

STATEMENT OF MEMBERS' RESPONSIBILITIES FOR THE PREPARATION OF THE FINANCIAL STATEMENTS

The following statement, which should be read in conjunction with the statement of auditors' responsibilities included in the Auditors' Report below, is made with a view to distinguishing the respective responsibilities of the Members and of the auditors in relation to the financial statements.

The Members are required by the Water Industry (Scotland) Act 2002 and directions made thereunder to prepare financial statements for each financial year which give a true and fair view of the state of affairs of Scottish Water and of its income and expenditure for that period. In preparing those financial statements, the Members are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to do so.

The Members are responsible for keeping proper accounting records, which disclose with reasonable accuracy, at any time, the financial position of Scottish Water and to enable them to ensure that the financial statements comply with statute and any financial reporting requirements. They are also responsible for taking reasonable steps to safeguard the assets of the business and to prevent and detect fraud and other irregularities.

Independent auditor's report to the members of the Board of Scottish Water, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Scottish Water for the year ended 31 March 2008 under the Water Industry (Scotland) Act 2002. These comprise the Income and Expenditure Account and Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow, and the related notes. These financial statements have been prepared under the accounting policies set out within them. We have also audited the information in the Remuneration Report that is described in that report as having been audited.

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Board Members, Chief Executive and auditor

The Board Members and Chief Executive are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers and for ensuring the regularity of expenditure and income. These responsibilities are set out in the Statement of Members' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers. We report to you whether, in our opinion, the information which comprises the Chair's Statement, Chief Executive's Statement, Financial and Business Review, Members' Report, Corporate Governance Report and Members' Remuneration Report included in the Annual Report, is consistent with the financial statements. We also report whether in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

In addition, we report to you if, in our opinion, the body has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the body's compliance with those provisions in the Combined Code specified for our review in the Accounts Requirements, and we report if, in our opinion, it does not. We are not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the body's corporate governance procedures or its risk and control procedures.

We read certain of the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Chair's Statement, Chief Executive's Statement, Financial and Business Review and Members' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. Our audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Board Members and Chief Executive in preparation of the financial statements, and of whether the accounting policies are most appropriate to the body's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinion

Financial statements

In our opinion

- the financial statements give a true and fair view, in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers, of the state of affairs of the body as at 31 March 2008 and of its surplus, total recognised gains and losses and cash flows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers; and
- information which comprises the Chair's Statement, Chief Executive's Statement, Financial and Business Review and Members' Remuneration Report included with the Annual Report is consistent with the financial statements.

Regularity

In our opinion in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

*PricewaterhouseCoopers LLP
Edinburgh*

25 June 2008

Notes:

a.) The maintenance and integrity of the Scottish Water website is the responsibility of the Members; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

b.) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income and expenditure account - consolidated

For the year ended 31 March 2008

	Notes	2008 £m	2007 £m
Turnover	2	1,051.7	1,017.0
Cost of sales		<u>(579.5)</u>	<u>(549.7)</u>
Gross surplus		472.2	467.3
Administrative expenses		<u>(100.2)</u>	<u>(97.9)</u>
Surplus on ordinary activities before interest	2, 3	372.0	369.4
Net interest payable	6	(140.5)	(143.3)
Other finance income	7	<u>5.3</u>	<u>2.8</u>
Surplus on ordinary activities before taxation		236.8	228.9
Taxation	8	<u>(41.4)</u>	<u>(70.6)</u>
Retained surplus for the financial year		<u>195.4</u>	<u>158.3</u>

Statement of total recognised gains and losses

Surplus for the financial year		195.4	158.3
Actuarial gain recognised in respect of pension funds	21	<u>64.0</u>	<u>53.5</u>
Total gains and losses recognised since last Annual Report		<u>259.4</u>	<u>211.8</u>

Balance Sheets

As at 31 March 2008

	Notes	Group		Company	
		2008 £m	2007 £m	2008 £m	2007 £m
Fixed assets					
Tangible fixed assets	9	3,820.1	3,443.8	3,819.4	3,442.5
Investments	10	-	-	34.6	-
Current assets					
Stocks	11	3.9	3.5	3.9	3.5
Debtors	12	187.9	156.8	181.0	160.1
Cash at bank and in hand	13	80.2	12.8	29.9	1.6
		<u>272.0</u>	<u>173.1</u>	<u>214.8</u>	<u>165.2</u>
Creditors: amounts falling due within one year	14	<u>(313.3)</u>	<u>(291.9)</u>	<u>(295.1)</u>	<u>(287.0)</u>
Net current liabilities		(41.3)	(118.8)	(80.3)	(121.8)
Total assets less current liabilities		3,778.8	3,325.0	3,773.7	3,320.7
Creditors: amounts falling due after more than one year	14	(75.2)	(58.1)	(74.9)	(58.0)
Provisions for liabilities and charges					
Deferred taxation	15	(242.3)	(205.8)	(243.3)	(205.8)
Other provisions	16	<u>(14.8)</u>	<u>(6.3)</u>	<u>(14.8)</u>	<u>(6.3)</u>
Net assets excluding pension liability		3,446.5	3,054.8	3,440.7	3,050.6
Pension liability	21	<u>(34.2)</u>	<u>(104.9)</u>	<u>(34.3)</u>	<u>(104.9)</u>
Net assets		<u>3,412.3</u>	<u>2,949.9</u>	<u>3,406.4</u>	<u>2,945.7</u>
Capital and reserves					
Government loans	17	2,615.2	2,412.2	2,615.2	2,412.2
Income and expenditure account reserve	18	663.7	404.3	657.8	400.1
Other reserves		<u>133.4</u>	<u>133.4</u>	<u>133.4</u>	<u>133.4</u>
		<u>3,412.3</u>	<u>2,949.9</u>	<u>3,406.4</u>	<u>2,945.7</u>

These financial statements were approved by the Board of Members on 25 June and signed on their behalf by

