M Tables – Regulatory Accounts Commentary

The sections in this document are:

1. General Comments

There have been some minor disclosure changes to the 2007/08 M Tables by the WICS, mainly to satisfy additional analysis. Consequently the comparative figures for 2006/07 have been restated on a consistent basis.

SW's structure changed in 2007/08 with the set up of Scottish Water Business Stream Holdings Ltd, a wholly owned subsidiary of SW. SW's investment in SW Business Stream Ltd was transferred to SWBSH to enable sufficient separation between the wholesale and retail businesses. The consolidation tables – M27 and M28 – include the results of SWBS and SWBSH in the Licensed column and within Non Core/Non Licensed respectively.

2. Results & Reconciliation

SW produces statutory consolidated accounts incorporating the results of SWBS and SWBSH. The consolidated statements also include the balance sheet (and relevant notes) for SW only ('company'). Detailed reconciliations between the statutory accounts and the regulatory tables have been attached in the appendix to this document.

M Table financial information is for SW only, i.e. excluding SWBS and SWBSH, and is analysed between Core (= Regulatory business) and Non Core (= Non regulatory businesses) where required. Tables M27 and M28 provide reconciliations from the SW Core figures to the group consolidated income and expenditure statement and balance sheet respectively.

Due to some different descriptions and terminology between the regulatory M tables and the statutory accounts, Appendix 1.1 and 1.2 provide reconciliations from the Table M27 totals and M28 totals to the statutory consolidated income and expenditure account and consolidated balance sheet, respectively. Appendix 1.3 shows the reconciliation between Table M2 and the statutory "company" balance sheet.

Regulated / Non Regulated have been accounted for separately in SW's general ledger system enabling the production of regulated/non-regulated profit & loss accounts and balance sheets. These form the basis for the historical cost figures and analysis, in particular Tables M1, M2, M24, M27 & M28. Further ring fencing of non-core activities will take place in 2008/09 with the creation of a separate ledger and legal entity called SW Horizons Holdings Ltd.

Cost analysis in Tables M18 W and M18 WW was prepared using reports from SW's Activity Based Management (ABM) systems. Detailed commentary on ABM methodology and cost allocation is provided in support of the E Tables and is not repeated in this document.

FRS17 entries in the statutory accounts have been included in the regulatory results, both HCA and CCA, but are excluded in Tables M18W and M18WW and the E Tables in the Annual Return. The impact of FRS 17 was an increase of operating costs of £3.7m (2006/07: £5.6m) and a credit to financing of £5.3m (2006/07: £2.8m), giving a net increase to profit before tax in the income and expenditure account of £1.6m (2006/07: reduction of £2.8m).

3. Assumptions

Non core tax charge
It has been assumed that there are no brought forward profits/losses or capital allowances for the non core element. The tax charge is based on the actual capital spend, profit and grant amortisation attributable to the non regulatory businesses in 2007/08. (Tables M1, M2)

CCA adjustments
RPI of 3.77% used in the relevant adjustments, being the rate as at March 2008.

CCA working capital adjustment
The working capital adjustment has been pro rated between water and waste water based on turnover values. (Table M7, line 7.14)

CCA fixed asset values
Opening and closing CCA fixed asset values have been taken from the H Tables for the relevant years. The H Tables for 2007/08 have been calculated on a MEAV basis. The movement in the fixed asset value due to the change in method is reflected through the 'Investment plan adjustment' lines. The RPI adjustment has been calculated on the opening balances as reported in the 2006/07 M Tables.

Tables M16 & M17 – 5 year rolling summaries
Only 2006/07 and 2007/08 figures have been entered (automatically). Figures for the previous years were not required.

4. Commentary – Tables M1 to M28

This section has comments on individual tables, where it is felt that such narrative will aid understanding, explain significant year-on-year movements or provide additional guidance on how the information was gathered or calculated. There are no comments on the tables which appear self explanatory.

Table M1 – HCA Income & Expenditure Account

The Core information is from the general ledger reports for the Regulated business. The 2006/07 comparatives figures for non core operating costs and depreciation have been restated and do not include the ABM costing allocations. Operating costs (line 1.2) for 2006/07 were restated for the £125.6m of PFI costs, now shown separately on line 1.3.

