

## COMPLIANCE OFFICER'S ACTIVITIES

### ANNUAL REPORT ON BUSINESS SEPARATION 2008/09

#### 1. Introduction

This report sets out Scottish Water's activities and the Compliance Officer's monitoring thereof for the year 2008/09 pursuant to reporting requirements set out in the Water Services (Intra-Group Regulation) Directions 2006, as amended ("the Intra-Group Directions").

- (i) The Report also sets out the overall business procedures in operation during 2008/09 to mitigate against the risk of failure to comply with the requirements set out in the Intra-Group Directions and how these have interacted with the activities of the Compliance Officer.
- (ii) It is Scottish Water's policy to comply with all regulatory and legislative requirements and Scottish Water has during the year taken steps to improve processes and procedures to facilitate compliance with the obligations under the Intra-Group Directions and the Water Services etc. (Scotland) Act 2005 in relation to business separation.

#### 2. General Points

The Intra-Group Directions requires Scottish Water to develop and operate ring-fencing to establish and maintain managerial and operational systems which would prevent any licensed provider from accessing any confidential information held unless this would otherwise be in the public domain, its release is in accordance with the Operational Code or Wholesale Services Agreement or the information relates to a customer of the Licensed Provider. The separation of Scottish Water Business Stream from Scottish Water took place on 1st November 2006, and the retail market itself opened on 1 April 2008. The key focus for the financial year 2008/09 was to embed business separation, to operate within the market to monitor compliance by measuring progress against strategic milestones which were deliverable, appropriate and realistic, and to start inter-working with the Central Market Agency and new licensed providers. Throughout this period, the Compliance Officer carried out duties in relation to monitoring Scottish Water's compliance with the Intra-Group Directions.

The section set out below outline the procedures set out in the Compliance Statement for 2008/09 to ensure the requirements of the Intra-Group Directions continue to be met. These procedures have been complied with.

#### **Requirement to establish and subsequently maintain independent managerial and operational functions which are separate from those of any licensed provider.**

Scottish Water's Compliance Statement sets out in detail the steps taken by Scottish Water in this regard. These include

- (i) physical separation of Scottish Water Business Stream employees and their IT systems;
- (ii) management of contractual arrangements between Scottish Water and Scottish Water Business Stream; and
- (iii) monitoring of compliance with the market codes and Wholesale Services Agreement.

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The delivery of the outputs set out in the Compliance Statement was monitored in the reporting period by a Wholesale Services Programme Board attended by the Compliance Officer who has offered advice and assistance to that Board.

The physical separation of Business Stream employees and IT has been monitored by the compliance function and exceptions reported to the Business Separation Steering Group. Business Stream continue to occupy a part of the Scottish Water office at Fairmilehead, but exited from the other Scottish Water offices during the year. Business Stream IT systems were hosted on Scottish Water infrastructure throughout the year, and Business Stream have sought the permission of the Commission to remain on the infrastructure for a further period.

During 2008/09 the Water Industry Commission for Scotland has carried out three audits on separation. The first audit focussed on Business Stream's arrangements for separation, which are a licence condition for Business Stream. That audit raised one issue for Scottish Water which has been remedied. The second audit focussed on the IT separation of Scottish Water and Business Stream's systems. While the final report from that audit is not yet available, no issues have been identified for Scottish Water. The third audit investigated Scottish Water's compliance with the Commission's rules on transfer pricing between Scottish Water and its subsidiary companies. One issue was identified in relation to transfer pricing between Scottish Water and Business Stream and this has been remedied.

The management of contractual arrangements including the Wholesale Services Agreement between Scottish Water and Business Stream is carried out by the Wholesale Services function, with exceptions raised with the compliance function. No issues were raised in 2008/09. Over the period, the number and scope of contractual arrangements between Scottish Water and Business Stream has fallen significantly. A small number of proposed new services have been discussed between Scottish Water and licensed providers and in each case approval has been sought from the Commission.

Compliance with the market codes was monitored through system generated reports which were made available to business functional areas. Summary data from these reports was provided to the Business Management Team, and an overall performance figure reported to each Board meeting. Through monitoring these reports, two business areas were identified as requiring remedial attention which has been carried out.

**Scottish Water shall implement systems to ensure that licensed providers (including its subsidiary Business Stream) do not have access to confidential information held by Scottish Water in connection with its core functions as water and sewerage provider.**

The Compliance Statement sets out the steps Scottish Water has taken in this regard. The Compliance Officer has attended the Wholesale Services Programme Board to monitor deliverability of the key separation outputs. One issue was identified with access to a Scottish Water system which has been remedied.

**Access by licensed providers to any systems for recording, processing or storage of data held by Scottish Water personnel in connection with its core functions.**

As set out in the Compliance Statement there has been a sharp reduction in the number of staff from Scottish Water and Business Stream able to access the other organisation's systems. A small number of Scottish Water staff retain access to Business Stream systems

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to carry out activities under service agreements approved by the Commission. Similarly a small number of Business Stream staff have access to Scottish Water GIS system in order to carry out work as a contractor to Scottish Water. This access is limited to the access that is allowed to any contractor in the same situation.

As mentioned above the Commission carried out an audit of IT separation arrangements and no issues have been raised with Scottish Water in this regard.