Cash flow statement - consolidated

For the year ended 31 March 2008

	Notes	2008 £m	2007 £m
Net cash inflow from operating activities	(i)	639.3	606.9
Returns on investments and servicing of finance			
Net cash outflow from returns on investment and servicing of finance	(ii)	<u>(140.4)</u>	<u>(143.9)</u>
		498.9	463.0
Taxation paid		(4.1)	-
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(636.5)	(455.4)
Sale of tangible fixed assets		9.9	2.1
Government grants and other contributions		<u>2.9</u>	<u>2.4</u>
Net cash (outflow)/inflow before management of liquid resources and financing		(128.9)	12.1
Financing			
Net cash inflow from financing	(iii)	<u>196.3</u>	-
Increase in cash		<u>67.4</u>	<u>12.1</u>

Reconciliation of net cash flow movement to movement in net debt

Increase in cash	67.4	12.1
Cash inflow from increase in debt financing	<u>(196.3)</u>	-
Movement in net debt	(128.9)	12.1
Net debt at 1 April	<u>(2,424.1)</u>	<u>(2,436.2)</u>
Net debt at 31 March	<u>(2,553.0)</u>	<u>(2,424.1)</u>

Analysis of net debt

	As at 1 April 2007 £m	Increase in cash £m	Increase in debt £m	As at 31 March 2008 £m
Cash at bank and in hand	12.8	67.4	-	80.2
Debt due within one year	<u>(68.0)</u>	-	<u>(119.0)</u>	<u>(187.0)</u>
Net borrowings due within one year	(55.2)	67.4	(119.0)	(106.8)
Net borrowings due after more than one year	<u>(2,368.9)</u>	-	<u>(77.3)</u>	<u>(2,446.2)</u>
Net debt	<u>(2,424.1)</u>	67.4	<u>(196.3)</u>	<u>(2,553.0)</u>

Notes to the consolidated cash flow statement

For the year ended 31 March 2008

	2008 £m	2007 £m
(i) Reconciliation of operating surplus to net cash inflow from operating activities		
Operating surplus	372.0	369.4
FRS 17 additional pension charge	3.7	5.6
Depreciation charges	251.8	225.4
Amortisation of grants and PFI assets	0.5	0.4
Surplus on disposal of tangible fixed assets	(9.3)	(1.4)
Increase in debtors	(32.7)	(15.7)
(Increase)/decrease in stocks	(0.4)	0.5
Increase in creditors	50.3	28.1
Increase/(decrease) in provisions	3.4	(5.4)
Net cash inflow from operating activities	639.3	606.9
(ii) Returns on investment and servicing of finance		
Interest received	4.0	2.6
Interest paid	(144.4)	(146.5)
Net cash outflow from returns on investment and servicing of finance	(140.4)	(143.9)
(iii) Financing		
Borrowings due within one year		
- repayment of loans	(190.0)	(73.0)
- increase in loans	295.8	73.0
Borrowings due after one year		
- repayment of loans	(68.0)	(69.6)
- increase in loans	158.5	69.6
Net cash inflow from financing	196.3	-

Notes to the financial statements

For the year ended 31 March 2008

1 Accounting policies

The consolidated financial statements have been prepared under the historical cost convention, in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002. The financial statements comply with all applicable United Kingdom accounting standards and the Companies Act 1985, except as disclosed below in relation to 'Capital grants and customer contributions'. There have been no significant changes to Scottish Water's accounting policies during the year.

The Members consider that the accounting policies set out below are the most appropriate and have been consistently applied.

Basis of consolidation

(a) *Subsidiary companies*

The consolidated financial information incorporates the results of Scottish Water (the Company) and of its trading subsidiary companies, using the acquisition method of accounting. The consolidated financial information does not include the non trading subsidiary companies as permitted under section 229 of the Companies Act 1985 (note 11).

Intercompany transactions, balances and any unrealised gains on transactions between Scottish Water Group companies have been eliminated within the consolidated financial statements.

(b) *Joint Arrangement Non Entity*

The nature of the contractual agreement between Scottish Water and the other shareholders in Scottish Water Solutions Limited is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, Scottish Water Solutions Limited has been accounted for under FRS 9 Associates and Joint Ventures, as a JANE, (Joint Arrangement Non Entity). On this basis Scottish Water accounts directly for its own gross assets, liabilities and cash flows in the joint arrangement.

Income recognition

Turnover comprises charges to customers for water and wastewater services, excluding value added tax. For measured customers, turnover includes an estimate of the value of water and wastewater services supplied to customers between the date of the last meter reading and the year-end. For unmeasured customers billed in advance, income is deferred and released to the income and expenditure account throughout the year.

Tangible fixed assets and depreciation

Freehold land and assets under construction are not depreciated.

The infrastructure network which comprise a network of water and wastewater systems including mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are considered to have an infinite life. Expenditure to maintain the network infrastructure is dealt with under a renewals accounting approach whereby the annualised planned expenditure to maintain the operating capacity of this infrastructure is treated and charged as depreciation to the income and expenditure account. The actual expenditure incurred on infrastructure assets is capitalised, as is any expenditure that increases the capacity of the network.

Depreciation is provided on other tangible fixed assets to write-off cost, less residual values, on a straight-line basis over their estimated operational lives, from the date of beneficial use as follows:

Non operational buildings and structures	60 years
Specialised operational buildings and structures	20 to 80 years
Plant, machinery, vehicles and fencing	1 to 20 years
Fixtures and fittings, furniture and temporary buildings	5 years

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be justified. The resulting impairment charge is included within depreciation.

Capital grants and customer contributions

Capital grants and customer contributions in respect of infrastructure assets are deducted from the cost of the fixed asset. This treatment is not in accordance with the Companies Act 1985 but has been adopted to show a true and fair view since, as explained above, infrastructure assets have an infinite economic life and hence no basis exists on which to recognise such contributions as deferred income. Grants and contributions received in respect of non-infrastructure assets are credited to deferred income and are released to the income and expenditure account over the expected useful lives of the relevant fixed assets.

Investments

Investments held as fixed assets are stated at cost less any provision for impairment.

Stocks

Stocks and work in progress are stated at the lower of cost or net realisable value. Cost includes all costs incurred in bringing each asset to its present location and condition. The valuation of work in progress is based on the cost of labour and materials plus appropriate overheads.

Leased assets

Leases where substantially all the risks and rewards of ownership of the assets remain with the lessor are accounted for as operating leases. Rentals payable under operating leases are charged to the income and expenditure account over the term of the lease on a straight-line basis. Scottish Water has no amounts due under finance leases.

