

WATER INDUSTRY (SCOTLAND) ACT 2002

The Scottish Water Governance Directions 2023

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Section 1 – Corporate Governance

In section 1, the Scottish Ministers in exercise of the powers conferred on them by section 56(1)(a) and (b) of the Water Industry (Scotland) Act 2002, after having consulted Scottish Water in terms of section 56(4) of the said Act, give Scottish Water the following directions:–

Part I - Corporate Governance and Procedures

General

1. Scottish Water must ensure that at all times:-
 - (1) it provides strategic direction to and focus for the exercise of its functions;
 - (2) it complies with any directions, guidance, procedure and requirements notified by the Scottish Ministers; so far as such matters relate to the functions of Scottish Water;
 - (3) it complies with any standards of integrity or propriety provided for in these Directions or in any guidance, procedures or requirements notified to it by the Scottish Ministers so far as such matters relate to the functions of Scottish Water; and
 - (4) it complies with the requirements of the Scottish Public Finance Manual (SPFM) and the Government Financial Reporting Manual (FReM), so far as such matters relate to Scottish Water.

Governance

2. (1) Scottish Water must operate its corporate governance arrangements in line with the principles and best practice contained in the UK Corporate Governance Code so far as relevant and applicable, except:
 - (a) where Schedule 3 of the Act requires it to do otherwise;
 - (b) where the SPFM requires it to do otherwise;
 - (c) where any other enactment requires it to do otherwise; or
 - (d) where notified to it by the Scottish Ministers in the form of guidance, procedures or directions.
- (2) Scottish Water must inform the Scottish Ministers as to the administrative arrangements that it will put in place as a result of its corporate governance arrangements.
3. Scottish Water must also, in as far as they are appropriate, meet the requirements of the Companies Act 1985 and the Companies Act 2006.

Part II - Business Planning

4. Scottish Water must prepare a Strategic Plan and submit it to the Scottish Ministers for approval. The Strategic Plan must set out:
 - (a) the business environment in which Scottish Water operates;
 - (b) the overarching business strategy for Scottish Water;
 - (c) how Scottish Water will deliver the Ministerial Objectives and its statutory obligations;
 - (d) how Scottish Water will lead and contribute to the co-created water industry vision;
 - (e) the strategic objectives Scottish Water has set for the future; and
 - (f) how Scottish Water expects to achieve these objectives to ensure:
 - i. it meets the expectations of current and future customers;
 - ii. service standards are maintained or improved over the long term;
 - iii. its services are resilient;
 - iv. it innovates and improves its activities; and
 - v. its investment plans are financially sustainable and enhance the overall sustainability of Scottish Water assets.
5. In association with the Strategic Plan, Scottish Water must prepare, maintain and implement a Transformation Plan, which sets out a vision of the future and identifies how Scottish Water will transform to achieve the objectives identified in the Strategic Plan.
6. By a date specified by the Scottish Ministers, Scottish Water must prepare and submit to the Scottish Ministers for approval a Delivery Plan setting out:
 - a. what Scottish Water plans to deliver for the period of the Delivery Plan;
 - b. the progress that will be made on the objectives identified in the Strategic Plan during that period;
 - c. how the activities identified are financed, including the expected drawdown of borrowing made available for that period by the Scottish Ministers; and
 - d. the risks associated with these activities.

Scottish Water must prepare and submit an annual update of the Delivery Plan to the Scottish Ministers for approval, on a date to be agreed with the Scottish Ministers.

7. Scottish Water must establish an Investment Planning and Prioritisation Group (IPPG) to assist in the development of a rolling investment programme in which capital investment projects are identified for delivery throughout the period of the Delivery Plan. After consideration by the IPPG, Scottish Water must seek the approval of the Scottish Ministers for the investment needs and opportunities proposed for development. Following development, Scottish Water must inform Scottish Ministers of the projects committed for delivery in Scottish Water's investment programme and those needs and opportunities identified that are not being taken forward to delivery at that point in time.