Nominal operating costs (i.e. excluding depreciation, PFI charges, FRS 17 pension charges and costs associated with non regulated activities) increased by £2.5m to £259.0m compared to £256.5m in 2006/07. On a like-for-like basis regulated operating costs increased by £7.3m, a 2.9% nominal increase. The table below summarises this movement:

	2007/08	2006/07	**Mvt fav/(adv)**
	£m	**£m**	**£m**
Core operating expenditure – line M1.2	**263.3**	**262.6**	**-0.7**
Less: Internal PFI costs	-0.6	-0.5	0.1
Less: FRS 17 operating cost adjustment	-3.7	-5.6	-1.9
SW Regulated operating costs	**259.0**	**256.5**	**-2.5**
Less retail non-household costs		-6.7	-6.7
CMA "a typical"	-2.0	-1.5	0.5
Bad debt provision release "a typical"	11.6	6.0	-5.6
Leakage	-8.3	-5.5	2.8
Non household septic tank emptying costs treated as non regulated in 2006/07		0.8	0.8
Additional new opex	-3.4		3.4
Like-for-like costs	**256.9**	**249.6**	**-7.3**

The 2.9% increase in like-for-like operating costs is after absorption of a £4.7m, or 17% increase in power costs (before new opex), a £2.3m increase in local authority rates and SEPA charges and £5.8m associated with higher levels of network maintenance.

The cost of the PFI schemes in the year was £127.0m, £1.9m higher than in 2006/07 due primarily to contract indexation.

The increase in depreciation year-on-year was primarily due to the first full year charge on the increased level of assets which came into beneficial use in the previous year.

Other operating income of £9.3m (line 1.8) was the gain on disposal of fixed assets which included the sale of New Stevenston (the sale of which was originally anticipated in 2005/06), Bellshill and Panmurifield. The current tax charge (line 1.13) relates to capital gains tax payments associated with these disposals.

The net interest charge of £135.0m (2006/07: £139.8m) (line 1.11) is net of the FRS 17 financing credit of £5.3m (2006/07: £2.8m credit). The lower net charge was also due to the timing of the drawdown of the new borrowings and higher net intercompany interest received (see Table M23).

As a result of the changes in the UK Corporation Tax rate from 30% to 28% from 1 April 2008, deferred tax balances were remeasured. Additionally, the abolition of balancing adjustments for industrial buildings allowances resulted in a decrease in the deferred tax liability recognised in respect of buildings.

Table M2 – HCA Balance Sheet

Core / Non core information is from the general ledger reports. The main difference from the statutory HCA balance sheet (£4.8m) is recognition of the Infrastructure Renewals prepayment (line 2.11) and the corresponding adjustment to the fixed asset total (line 2.1).

Debtors (line 2.6) for 2006/07 is restated by £20.94m, from £77.08m to £56.14m. This is due to ‘Assets transferred to PPP contractors’ (line 2.10) of £35.5m and ‘Credit note provisions’ (line 11.11) of £(14.56)m which are now analysed separately in these tables.

The cash balance (line 2.7) for 2006/07 is restated to reflect the transfer of £1.821m from cash to creditors (line 2.15) being the amount of unpresented cheques over six months old. This restatement aligns the March 2007 balance with the accounting treatment adopted in 2007/08. This restatement was also made in the Quarterly Reports for 2007/08.

Creditors (line 2.15) for 2006/07 have been restated by £16.381m, being the opposite entries for the credit note provision and the unpresented cheques above.

Investment – loan to group company (line 2.2) is the intercompany loan to SWBSH (2006/07: loan to SWBS). SW has used a Government loan to finance the intercompany loan to SWBSH. This arrangement will remain in place until SWBSH is able to borrow directly from the Scottish Government, expected during 2008/09. The loans are identifiable and match in interest rate and maturity. Consequently there are no differences to report.

Investment – other (line 2.3) is the total investment in SWBSH.

The increase in debtors (from £62.1m to £88.6m; line 2.6) is due to higher:
- household trade debtors (from £21.9m to £28.5m; line 11.2);
- non core debtors and accrued income (from £6.0m to £9.4m);
- prepayments and other short term debtors (from £12.3m to £16.7m; line 11.6) due to the prepayment of insurance premiums (£1.8m) and costs for Glencorse WTW (£4.5m); and
- non trade debtors (from £20.9m to £32.5m; line 5.12) being VAT receivable outstanding from HMRC.