Research and development costs

Research and development expenditure is charged to the income and expenditure account in the year in which it is incurred.

Private Finance Initiative (PFI) costs

All costs incurred in relation to the development of PFI schemes are charged to the income and expenditure account as incurred. However, costs relating to

Notes to the financial statements

For the year ended 31 March 2008

1 Accounting policies

Other tangible fixed assets belonging to Scottish Water and transferred to the PFI operator are treated as a debtor and amortised over the length of the service contract. PFI land transferred to the operator is not amortised. Rental costs arising under PFI operating leases are expensed to the income and expenditure account over the terms of the lease.

Indebtedness to the Scottish Ministers and other long term loans

Loans from the National Loans Fund, the Scottish Consolidated Fund and other Government borrowings are treated as part of capital and reserves, including loan repayments due within one year, in accordance with the Accounts Direction.

Overdrafts and other loans are included under creditors, as appropriate, in accordance with the Companies Act.

Financial instruments

Scottish Water's financial instruments comprise borrowing, cash and liquid resources, and various items such as debtors and creditors that arise directly from operations.

Financial instruments are recognised in the balance sheet when an obligation is identified and released as that obligation is fulfilled. Cash, debtors and creditors are held at cost. Borrowings are held at cost in the balance sheet, but disclosed at fair value in note 17. Fair values were estimated by independent appraisal using a valuation technique based on prevailing market interest rates at the end of the financial year. Interest on loans and cash is recognised and reported in the period in which the payment is made or received.

Scottish Water's policy is not to trade or speculate in financial instruments. All treasury activities are undertaken in accordance with the permitted activities as set out in the Delegated Limits Direction made under the Water Industry (Scotland) Act 2002.

Taxation

Current tax is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences which have originated but not reversed at the balance sheet date, subject to certain exceptions. Deferred tax assets are recognised to the extent that they are recoverable.

Full provision has been made without discounting.

Pensions

Scottish Water has voluntarily adopted the Accounting Standards Board amendments to FRS 17. The disclosures for the prior year have been amended accordingly and the impact of the revised calculations on prior years has been taken through the Statement of recognised gains and losses in the current year (see note 21). Employees of Scottish Water participate in the Local Government Pension Scheme administered by Aberdeen, Glasgow and Edinburgh City Councils, all of which are defined benefit schemes.

Pension scheme assets are measured using the bid values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Any increase in the present value of liabilities within the defined benefit pension schemes expected to rise from employee service in the period is charged to operating profit. The expected return on the schemes' assets and the increase during the period in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses. Pension scheme deficits and surpluses, to the extent that the surplus is considered recoverable, are recognised in full and presented on the face of the balance sheet net of related deferred tax.

Bad debts

The bad debt provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile of the outstanding debt.

Provisions

Provisions are recognised when there is a present obligation for a past event, for which it is probable that a transfer of economic benefits will be required and a reliable estimate can be made of the amount of the obligation.

Related party transactions

Scottish Water has taken advantage of the exemption provided by FRS 8, which permits the non-disclosure of transactions and balances with related parties that have been eliminated on consolidation.

Notes to the financial statements

For the year ended 31 March 2008

2 Segmental analysis

All turnover and surplus before taxation arises from continuing operations within the United Kingdom.

Scottish Water group principal activities are the supply of water and wastewater services to household and business customers across Scotland. In view of the integrated nature of Scottish Water's operational activities, the financial statements include all of the costs of water and wastewater collection, treatment and distribution within cost of sales. An analysis of turnover, operating surplus and net assets by activity is provided below:

	Turnover		Operating surplus		Net operating assets	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Regulated water and waste water services	986.7	972.8	354.2	360.8	3,595.7	3,240.7
Licensed water and waste water services	350.9	140.9	14.8	6.8	31.5	31.8
	<u>1,337.6</u>	<u>1,113.7</u>				
Less Intercompany turnover	(316.6)	(126.8)				
	<u>1,021.0</u>	<u>986.9</u>	<u>369.0</u>	<u>367.6</u>	<u>3,627.2</u>	<u>3,272.5</u>
Non regulated trading activities	30.7	30.1	3.0	1.8	2.0	1.8
	<u>1,051.7</u>	<u>1,017.0</u>	<u>372.0</u>	<u>369.4</u>	<u>3,629.2</u>	<u>3,274.3</u>
Reconciliation of net operating assets to net assets						
Net operating assets					3,629.2	3,274.3
Corporation tax					(2.6)	(1.8)
Deferred tax					(242.3)	(205.8)
Non Government loans					(18.0)	(24.7)
Cash					80.2	12.8
Pension liability					(34.2)	(104.9)
Net assets					<u>3,412.3</u>	<u>2,949.9</u>

The segmental analysis reflects the licensed water and waste water services that commenced under Scottish Water Business Stream Limited. Non regulated trading activities reflect the business structure under the new regulatory regime effective from 1 April 2006.

3 Operating surplus

	2008 £m	2007 £m
Operating surplus is arrived at after charging/(crediting):		
PFI operating costs	127.5	125.6
Infrastructure maintenance charge	90.0	88.0
Depreciation of tangible fixed assets	161.8	137.4
Amortisation of assets transferred to PFI service companies	1.6	1.6
Gain on sale of tangible fixed assets	(9.3)	(1.4)
Release of deferred income in relation to capital grants	(1.1)	(1.2)
Operating lease rentals - land and buildings	1.7	2.7
- other	2.0	1.9
Auditors remuneration - audit services	0.2	0.2
- other	-	-
Research and development expenditure	0.3	0.3

4 Staff costs

	2008 £m	2007 £m
Wages and salaries	105.8	100.3
Social security costs	8.8	7.8
FRS17 pension costs	17.9	19.7
	<u>132.5</u>	<u>127.8</u>
Less: charged as capital expenditure	(31.2)	(26.1)
Less: seconded staff charged to Scottish Water Solutions Limited	(6.9)	(8.6)
	<u>94.4</u>	<u>93.1</u>

Notes to the financial statements

For the year ended 31 March 2008

4 Staff costs (continued)

The average number of people (including Executive and Non-executive Members) employed by Scottish Water during the year was 3,683 (2007: 3,587):

	2008	2007
Regulated water and waste water services	3,158	2,976
Licensed water and waste water services	126	132
Non regulated trading activities	236	270
Scottish Water Solutions Limited secondees	163	209
	<u>3,683</u>	<u>3,587</u>

The number of people employed at 31 March 2008 was 3,727 FTE (2007: 3,575).

