deliver Finance Transformation Projects	All costs associated with deliverance and monitoring of finance transformation projects funded from transformation. Projects include accounting services, ABM, customer revenue reporting, financial systems, internal consultancy efficiency, internals SLA's, management information, procurement sourcing teams, procurement procedures & information, tariff review and the 3 P's	CORE	**P**	RAR 4, RAR 5	

Detailed Allocation of Activities   **Appendix 3**

Activity	Description	Business activity allocation	Potentially a shared service?	Covered by	RAR 4 Activity
Deliver HR Transformation Projects	All costs associated with deliverance and monitoring of HR transformation projects funded from transformation. Projects include compensation & benefits, digital media intranet, health & safety scoping, internal communications strategy, organisational design, quality systems, training strategy and values	CORE	**P**	RAR 4, RAR 5	
Voluntary Severance	All redundancy payments and associated costs	CORE	**P**	RAR 4, RAR 5	