Cash at bank includes the £27.4m out-performance monies which will be invested in Government Gilts in line with the Regulatory Contract for 2006-10.

Other creditors due after one year (line 2.23), which have increased over the year by £17.7m to £39.0m, include infrastructure income not yet invested and payments received in advance in relation to connections i.e. network, developers and inspection deposits.

Deferred income (line 2.26) includes the proceeds from the sale of the masts and towers income stream (£6.4m) and an up-front payment of £2.8m associated with development works which cause the increase to £28.3m at March 2008.

Post employment liability (line 2.27) is the FRS 17 pension liability which has reduced from £104.9m to £34.3m due mainly to an actuarial gain of £99.0m reflecting the higher discount rate of 6.9% (2007 – 5.4%) applied to scheme liabilities. The higher discount rate reflects the higher bond yields now being experienced in the market place.

Other provisions (line 2.28) have increased due to the creation of the wholesale income uncertainty provision of £8.9m (line 26.9). The different elements within the £14.8m total are detailed in Table M26 (lines 26.8-26.10).

Table M3 – HCA Balance Sheet – Reconciliation to Statutory Accounts

This provides a summary of the main reconciling items. The Profit and Loss section (lines 3.1-3.7) reconciles the statutory Group consolidated figures to Table M1 Core figures, because no profit and loss figures are provided for SW company in the statutory accounts. However, more details have been given in the appendices – 1.1, 1.2 and 1.3. The balance sheet section (lines 3.8-3.15) reconciles SW Company figures from the statutory accounts to Table M2 Core figures.

Table M4 – CCA Income & Expenditure Account

Operating costs (line 4.2) for 2006/07 was restated by £125.1m, being the PFI costs now shown separately on line 4.3.

The only differences between the HCA and CCA Income and Expenditure Accounts are due to the CCA adjustments.

- CCA depreciation is calculated based on the brought forward CCA net book values. The net/gross % per the H Tables at March 2008 indicates 52.6% of the average useful life remains. Therefore 50% has been used in the CCA depreciation calculation.
- The index applied is the RPI of 3.77%.
- Amortisation of deferred income (grants and contributions) is adjusted for the indexing.
- The working capital adjustment is the indexed of the opening (operating) working capital (as in Table M11).
- The financing adjustment is the index applied to the opening net finance amount for SW.

Table M5 – CCA Balance Sheet

The non trade debtors amount (line 5.12) for 2006/07 is restated by £35.5m, being the ‘Assets transferred to PPP contractors’ (line 5.11). The cash balance (line 5.4) for 2006/07 is restated by £1.821m, as detailed above in the comments on Table M2. The opposite entry for this causes the restatement to non trade creditors (line 5.13).

Third party contributions (line 5.2) include the index-adjusted value of both grants and contributions.

Non trade debtors (line 5.12) is VAT receivable at March. The increase of £11.6m compared to the previous year is due to the delay in receiving the VAT refund for February 2008.

Non trade creditors (line 5.13) consist of the interest accrual (£33.6m), infrastructure income not yet invested (£9.0m), payments received in advance in relation to connections i.e. network, developers and inspection deposits (£19.0m) and other (£11.5m).

Other creditors due after one year (line 5.20) consists of infrastructure income not yet invested (£13.4m) and payments received in advance (£25.4m).

The income & expenditure reserve (line 5.28) is the total of the CCA reserve at 31 March 2007, the CCA profit for 2007/08 and the movements detailed in the STRGL (Table 19).

Table M6 – CCA Cash Flow
New lines have been inserted to capture the movements in non trade debtors/creditors. Therefore the 'Net cash flow from operating activities' for 2006/07 (line 6.1) has been restated by the £4.511m shown on line 6.2. The other line impacted by this restatement is line 13.10, which is now only the FRS 17 adjustment to operating costs.

Interest received (line 6.4) includes the intercompany interest received from SWBS and SWBSH. The movement on loans to group companies (line 6.13) of £6.0m is the net of the intercompany loan paid to SWBSH of £58.5m and the repayment by SWBS of their loan of £64.5m. The £25.0m acquisitions and disposals (line 6.15) is the cash investment made by SW in SWBSH for the equivalent value of shares. Interest paid, receipts from grants and disposal proceeds are the same amounts as disclosed in the statutory cash flow statement.