5 Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 26 to 30. No Member or director had, during the year or at the end of the year, any material interest in any contract of significance in relation to Scottish Water's business.

6 Net interest payable

	2008 £m	2007 £m
Interest receivable		
Interest from short-term deposits	4.0	2.6
	<u>4.0</u>	<u>2.6</u>
Interest payable		
Government loans	(142.6)	(143.5)
Other loans	(1.9)	(2.4)
	<u>(144.5)</u>	<u>(145.9)</u>
Net interest payable	<u>(140.5)</u>	<u>(143.3)</u>

7 Other finance income/costs

	2008 £m	2007 £m
Expected return on pension scheme assets	55.4	49.4
Interest on pension scheme liabilities	(50.1)	(46.6)
	<u>5.3</u>	<u>2.8</u>

8 Taxation

Analysis of tax charge in the year

	2008 £m	2007 £m
Current tax: UK corporation tax	4.9	1.8
Deferred tax: Origination and reversal of timing differences	36.5	68.8
	<u>41.4</u>	<u>70.6</u>

Tax on surplus on ordinary activities

Factors affecting current tax charge

The total current tax charge for the year is lower than the standard rate of corporation tax in the UK of 30% (2007: 30%). The differences are explained below.

Surplus on ordinary activities before taxation	236.8	228.9
Tax on surplus on ordinary activities at standard UK corporation tax rate of 30% (2007: 30%)	71.0	68.7
(Income)/expenses not deductible for tax purposes	(0.5)	0.9
Decrease in general provisions not deductible for tax purposes	(1.4)	(5.1)
Other timing differences	0.3	0.4
Capital allowance in excess of depreciation	(40.2)	(37.7)
Chargeable gains	0.6	-
Tax losses	(24.9)	(25.4)
	<u>4.9</u>	<u>1.8</u>

Current tax charge for the year

Notes to the financial statements

For the year ended 31 March 2008

8 Taxation (continued)

During the year, as a result of the change in the UK Corporation Tax rate from 30% to 28% that will be effective from 1 April 2008, deferred tax balances have been remeasured. Deferred tax expected to reverse in the future has been measured using the effective rate of 28%.

A number of changes to the UK Corporation Tax system were announced as part of the March 2007 budget statement. Certain of these changes were substantively enacted in the Finance Act 2007. The impact of the changes has been reflected in these accounts. Certain other changes are expected to be enacted in the Finance Act 2008. The impact of these changes will be recognised in the period in which the Finance Act 2008 is substantively enacted, which is expected to be in the year to 31 March 2009.

The abolition of balancing adjustments for industrial buildings allowances has resulted in a decrease of £16.5m in the deferred tax liabilities recognised in respect of buildings.

9 Tangible fixed assets

Group	Specialised operational properties & structures £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant, machinery & vehicles £m	Assets under construction £m	Total £m
Cost						
At 1 April 2007	1,835.6	60.2	1,864.5	845.2	792.7	5,398.2
Additions	-	-	-	0.4	628.3	628.7
Disposals	(0.4)	(0.5)	-	(2.7)	-	(3.6)
Transfers	120.8	1.8	234.1	193.3	(550.0)	-
At 31 March 2008	1,956.0	61.5	2,098.6	1,036.2	871.0	6,023.3
Depreciation						
At 1 April 2007	549.3	22.9	961.8	420.4	-	1,954.4
Charge for the year	47.5	1.1	90.0	113.2	-	251.8
Disposals	(0.1)	(0.4)	-	(2.5)	-	(3.0)
At 31 March 2008	596.7	23.6	1,051.8	531.1	-	2,203.2
Net book value						
At 31 March 2008	1,359.3	37.9	1,046.8	505.1	871.0	3,820.1
At 31 March 2007	1,286.3	37.3	902.7	424.8	792.7	3,443.8

All capital investment is recognised initially within assets under construction. When assets are capable of performing the function for which they were constructed and come into beneficial use, they are reclassified and transferred from assets under construction to the appropriate fixed asset category.

£2.9m of capital grants were received during the year and credited to deferred income (2007: £2.4m). These amounts will be released to the income and expenditure account over the expected useful lives of the relevant fixed assets. No capital grants were received during the year in respect of infrastructure assets.

Company	Specialised operational properties & structures £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant, machinery & vehicles £m	Assets under construction £m	Total £m
Cost						
At 1 April 2007	1,835.6	60.2	1,864.5	838.8	792.7	5,391.8
Additions	-	-	-	-	628.3	628.3
Intercompany transfer	-	-	-	(0.2)	-	(0.2)
Disposals	(0.4)	(0.5)	-	(2.5)	-	(3.4)
Transfers	120.8	1.8	234.1	193.3	(550.0)	-
At 31 March 2008	1,956.0	61.5	2,098.6	1,029.4	871.0	6,016.5
Depreciation						
At 1 April 2007	549.3	22.9	961.8	415.3	-	1,949.3
Charge for the year	47.5	1.1	90.0	112.2	-	250.8
Intercompany transfer	-	-	-	-	-	-
Disposals	(0.1)	(0.4)	-	(2.5)	-	(3.0)
At 31 March 2008	596.7	23.6	1,051.8	525.0	-	2,197.1
Net book value						
At 31 March 2008	1,359.3	37.9	1,046.8	504.4	871.0	3,819.4
At 31 March 2007	1,286.3	37.3	902.7	423.5	792.7	3,442.5

Notes to the financial statements

For the year ended 31 March 2008

10 Investments

	Company 2008 £m	2007 £m
At 1 April 2007	-	-
Additions	44.2	-
Disposals	(9.6)	-
At 31 March 2008	<u>34.6</u>	<u>-</u>

Group

Investment in Joint Arrangement Non Entity (JANE)

On 26 June 2002 Scottish Water formed a company, Scottish Water Solutions Limited. This company, which commenced trading on 30 June 2003 and is jointly owned with Stirling Water Limited and UUGL Limited, delivers a majority of Scottish Water's capital investment programme. The nature of the contractual agreement between Scottish Water and the other shareholders in Scottish Water Solutions Limited is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, Scottish Water Solutions Limited has been accounted for, under FRS 9 'Associates and Joint Ventures', as a JANE.