8. Scottish Water must direct Business Stream Holdings to prepare a Retail Plan for Business Stream Holdings that is consistent with the Governance Code and to submit this, and any update to the Retail Plan, directly to the Scottish Ministers for approval. The Retail Plan must set out the strategy for Business Stream together with key financial targets.
9. The Scottish Ministers may:
 - (a) approve the Strategic Plan, Delivery Plan and/or Retail Plan in its/their entirety;
 - (b) approve parts of the Strategic Plan, Delivery Plan and/or Retail Plan and seek such modifications as they deem appropriate to the remaining parts; or
 - (c) reject the Strategic Plan, Delivery Plan and/or Retail Plan in its/their entirety and require revised plan(s) to be drawn up.

Part III – General Powers and Delegated Limits

10. (1) Scottish Water may carry out any activity, exercise any powers involved in carrying out any activity (including its general powers under section 25 of the Act) or incur any expenditure in connection with any activity, if the activity is necessary or ancillary to the delivery of its core functions providing that the activity:-
 - (a) is consistent with the approved Delivery Plan; and
 - (b) is not novel or contentious.
 - (2) Scottish Water may carry out any activity, exercise any power involved in carrying out any activity, or incur any expenditure in connection with any activity, if the activity is necessary or ancillary to the delivery of its non-core functions, providing that the activity:-
 - (a) is consistent with the approved Delivery Plan; and
 - (b) is not novel or contentious.
 - (3) Scottish Water may carry out any activity, exercise any power involved in carrying out any activity or incur any expenditure in connection with any activity, which does not fall within Articles 10.(1)-(2) providing that:
 - (a) the activity is not novel or contentious;
 - (b) the activity is closely aligned to existing business competencies; and
 - (c) the maximum financial exposure to Scottish Water is less than £1.0m.
 - (4) Activities undertaken under Article 10.(3) are subject to a cumulative limit of £2.0m. Activities initially undertaken under Article 10.(3) and which are subsequently included within an approved Delivery Plan do not count towards the £2.0m cumulative limit.
 - (5) The Scottish Ministers may give consent to any activity not falling within Article 10.(1)-(3) in response to a specific written request made by the Board. In approving any such request the Scottish Ministers may set such conditions as they consider appropriate.
11. (1) Scottish Water must direct Business Stream Holdings that it may carry out any activity or incur any expenditure provided the activity:-

- (a) is contained within the approved Retail Plan; and
 - (b) is not novel or contentious;
- (2) Scottish Water must direct Business Stream Holdings that it may carry out any activity or incur any expenditure which is not contained within the approved Retail Plan and which is not novel or contentious if:
- (a) the activity is closely aligned to existing business competencies; and
 - (b) the maximum financial exposure to Business Stream Holdings is less than £1.0m.
- (3) Activities undertaken under Article 11.(2) are subject to a cumulative limit of £2.0m. Activities initially undertaken under Article 11.(2) and which are subsequently included within an approved Retail Plan do not count towards the £2.0m cumulative limit.
- (4) The Scottish Ministers may give consent to any activity not covered under Article 11.(1)-(2) in response to a specific written request made by the board of Business Stream Holdings. In approving any such request the Scottish Ministers may set such conditions as they consider appropriate.

Reporting Requirements

12. Scottish Water must, at the end of each financial year, make an itemised report to the Scottish Ministers of all expenditure it incurred which exceed the thresholds set out in the following table:

Project Expenditure (per Project)	£ per Project
Capital Expenditure on major works (eg treatment works) including improvements to existing assets	10,000,000
Purchase of individual capital items, including land, with a life of more than one year	1,000,000
Advertising	1,000,000
Sponsorship	10,000
Gifts	200

Subsidiaries

13. With the exception of its licensed retail subsidiary, Business Stream, these directions apply to any subsidiary formed or promoted by Scottish Water.

Part IV – The Investment of Funds on Short-Term Deposit

14. (1) Scottish Water must maintain an investment policy for the short-term deposit of funds, which should be consistent with wider Scottish Government guidance. This policy must be submitted to Scottish Ministers for their approval.
- (2) Scottish Water must invest funds in accordance with the investment policy referenced in article 14(1).
- (3) Scottish Water must ensure the investment policy is reviewed regularly, or when Scottish Ministers direct it to do so. When Scottish Water makes changes to the investment policy, it must first submit a copy of those changes to Scottish Ministers for their approval.
- (4) Scottish Water is not permitted, without the prior written consent of the Scottish Ministers, to:-
- (a) anticipate interest rate changes;
 - (b) undertake arbitrage between facilities open to them;
 - (c) write or purchase interest or currency swap rates, hedges, options, future contracts or other similar financial products; or
 - (d) borrow, other than by way of overdraft, from the financial markets;
- (5) The Scottish Ministers may give consent to the activities falling within article 14(4) subject to such conditions as they consider appropriate.
- (6) Notwithstanding article 14(4), Scottish Water may in the normal course of business and pursuant to the purchase or sale of any goods or services overseas determine any foreign currency exposure under a project but, prior to determining any exposure for a sum in excess of £2 million, must inform the Scottish Ministers of the nature and extent of the proposed arrangements to do so.