Table M7 – Analysis of Turnover and Operating Income
Household income increased by 4.9% to £673.7 million driven mainly by the tariff increase effective from 1 April 2007. 2007/08 was the first full year of SWBS being the wholesale customer of SW for the non household market, hence the £193.6m reduction in retail non-household income (line 7.2) and the £178.7m increase in wholesale non-household income (line 7.3).

Table M8 – CCA Analysis of Fixed Assets by Asset type (Core)
For Water Services and Sewerage Services columns, the opening (lines 8.1 & 8.14) and closing (8.7 & 8.15) values in Table M8, agree to the values in Table H1 as at 31 March 2007 and 31 March 2008 respectively. The additions in the year are at actual cost. The inflation adjustment figures (lines 8.3 & 8.10) are the indexing of the brought forward values, using RPI of 3.77%. The values shown for the investment plan adjustment (lines 8.2 & 8.9) are the revaluation adjustments bringing the closing values back into agreement with Table H1 values. H Table analysis generates a valuation of assets at a point in time and does not analyse year on year movements.

The H Tables categorise the assets into water / wastewater non infrastructure, water / wastewater infrastructure and support services. In Table M8 the support services have been allocated between water and wastewater based on their HCA values.

SW's additions to fixed assets are entered firstly to assets in the course of construction (AUC) then, on beneficial use, reclassified to the appropriate asset category. All values for AUC are HCA.

CCA depreciation is calculated based on the brought forward CCA net book values (as H and M Tables for 2006/07). The calculation also assumes 50% of the relevant average useful life remains, based on the ratio of net to gross values per Table H1 at 31 March 2008. The index applied is the RPI of 3.77%. For additions during the year, half of the actual cost (i.e. assuming additions are in use for half of the year, on average) and the relevant average useful lives are the basis, with no indexing.

Table M11 – CCA Working capital
New lines were inserted in this table for 2007/08 for the Wholesale charge prepayment (line 11.8; previously included in Trade creditors, line 11.7) and the Credit note provisions (line 11.11; previously within Trade debtors, line 11.2). Consequently the previous year comparatives have been inserted/amended accordingly but the total CCA working capital for 2006/07 remains as £(181.0)m.

The increase of £6.6m in Household trade debtors is predominantly due to lower bad debt provision requirements due to improved cash collection levels. Other trade debtors relate to sundry (non primary) billing, which moved on to SW's own new billing system during the year, increased by £0.4m.

The increase in trade creditors of £7.2m to £20.0m was partly offset by a decrease in accruals £2.1m to £83.1m.

The wholesale charge prepayment at March 2008 is the provisional invoice for April less amounts due by SWBS following the reconciliations for prior months. (See M26 below.)

Capital creditors consist of the balance due to SW Solutions (£32.3m) and capital creditors and accruals relating to external parties (£39.2m). The lower total at March 2008 reflects the higher payments made towards the end of the year.

A separate reconciliation (Appendix 1.4) has been prepared showing reclassifications from statutory basis of debtors and creditors into regulatory CCA working capital (operating items) and non operating debtors and creditors. (Tables M11 & M5).

Table M12 – Movement on Current Cost Reserve

The investment plan adjustment (line 12.2) is the net opposite entry from Table M8 (lines 8.2 & 8.9). The fixed asset inflation adjustment (line 12.3) represents the net of the cost and depreciation adjustments from Table M8 (lines 8.3 & 8.10). The other items are the opposite entries of the CCA adjustments described under Table M4. The detailed calculations for the financing adjustment and grants and third party contributions are provided in the tables below.

M Table line no.		2006/07 £m	RPI %	Financing adjustment £m	M Table line no.
5.26	Net assets employed	27,109.210			
5.8	Net oprating assets	27,409.538			
		-300.328			
5.29	Deferred tax - add back	205.298			
	Net finance	-95.030	*3.77%*	-3.580	12.5/4.14

M Table line no.		2006/07 £m	RPI %	Grants & 3rd party contrib. adjustment £m	M Table line no.
5.2	Third party contributions	-19.689	*3.77%*	-0.742	12.6

Table M13 – Reconciliation of Current Cost operating surplus to net cash flow from operating activities

The working capital movement (line 13.3) is an input figure (not a calculation). The actual movement of £(14.4)m reflects the lower level of net current liabilities (Table M11 - working capital excluding capital creditors and interest accrual). The movement of £72.6m in 2006/07 was due to transfer of non household business to SWBS.