Details of the investments are as follows:

	Country of incorporation	% of Equity & votes held	Value £	Principal activity
Scottish Water Solutions Limited	Scotland	51.0	510	Contracting services

Company

Investment in subsidiaries

In November 2007, Scottish Water's investment in Scottish Water Business Stream Ltd (Business Stream) increased by £9.6m when Business Stream capitalised £9.6m of reserves through a bonus share issue. At the same time, Scottish Water set up a 100% owned subsidiary company, Scottish Water Business Stream Holdings Limited (SWBSH), with an initial cash investment of £25.0m. SWBSH acquired Scottish Water's investment in Business Stream for £9.6m by issuing share capital to the same value, increasing Scottish Water's investment to £34.6m.

Principal subsidiary undertakings	Country of incorporation	% of Equity & votes held	Value £m	Principal activity
Scottish Water Business Stream Holdings Limited	Scotland	100.0	34.6	Holding company Licensed water and waste water services
Scottish Water Business Stream Limited*	Scotland	100.0	11.5	

* Note: owned by SWBSH

Scottish Water owns shares in a further twelve companies, which did not trade during the year ended 31 March 2008. The companies' financial statements have not been consolidated as permitted by Section 229 of the Companies Act 1985, as they did not trade during the year and the issued share capital is immaterial.

11 Stocks

Group and Company	2008 £m	2007 £m
Raw materials and consumables	3.0	2.9
Work in progress - recoverable work	0.9	0.6
	<u>3.9</u>	<u>3.5</u>

Notes to the financial statements

For the year ended 31 March 2008

12 Debtors

	Group		Company	
	2008	2007	2008	2007
	£m	£m	£m	£m
Amounts falling due within one year:				
Trade debtors	64.3	49.8	36.6	26.3
Other debtors	34.3	21.6	34.8	22.0
Prepayments and accrued income	57.0	51.5	18.5	12.7
Amounts due from subsidiary companies			0.3	0.7
Loans to Scottish Water Business Stream Holdings Limited			58.5	-
Loans to Scottish Water Business Stream Limited			-	64.5
	155.6	122.9	148.7	126.2
Amounts falling due after more than one year:				
PFI assets transferred to service contractors	32.3	33.9	32.3	33.9
	187.9	156.8	181.0	160.1

Management considers the carrying value of trade and other receivables are equal to the fair value.

13 Cash

The total cash balance at 31 March 2008 was £80.2m, of which £29.9m related to the Company. Of the £29.9m balance, £27.4m was in respect of the out-performance funds relating to 2006/07, which will be invested in Government Gilts in line with the Regulatory Contract for 2006-2010.

14 Creditors

	Group		Company	
	2008	2007	2008	2007
	£m	£m	£m	£m
Amounts falling due within one year:				
Non-government loans	8.0	6.6	8.0	6.6
Trade creditors	20.7	12.6	20.6	12.6
Capital creditors and accruals	39.0	59.7	38.9	59.7
Accruals	157.8	156.0	131.8	130.9
Payments received in advance	28.4	15.2	28.0	15.1
Other creditors	19.1	14.9	11.2	8.8
Deferred income	2.3	2.8	2.3	2.8
Corporation tax	2.6	1.8	-	-
Other taxes and social security	2.8	2.6	2.7	2.5
Amounts due to subsidiary companies	-	-	19.0	28.3
Amounts due to Scottish Water Solutions Limited	32.6	19.7	32.6	19.7
	313.3	291.9	295.1	287.0
Amounts falling due after more than one year:				
Non-government loans	10.0	18.1	10.0	18.1
Other creditors	39.1	21.4	38.8	21.3
Deferred income	26.1	18.6	26.1	18.6
	75.2	58.1	74.9	58.0

The fair values of trade and other payables are not different from those disclosed above.

Notes to the financial statements

For the year ended 31 March 2008

15 Deferred taxation

	Group		Company	
	2008	2007	2008	2007
	£m	£m	£m	£m
Deferred taxation comprises:				
Accelerated capital allowances on fixed assets	284.2	271.8	285.2	271.8
Other timing differences	(17.4)	(22.0)	(17.4)	(22.0)
Tax losses carried forward	(24.5)	(44.0)	(24.5)	(44.0)
Provision for deferred taxation	242.3	205.8	243.3	205.8
The movement in deferred taxation can be analysed as follows:				
At 1 April	205.8	137.0	205.8	137.0
Deferred tax charged to the income and expenditure account	36.5	68.8	37.5	68.8
At 31 March	242.3	205.8	243.3	205.8
Being:				
Deferred tax asset	(1.0)	-	-	-
Deferred tax liability	243.3	205.8	243.3	205.8
At 31 March	242.3	205.8	243.3	205.8

16 Provisions for liabilities and charges

Group and Company	Restructure provision £m	Income uncertainty provision £m	Other £m	Net total £m
At 1 April 2007	3.7	-	2.6	6.3
Charged to income and expenditure account	3.4	8.9	(0.1)	12.2
Utilised during the year	(1.7)	-	(2.0)	(3.7)
At 31 March 2008	5.4	8.9	0.5	14.8

The restructuring provision relates to redundancy costs associated with employees who will leave Scottish Water under voluntary redundancy and early retirement. Pension related liabilities associated with employees who have left Scottish Water under the voluntary severance scheme are recognised in the pension liability (note 21).

The income uncertainty provision relates to wholesale non domestic revenues.

The other provision of £0.5m relates to onerous property rental costs which will be utilised over the next four years.

Notes to the financial statements

For the year ended 31 March 2008

17 Government and other loans

Group and Company

Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002. The limit at 31 March 2008 on these powers was that total net new borrowings for the year ended 31 March 2008 should not exceed £196.4m. Net new borrowings were £196.3m in the year.

At 31 March 2008 Scottish Water had outstanding debt on borrowings from Scottish Ministers of £2,615.2m (2007: £2,412.2m). This consisted of £1,046.7m (2007: £1,088.2m) of debt issued prior to 1 April 1999 and £1,568.5m (2007: £1,324.0m) issued on or after that date. In addition, Scottish Water had a committed bank overdraft facility of £20.0m which is guaranteed by Scottish Ministers.