#### **Procedures to manage the transfer of personnel between Scottish Water and Scottish Water Business Stream**

The policy on transfer of employees between Scottish Water and Scottish Water Business Stream requires the Compliance Officer to approve when necessary a "quarantine period" for staff holding any confidential information for periods relating to the nature and extent of the previous role and the role to be taken up. No members of staff from Business Stream took up a post in Scottish Water in the reporting period. There was one statutory transfer of eight staff from Scottish Water to Business Stream, approved by the Commission, which took place in 2008/09.

### **3. Role of the Compliance Officer**

The role of the Compliance Officer during the financial year 2008/09 has primarily been in relation to monitoring performance towards specific outputs required under the Intra-Group Directions in relation to business separation.

The agreed compliance policy for Scottish Water's core business is set out in Scottish Water's Compliance Code of Conduct. The policy was delivered through the following measures:

- (i) There is a framework of Compliance Champions across Scottish Water who act as a focus for compliance in each part of their business, and to support the functional area in ensuring that the requirements of the overall framework are met.
- (ii) Deployment of a targeted training programme in response to specific compliance issues. Corporate induction courses are used to ensure that new staff are aware of their obligations.
- (iii) The reflection within Scottish Water's Values of the importance of compliance as a key part of the employee's day to day functions, and the consequences to Scottish Water and staff of non-compliance.

#### **Complaint Investigation**

The Compliance Officer has established arrangements for the investigation of any complaints received from the Commission or any other third party. Arrangements are in place to ensure any complaints which were received can be thoroughly and quickly investigated and a report issued. The undernoted issues were considered in the reporting period.

#### ***Informing customers of their licensed provider***

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An issue was raised by a licensed provider in relation to the manner in which a call operative in Scottish Water contact centre redirected a business customer to its licensed provider. An investigation was undertaken and a report sent to the Commission and the licensed provider. Contact centre staff received a briefing on the correct approach to take. The licensed provider was content with this approach.

#### ***Meetings held in the shared area at Fairmilehead***

The Water Industry Commission for Scotland raised an issue with Scottish Water in relation to the holding of meetings in the area of Fairmilehead which is shared by Scottish Water and Business Stream. As a result, staff have been stopped from holding meetings in this area.

#### ***Performance against market KPIs***

Two areas of the business appeared to be performing poorly against market obligations. In each case, remedial action is in train to ensure that on-going performance meets Scottish Water's obligations.

#### **4. Governance Code**

The Governance Code requires Scottish Water to establish a holding company – Scottish Water Business Stream Holdings (SWBSH) – to exercise its ownership functions, and to provide funding to Business Stream. These arrangements took effect in January 2008. The Compliance Officer is the company secretary of SWBSH, attends SWBSH board meetings and monitors its activities for compliance with the Code.

The Code also requires Scottish Water to monitor meetings between Scottish Water and Business Stream. A register of meetings has been established and meetings are attended by a member of the compliance function where appropriate.

#### **5. Risk Management**

Scottish Water has a risk register which is monitored monthly by the Business Management Team of Scottish Water and reviewed every six months by the Audit Committee and annually by the Board. In addition every Board paper includes a risk management appraisal and the Board reviews changes in strategic risks quarterly. A summary of the key elements of Scottish Water's Risk Management and Control Policy is set out below

- (a) It is a Line Management responsibility to ensure the business activities are conducted in an appropriately controlled manner and the business risks are identified and mitigated in a timely manner.
- (b) Business Units are responsible for training and awareness with inputs from specialists in relation to legal obligations which impact on day to day operation including competition and regulatory law. Specialised training sessions were rolled out in the reporting period. Employees' records include records of training courses attended by them.
- (c) Risk Management shall include an element of independent oversight of unit risk management issues.

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- (d) Scottish Water has established proper resource for an independent internal audit process and responsibility for internal audit activity within Scottish Water lies with the Head of Internal Audit. This department has the remit to conduct internal audit activity throughout Scottish Water's business and report its findings direct to the Audit Committee and Directors. The Head of Internal Audit has direct access as appropriate to the Chair of the Audit Committee or the Chairman and Chief Executive of Scottish Water.
- (e) Internal Audit work to an audit plan approved by the Audit Committee. The plan covers all major business units and processes within Scottish Water and focuses on areas of significant risk.
- (f) As Scottish Water's is a regulated business non-compliance with regulatory and statutory obligations is classed as a significant risk and receives appropriate coverage in the internal audit plan. An Internal Audit investigation of compliance structures took place in April 2009.

As set out above, Scottish Water operated in 2008/09 on the basis of a significant level of formal business separation and inter-working with new market participants. The focus of the Compliance Officer was to monitor performance against separation and other market obligations. A Compliance Plan was prepared to assist the Compliance officer in monitoring compliance.

A separation compliance policy is in place through a Compliance Code of Conduct which:

- (a) Promotes a culture of compliance.
- (b) Empowers Compliance Management throughout the organisation.
- (c) Reiterates that the responsibility for compliance sits with the business line management and the Compliance Officer is an advisory and monitoring function.
- (d) Is an integral part of the overall business planning process to ensure compliance requirements are acknowledged.

#### 5. Summary

The report period for the 2008/09 financial year reflects the bedding down of separation and market-facing activities within Scottish Water. Robust market systems are now in place which to allow the monitoring of the level of Scottish Water's performance, and the identification of potential issues. Going forward, Scottish Water will continue to ensure that its separation and market obligations are met.

**Tom Axford**  
**Compliance Officer**