For both years the amount in line 13.10 is the FRS17 adjustment in operating costs. The 2006/07 figure has been restated due to the movement in non trade debtors/creditors now shown separately in line 6.2.

Table M14 – Analysis of net debt

Table M14 shows net debt for core activities of £2,606.1m. However, for the purposes of determining SW's out-performance of the Regulatory Contract the net debt figure should be adjusted as follows:

	£m
Net Debt per M14, line 14.9	2,606.1
Less funding for Business Stream Group	83.5
Adjusted Net Debt	**2,522.6**

Table M16 – 5 year rolling summary: Current Cost Income & Expenditure Account for Core Business

As agreed with the WICS, this table has not been populated for the earlier years. 2007/08 and 2006/07 figures are entered automatically from the other tables.

Table M17 – 5 year rolling summary: Current Cost Balance Sheet for Core Business

As agreed with the WICS, this table has not been populated for the earlier years. 2007/08 and 2006/07 figures are entered automatically from the other tables.

Table M18B W – Analysis of fixed assets – Water Service

The information presented here is a more detailed analysis of the non infrastructure and infrastructure water assets provided in Table M8. The opening (lines 18b.1 & 18b.16) and closing (lines 18b.6 & 18b.15) balances agree to the values in Table H1 at 31 March 2007 and 31 March 2008 respectively. The Table H1 figures for water storage (H1.2) and water resources (H1.4) are combined under "Sourcing"; water treatment works (H1.1) is "Treatment"; water pumping (H1.3) and water mains (H1.5) are "Water distribution". Support service assets are not included in Table M18b. Their inclusion, which could only be by means of allocation across the current category headings, would distort the clear tie between Tables H1 and M18B.

Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.77% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). The revaluation adjustments to bring the closing figures back to the H1 values are shown in the investment plan adjustment (lines 18b.2 & 18b.8). H Table analysis generates a valuation of assets at a point in time and does not analyse year-on-year movements.

Table M18B WW – Analysis of fixed assets – Waste water Service

The information presented here is a more detailed analysis of the non infrastructure and infrastructure waste water assets provided in Table M8. The opening (lines 18b.1 & 18b.16) and closing (lines 18b.6 & 18b.15) balances agree to the values in Table H1 at 31 March 2007 and 31 March 2008 respectively. The Table H1 figures for wastewater infrastructure (H1.6, H1.7 & H1.8) and sewage pumping (H1.9) are combined under "Sewerage"; sewage treatment works (H1.10) is "Sewage treatment"; sludge treatment facilities (H1.11) is "Sludge treatment & disposal". Support service assets are not included in Table M18b. Their inclusion, which could only be by means of allocation across the current category headings, would distort the clear tie between Tables H1 and M18B.

Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.77% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). The revaluation adjustments to bring the closing figures back to the H1 values are shown in the investment plan adjustment (lines 18b.2 & 18b.8). H Table analysis generates a valuation of assets at a point in time and does not analyse year on year movements.

Table M19 – Statement of total recognised gains and losses (core)
Although the table title states 'Core', line 19.1 is actually referenced to the total column of Table M1, i.e. total of Core and Non Core.

The actuarial gain is calculated as part of the FRS 17 statutory adjustments. The Other gain of £9.6m is SW's gain on the value of the investment in SWBS following SWBS's capitalisation of £9.6m of reserves through a bonus share issue. SWBSH acquired SW's investment in SWBS for £9.6m by issuing share capital to the same value.

Table M21 – Taxation analysis
The amended 2006/07 tables reflect the position as per the submitted 2006/07 tax computation which was submitted to HMRC in March 2008. The 2006/07 annual return is populated using estimated values in some circumstances.

In addition the 2006/07 tax computation includes capital allowances claimed on £84m of work in progress capital spend. This is as a result of an agreement with HMRC that Scottish Water could claim capital allowances on WIP for all projects commencing after 1 April 2006 in the Q&S111 capital programme.