Government loans, both short and long-term, are recorded on the balance sheet under Capital and Reserves in accordance with the Accounts Direction. Other debt is recorded under short and long-term creditors following best practice.

(a) Analysis of borrowings by type and maturity

	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Over 10 years £m	Total £m
Scottish Consolidated Fund	148.4	32.9	97.9	136.0	1,153.2	1,568.4
National Loans Fund	7.0	18.0	60.0	80.0	621.9	786.9
Public Works Loan Board	23.6	12.6	58.0	119.5	46.2	259.9
Total Government Loans	179.0	63.5	215.9	335.5	1,821.3	2,615.2
Other loans	8.0	2.9	4.7	1.4	1.0	18.0
At 31 March 2008	187.0	66.4	220.6	336.9	1,822.3	2,633.2
At 31 March 2007	68.0	81.1	214.4	337.0	1,736.4	2,436.9

(b) Interest rate profile

The interest rate profile of all borrowings, which were obtained with fixed interest rates, was as follows:

	Total borrowings £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
At 31 March 2008	2,633.2	5.83	17.20
At 31 March 2007	2,436.9	5.92	16.40

(c) Fair values

The table below sets out a comparison of the book and fair values of the loan debt.

	Book value £m	Fair value £m
At 31 March 2008	2,633.2	2,856.6
At 31 March 2007	2,436.9	2,614.0

Notes to the financial statements

For the year ended 31 March 2008

18 Reserves

Group	Income & expenditure account reserve excluding pension reserve	Pension reserve	Income & expenditure account reserve including pension reserve
	£m	£m	£m
At 1 April 2007	444.2	(39.9)	404.3
Retained surplus for the year	195.4	-	195.4
Actuarial profit net of deferred taxation (note 21)	-	64.0	64.0
At 31 March 2008	639.6	24.1	663.7

Company	Income & expenditure account reserve excluding pension reserve	Pension reserve	Income & expenditure account reserve including pension reserve
	£m	£m	£m
At 1 April 2007	440.0	(39.9)	400.1
Retained surplus for the year	184.2	-	184.2
Gain on investment taken to reserves	9.6	-	9.6
Actuarial profit net of deferred taxation	-	63.9	63.9
At 31 March 2008	633.8	24.0	657.8

19 Results of the holding company

Of the results for the financial year, a retained surplus of £184.2m (2007: £154.1m) is dealt with in the consolidated accounts of Scottish Water. The Members have taken advantage of the exemption available under section 230 of the Companies Act 1985 and do not present an income and expenditure account for Scottish Water alone.

20 Obligations under leases

Scottish Water had no amounts due under finance leases.

At 31 March 2008 the Group and the Company had annual commitments under non-cancellable operating leases as set out below:

	Land and buildings £m	Other £m	PFI schemes £m	Total 2008 £m	Total 2007 £m
Within one year	-	0.7	-	0.7	0.8
Between two and five years	-	0.6	-	0.6	0.6
After five years	2.0	-	129.9	131.9	128.4
	2.0	1.3	129.9	133.2	129.8

PFI schemes

As at 31 March 2008 there were nine PFI contracts in operation with contract start dates ranging from December 1996 to October 2000 and contract end dates ranging from December 2021 to October 2040.

Notes to the financial statements

For the year ended 31 March 2008

21 Pensions

Employees of Scottish Water participate in the Aberdeen City Council Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund, which are part of the Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively. The schemes provide defined benefits based on final pensionable pay. Actual pension costs for the year for each fund, as a % of employee contributions, were 285% (2007: 275%), 355% (2007: 335%) and 295% (2007: 265%) respectively.

Total FRS 17 pension costs for Scottish Water were £17.9m (2007: £19.7m) (note 4). The unpaid contributions outstanding at the year end included in other creditors (note 14) was £1.6m (2007: £1.6m). It is estimated that Scottish Water will make contributions of £15.0m to the pension funds in financial year 2008/09.

A full actuarial valuation was carried out at 31 March 2005 for all three funds and updated at 31 March 2008 by a qualified independent actuary, to take account of the requirements of FRS 17.

The major assumptions used by the actuaries were:

	2008	2007	2006
	%	%	%
Rate of increase in pensionable salaries	5.1	4.7	4.6
Rate of increase in pensions payment	3.6	3.2	3.1
Discount rate	6.9	5.4	4.9
Inflation rate	3.6	3.2	3.1

Longevity assumptions on retiring at age 65 adopted for each fund

	Aberdeen Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2008			
Male staff	18.31	20.32	19.35
Male operatives	18.31	17.70	16.82
Female staff	21.24	23.27	22.31
Female operatives	21.24	21.49	20.58
Retiring at 31 March 2028			
Male staff	19.09	21.41	20.32
Male operatives	19.09	18.72	17.70
Female staff	22.02	24.34	23.27
Female operatives	22.02	22.52	21.49

Scottish Water's share of the assets in the schemes and the expected rate of return were:

	Long term rate of return %	Value 2008 £m	Long term rate of return %	Value 2007 £m	Long term rate of return %	Value 2006 £m
Equities	7.7	557.0	7.8	583.9	7.4	557.4
Bonds	5.7	84.4	4.9	80.0	4.6	74.7
Property	5.7	76.7	5.8	81.9	5.5	66.6
Other	4.8	31.3	4.9	32.1	4.6	21.3
Total market value of assets		749.4		777.9		720.0
Present value of scheme liabilities		<u>(796.9)</u>		<u>(927.7)</u>		<u>(955.7)</u>
Gross pension liability		(47.5)		(149.8)		(235.7)
Related deferred tax asset		<u>13.3</u>		<u>44.9</u>		<u>70.7</u>
Net pension liability		<u>(34.2)</u>		<u>(104.9)</u>		<u>(165.0)</u>

Scheme assets are stated at their bid values in line with revised FRS 17 disclosure requirements.