Part V - Other Investment

15. (1) Scottish Water must maintain an investment policy for the investment of funds, other than on short-term deposit, which should be consistent with wider Scottish Government guidance. This policy must be submitted to Scottish Ministers for their approval.
- (2) Scottish Water must invest funds in accordance with the investment policy referenced in article 15(1).
- (3) Scottish Water must make withdrawals of funds invested under article 15(2) if Ministers direct it to do so.
- (4) Scottish Water must ensure the investment policy, set out in accordance with article 15(1), is reviewed regularly, or when Scottish Ministers direct it to do so. When Scottish Water makes changes to this policy, it must first submit a copy of those changes to Scottish Ministers for their approval.

Section 2 – Accounts

In section 2, the Scottish Ministers in exercise of the powers conferred on them by section 45(2) of the Water Industry (Scotland) Act 2002 give Scottish Water the following directions:–

1. Scottish Water must prepare in respect of each financial year a statement of accounts, presented as an annual report and accounts, in accordance with:
 - (a) International Financial Reporting Standards using the cost model for property, plant and equipment and, where otherwise appropriate, as adapted and interpreted by the FReM; and
 - (b) relevant statutes, and any other Directions or guidance issued by Scottish Ministers.
2. The annual report must cover the activities of any corporate, subsidiary or joint ventures under the control of Scottish Water. It must outline Scottish Water's main activities and performance against agreed objectives and targets for the previous financial year.
3. The balance sheet must include indebtedness to the Scottish Ministers under the heading 'equity'. The notes thereto must show separately any amounts falling due for payment within twelve (12) months of the date of the balance sheet.
4. The annual report and accounts must be audited and laid before the Parliament not later than six (6) months after the end of the financial year.
5. Scottish Water must publish the audited annual report and accounts, once they have been laid before Parliament.

Section 3 – Previous Directions, Citation and Interpretation

In section 3, the Scottish Ministers in exercise of the powers conferred on them by section 45(2) and section 56(1)(a) and (b) of the Water Industry (Scotland) Act 2002, after having consulted Scottish Water in terms of section 56(4) of the said Act, give Scottish Water the following directions:

1. The Directions contained in sections 1-3 supersede the Scottish Water Governance Directions 2022.

2. The Directions contained in sections 1-3 may be cited as the Scottish Water Governance Directions 2023 and come into force on 27 March 2023.

3. In these Directions:–

“Board” means the Board of Scottish Water appointed in accordance with paragraph 2 of Schedule 3 to the Act;

“Business Stream” means Scottish Water Business Stream Limited incorporated under the Companies Act 1985 with the registered number SC294924;

“Business Stream Holdings” means Scottish Water Business Stream Holdings Limited incorporated under the Companies Act 1985 with the registered number SC332622;

“core functions” has the same meaning as in section 70(2) of the Act;

“Delivery Plan”, “Retail Plan”, and “Strategic Plan” means the relevant plan prepared in accordance with Section 1, Part II of these Directions;

“financial exposure” means, in relation to any project, the sum of Scottish Water’s planned expenditure on the project over its period of operation, discounted back to current values, and the maximum potential value of any guarantees to be issued by Scottish Water to third parties, or other risks or contingent liabilities that could be incurred, in respect of the project;

“Ministerial Objectives” means the objectives set by Scottish Ministers in directions to Scottish Water under section 56 and 56A of the Act, in respect of a period specified under section 29B(2) of the Act;

“needs and opportunities” shall have the same meanings as stated in the Terms of Reference for the Investment Planning and Prioritisation Group;

“non-core functions” means the activities Scottish Water undertakes which are not core functions; and

“the Act” means the Water Industry (Scotland) Act 2002, as amended.

Jon Rathjen

A member of the staff of the Scottish Ministers

Edinburgh
24 March 2023