Changes in definition:
1. The 2006/07 tax tables were submitted with all assets not qualifying for capital allowances or revenue deductions shown in Section M Line 21.15. This included non qualifying infrastructure and other non qualifying assets such as landscaping and land related transaction costs. However, we are now showing the non qualifying infrastructure in line 21.13 as this is a more accurate definition of this type of expenditure. Line 21.15 only shows the expenditure relating to other non qualifying assets.

2. The 2006/07 tax tables were submitted with net interest reflected in Line 21.33. The 2007/08 tables now reflect interest paid in line 21.33 and interest received in line 21.40.

Table M22 – Fixed asset additions and expected depreciation (CCA)
The non infrastructure additions (line 22.8) are the amounts reclassified from AUC, as described above.

The figures in the section "Infrastructure renewals charges, expenditure and provision", (lines 22.20 – 22.22), are the movements during 2006/07 and 2007/08. Therefore the resulting total is not the closing balance as given in the balance sheets at 31 March 2008. The table below shows the full reconciliation:

Infrastructure renewals:	**31 March 2007**	**2007/08 movements**	***M22 refs***	**31 March 2008**	***M2 / M5 refs***
- Expenditure	605.288	115.530	*22.20*	720.818	
- Charges	-626.000	-90.000	*22.21*	-716.000	
Prepayment/(accrual)	-20.712	25.530	*22.22*	4.818	2.11 / 5.7

In the section "Expected depreciation on closing assets as of 31 March 2008", (lines 22.23 – 22.28), the gross book values and net book values are taken from Table H1. The forecast depreciation charges are calculated using the relevant NBV at 31 March 2008 and are aligned to the 1st Draft Business Plan.

Table M23 – Interest analysis
Intercompany interest (line 23.1) is made up of £1.6m received from SWBSH and £0.5m received from SWBS.
Other finance charges (line 23.5) is the FRS 17 statutory adjustment.

Table M24 - Turnover
Primary income (lines 24.1 – 24.13): The majority of the income types are directly identifiable with specific accounts in the SW general ledger. 2007/08 was the first full year of business separation. Therefore there is no income in any of the Non-Household categories (lines 24.3-24.10). The income in the wholesale revenue lines (24.11 & 24.12) are for a full year (2006/07: 5 months).

Other sources (line 24.14 onwards): Each income source representing > 2% of the other sources total has been separately identified. The balance (around 1% of the total) has been shown as "Sundry" (line 24.20). There is no income for field troughs in 2007/08 as this revenue is billed by SWBS. Similarly for business connections which are now handled initially by SWBS, who record the income along with the corresponding cost of sales. However, SW record this contribution, passed from SWBS, associated with connections on to the balance sheet to net-off against the cost of providing the connections.

Table M25 – Bad Debts (Trade debtors)
This table shows the gross receivable less bad debt provision. The net receivable amounts here are taken to Table M11 (lines 11.2 & 11.4).

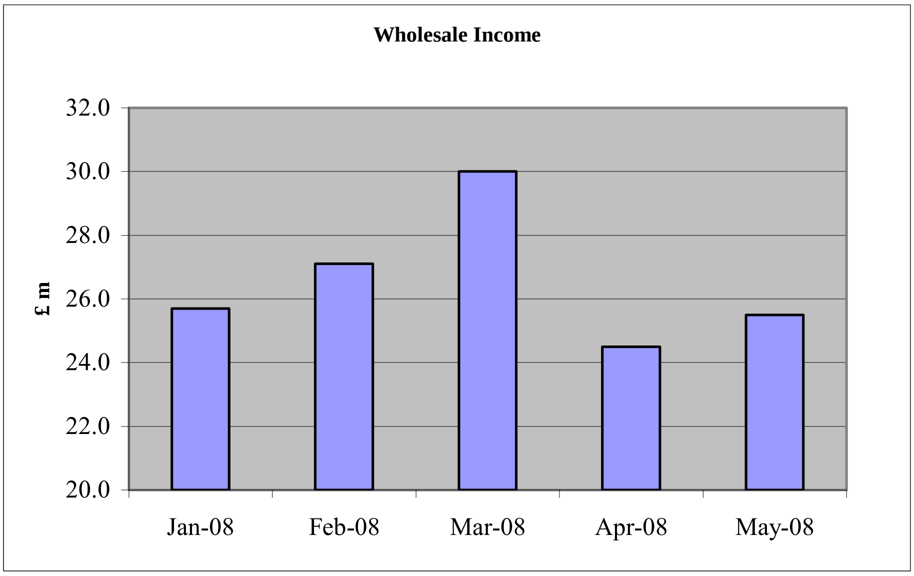
The amounts shown in the Wholesale/non-household trade debtors section relate to sundry / other regulated income.