Notes to the financial statements

For the year ended 31 March 2008

21 Pensions (continued)

Reconciliation of opening and closing retirement benefit liabilities and assets

	2008 £m	2007 £m
Movements in liabilities during the year:		
Opening value of total liabilities	(927.7)	(955.7)
Current service cost	(17.9)	(19.7)
Interest on pension scheme liabilities	(50.1)	(46.6)
Contributions by members	(5.3)	(4.9)
Actuarial gain	179.8	74.0
Impact of settlements and curtailments	(0.8)	(0.4)
Benefits paid	25.1	25.6
Closing value of total liabilities	(796.9)	(927.7)
Movement in assets during the year:		
Opening fair value of total assets	777.9	720.0
Adjustment for restatement of asset value to bid value at 31 March 2007	(2.6)	-
Expected return on pension scheme assets	55.4	49.4
Contributions by members	5.3	5.0
Contributions by the employer	19.3	27.4
Actuarial gain/(loss)	(80.7)	1.7
Benefits paid	(25.2)	(25.6)
Closing fair value of assets	749.4	777.9
Gross deficit in the schemes at 31 March	(47.5)	(149.8)

Actuarial gain/loss in the statement of total recognised gains and losses (STRGL)

	2008 £m	2007 £m
Variance between pension fund actuarial assumptions and actual experience	99.0	75.8
Impact of settlements and curtailments	(0.8)	(0.4)
Additional contributions to Lothian Pension Fund	-	3.9
Adjustment for restatement of asset value to bid value at 31 March 2007 and deferred tax	(2.6)	-
Gross actuarial gain recognised in the pension fund	95.6	79.3
Deferred tax movement	(31.6)	(25.8)
Net actuarial gain recognised in the Statement of total recognised gains and losses	64.0	53.5

Notes to the financial statements

For the year ended 31 March 2008

21 Pensions (continued)

History of experience gains and losses

	2008	2007	2006	2005	2004
	£m	£m	£m	£m	£m
Difference between the expected and actual return on scheme assets:					
Amount	(80.7)	1.7	89.4	16.0	70.8
Value of assets	749.4	777.9	720.0	558.9	494.2
Percentage of scheme assets	(10.8)%	0.2%	12.4%	2.9%	14.3%
Experienced gains/(losses) on scheme liabilities:					
Amount	(0.3)	(5.3)	(4.0)	10.5	(17.5)
Present value of liabilities	796.9	927.7	955.7	761.8	701.4
Percentage of the present value of scheme liabilities	(0.0)%	(0.6)%	(0.4)%	1.4%	(2.4)%
Changes in assumptions underlying the present value of scheme liabilities:					
Amount	180.0	79.4	(114.1)	(15.6)	(33.8)
Percentage of the present value of scheme liabilities	22.6%	8.6%	(11.9)%	(2.0)%	(4.8)%
Total variance between pension fund actuarial assumptions and actual experience	99.0	75.8	(28.7)	10.9	19.5
Gross deficit in the schemes at 31 March	(47.5)	(149.8)	(235.7)	(202.9)	(207.2)

22 Capital commitments

The Group has contracted capital commitments of £677.9m (2007: £651.8m) at the balance sheet date.

23 Contingent liabilities

In May 2007 a material legal claim was received from Caledonian Environmental Services Ltd (CES), the Concessionaire in respect of Levenmouth PFI Project, relating to alleged losses arising under the PFI contract between Scottish Water and that company. The claim originates from an action raised by Degremont Societe Anonyme and Amec Capital Projects Limited under their Design and Construction Contract (DCC) and the extent of CES's claim against Scottish Water will depend on the outcome of that claim. Defences were lodged and the action has been sisted until the resolution of the DCC claim.

24 Related party transactions

Scottish Water is a public corporation of a trading nature sponsored by The Scottish Government. In terms of FRS 8 'Related Party Transactions', the Scottish Government is regarded as a related party. During the year Scottish Water has had various material transactions with the Scottish Government and with entities for which the Scottish Government is regarded as the parent.

In the course of normal operations, Scottish Water contracted on an arms-length basis with Scottish Water Solutions Limited, a Joint Arrangement between Scottish Water, Stirling Water Limited and UUGL Limited. The aggregate transactions which are considered to be material and which have not been disclosed elsewhere in the financial statements are summarised below:

	2008	2007
	£m	£m
Sales and costs charged to Scottish Water Solutions Limited	21.6	26.4
Purchases from Scottish Water Solutions Limited	(323.1)	(182.2)
Amounts due to Scottish Water Solutions Limited (note 14)	32.6	19.7

Notes to the financial statements

For the year ended 31 March 2008

25 Financial instruments

Scottish Water's financial instruments comprise cash, borrowings, certain provisions for liabilities and charges and items such as trade debtors and trade creditors arising in the ordinary course of business. No trading in derivative financial instruments was undertaken.

Fair values of financial assets and liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing partners, other than in a forced or liquidation sale, and excludes accrued interest.

The carrying amounts of financial assets and liabilities, excluding borrowings, are equal to their fair values. Borrowings are held at cost in the balance sheet but the fair value is disclosed in Note 17.

Risks and uncertainties

The management of Scottish Water and the execution of strategy are subject to a number of risks as detailed below. All risks are reviewed by the Board and appropriate processes are in place to monitor and mitigate them. See Corporate Governance report on pages 23 to 25.

(a) Operational and business risk

This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes losses due to external factors such as the market situation or government regulations. Reputational risk is included in this category. The risk register and risk management processes identify key operational and other risks and are reviewed on a regular basis.

(b) Credit risk

Credit risk is the risk that Scottish Water is exposed to loss if another party fails to perform its financial obligation to Scottish Water. Scottish Water monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its exposure to any one party to ensure that they are within board approved limits and that there are no significant concentrations of credit risk. The maximum exposure to credit risk for receivables and other financial assets is represented by their carrying amount.

(c) Liquidity risk

Scottish Water's policy is to ensure that it has adequate financial resources to enable it to finance its day-to-day operations and capital investment programme, based on cash flow projections, while adhering to the annual limits set by the Scottish Government for new borrowings. Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002.

26 Ultimate controlling body

Scottish Water is a public sector body, classified as a public corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers.

27 Regulatory information

The Water Industry Commission (the 'Commission') has the general function of promoting interests for customers in relation to the provision of core services. The Commission determines Scottish Water's price limits and approves Scottish Water's annual charges scheme.

The Commission monitors Scottish Water's performance on efficiency and customer service and approves our code of practice. Each year the Commission publishes reports on the exercise of its functions. In preparing these reports, the Commission assesses our performance by using information supplied by Scottish Water and by making comparisons with information obtained on other regulated water companies. In carrying out this performance monitoring, the Commission may make regulatory amendments to figures published in Scottish Water's audited financial statements to ensure like for like comparisons with other companies.

COMPLIANCE WITH GOVERNMENT TARGETS

a) Sufficiency of revenue

Scottish Water reported a surplus before tax of £236.8m for the year (2007: £228.9m). There were no exceptional costs charged during the financial year to 31 March 2008 (2007: nil).

b) Borrowing Limit

Scottish Ministers set Scottish Water a maximum net new borrowing limit at £196.4m for 2007/08. Actual net new borrowing during the year to 31 March 2008 was £196.3m.

DIRECTION BY THE SCOTTISH MINISTERS

in accordance with section 45(2) of the Water Industry (Scotland) Act 2002

1. The Report and Accounts, which it is the duty of Scottish Water to prepare, in respect of its financial year ending on 31 March 2008 and each subsequent financial year shall comprise:

- 1.1. a foreword;
- 1.2. an income and expenditure account;
- 1.3. a statement of total recognised gains and losses;
- 1.4. a balance sheet; and
- 1.5. a cashflow statement

together with such further information as may be necessary to comply with this Direction.

2. The Report and Accounts referred to in paragraph 1 shall give a true and fair view of the income and expenditure and cash flows for the financial year and of the state of affairs at the end of the financial year.

3. The Report and Accounts shall also meet in as far as they are appropriate:

- 3.1. the accounting and disclosure requirements of the Companies Act 1985;
- 3.2. generally accepted accounting practice including financial reporting standards issued by the Accounting Standards Board;
- 3.3. the accounts disclosure requirements of paragraph 43 of Chapter 12 of the Listing Rules issued by the Financial Services Authority (formerly the London Stock Exchange);
- 3.4. the accounting and disclosure requirements given in 'The Scottish Public Finance Manual' as amended or augmented from time to time; and
- 3.5. the accounting and disclosure requirements contained in other guidance issued by the Scottish Ministers from time to time in respect of Accounts, which are required to give a true and fair view.

4. Clarification of the application of the accounting and disclosure requirements of the Companies Acts and financial reporting standards is given in Schedule 1 attached. Additional disclosure requirements are set out in Schedule 2 attached.
5. The Report and Accounts referred to in paragraph 1 shall be prepared under the historical cost convention.
6. The foreword and balance sheet shall be signed by the Chief Executive of Scottish Water and dated.
7. The Report and Accounts shall be audited and laid before the Parliament not later than 6 months after the end of the financial year.
8. These requirements shall be reproduced as an appendix to the Report and Accounts.

Schedule 1

Application of the accounting and disclosure requirements of the Companies Act 1985 and Accounting Standards

1. The income and expenditure account shall be prepared in accordance with profit and loss account format 1 set out in Schedule 4, Companies Act 1985.
2. The Report and Accounts need not include a 'Note of historical cost profits and losses' as required by Financial Reporting Standard 3.
3. The balance sheet shall be prepared in accordance with balance sheet format 1 set out in Schedule 4, Companies Act 1985.
4. The balance sheet shall include indebtedness to the Scottish Ministers under the heading 'capital and reserves'. The notes thereto shall show separately any amounts falling due for payment within 12 months of the date of the balance sheet.
5. Grants and contributions in respect of expenditure on fixed assets shall be treated as deferred income and recognised in the income and expenditure account over the expected useful lives of the related assets, except that grants and contributions specifically relating to infrastructure assets shall be deducted from the cost of those assets.
6. The Accounts' presentation and disclosure exemptions permitted by the Companies Act 1985 shall not apply unless specifically approved by the Scottish Ministers.

Schedule 2

Additional disclosure requirements

1. The notes to the income and expenditure account shall disclose:
 - a) an analysis of turnover and operating surplus before interest and tax over the following activities – water, sewerage and other services;
 - b) in turnover, separately identified, the amount of revenue grants received from the Scottish Ministers and the source and authority for each grant, broken down between payments in respect of earlier years and the current year;
 - c) an analysis of the interest charge, showing separately the interest on capital loans.
2. The notes to the balance sheet shall disclose:
 - a) Scottish Water's maximum borrowing limit as specified by Scottish Ministers;
 - b) indebtedness to the Scottish Ministers, showing separately loans issued prior to 1 April 1999 and loans issued on and after that date, and other borrowings and showing when repayments are due;
 - c) an analysis of net assets over the activities set out in paragraph 1a) above; and
 - d) the amount, source and purpose of capital grants received and receivable.
3. The foreword to the Report and Accounts shall contain, insofar as it is appropriate:
 - a) a statement that the Accounts have been prepared in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002;
 - b) a brief history of Scottish Water and its statutory background;
 - c) a statement confirming compliance by Scottish Water with any Directions, requirements and guidance issued by the Scottish Ministers insofar as such matters relate to the functions of Scottish Water;
 - d) a statement of Scottish Water's Members' responsibilities in respect of the preparation of the Report and Accounts;
 - e) the information required by the Companies Act 1985 to be included in the directors' report; and
 - f) a discussion and analysis of Scottish Water's performance and the factors underlying its results and financial position, having regard to the guidance in the Statement 'Operating and Financial Review' published by the Accounting Standards Board.

4. The notes to the Report and Accounts shall include:
 - a) an analysis of operating costs and assets having regard to prevailing practice in the water industry;
 - b) details of Scottish Waters Members' and senior employees' remuneration in accordance with the guidance contained in the Resource Accounting Manual published by HM Treasury for the financial year, except that the amounts disclosed should be to the nearest £000 and not in bands;
 - c) a comparison of Scottish Water's financial targets set for a financial year by the Scottish Ministers with the outturn for that year.
5. Notwithstanding the requirements relating to corporate governance contained in paragraph 12.43 of the Listing Rules issued by the Financial Services Authority referred to above, the Report and Accounts shall also include such additional disclosures relating to corporate governance as may be required by any Directions or guidance issued by the Scottish Ministers from time to time.