Bad debt provision in the year: The Household charge to the profit and loss account (line 25.7) is net of an a-typical credit of £11.6m. The movement on the sundry bad debt was a net credit to the profit and loss account.

The table below provides a breakdown of the household gross balances and bad debt provisions by age:

	96/03 £m	03/04 £m	04/05 £m	05/06 £m	06/07 £m	07/08 £m	Total £m
Gross Debt	108.9	25.6	26.8	29.8	34.1	51.3	276.5
Bad Debt Provision	(104.8)	(24.4)	(25.4)	(27.9)	(31.5)	(34.0)	(248.0)
Net Debt	**4.1**	**1.2**	**1.4**	**1.9**	**2.6**	**17.3**	**28.5**

Table M26 – Provisions analysis
The income uncertainty provision – wholesale (line 26.9) was set up during 2007/08 and relates to uncertainty around wholesale non-domestic income. The graph below highlights the volatile fluctuations in monthly invoices in 2008.



The other provision (line 26.10) relates to onerous leases and decreased during the year following the settlement of one of these leases.

Table M27 – Consolidated HCA Income & Expenditure Account
The only intercompany item being visibly eliminated (in col 5) on this table is the intercompany cost of sales in SWBS which is the wholesale income for SW. The intercompany interest already eliminates across line 27.11.

Non core / non licensed includes the non regulatory businesses (as per table M1) and the results for SWBSH (interest and taxation).

Appendix 1.1 provides a reconciliation between Table M27 and the statutory consolidated income and expenditure account. The differences are due to the terminology and descriptions being used.

Table M28 – Consolidated HCA Balance Sheet
The intercompany items being visibly eliminated are:
- intercompany debtor and creditor balances (lines 2.6 & 2.15); and
- investments in subsidiary companies and the relevant share capitals (lines 2.3 & 2.30).

The intercompany loans eliminate across line 2.2.

Non core / non licensed includes the non regulatory businesses (as per table M2) and the balance sheet for SWBSH (intercompany loans, investment in subsidiary, intercompany debtors and creditors, taxation, share capital and reserves).

Appendix 1.2 provides a reconciliation between Table M28 and the statutory consolidated balance sheet. The differences are primarily due to reclassifications and grouping of various items.

4.2 M Table 18W & 18WW detailed commentary

Methodology & Cost Allocation

Cost analysis in M Tables (M18W, M18WW) was prepared using reports from Scottish Water's Activity Based Management (ABM) systems.

Detailed commentary on ABM methodology and cost allocation is provided in support of table E and is not repeated in this document.

Trading Results & Reconciliation

Business Stream is a fully owned subsidiary of Scottish Water. Scottish Water produces group consolidated accounts incorporating the results of Business Stream. E & M Table financials are produced for Scottish Water company only, excluding Business Stream.

To aid E & M Table year-on-year comparison, the table below summarises Scottish Water group consolidated results and Scottish Water company results.

			Total	Core	Non Core
		£m	£m	£m	£m
SW Group Statutory Accounts:					
	Cost of sales	579.5			
	Administration expenses	100.2			
SW Group Expenditure			**679.7**		
Less	SWBS		(19.5)		
SW Company Expenditure - per Table M1			**660.2**	**632.5**	**27.7**
Less	FRS 17 adjustment		(3.7)	(3.7)	-
SW Company Expenditure, excluding FRS 17			**656.5**	**628.8**	**27.7**
Add	SWBS support costs		4.1	4.1	-
SW Company Expenditure - per Tables M18W & 18WW			**660.6**	**632.9**	**27.7**

E & M Tables include the costs of Scottish Water (Core / Regulated) and Scottish Water (Non Regulated). The costs of business retail activity undertaken by Business Stream are not reported in Scottish Water's E or M tables.

Scottish Water company results are summarised and reconciled below, to E tables and M18 (W & WW) tables.

	SW	Diff	M Tables			Diff	E Tables
(£m)	Company	Board - M	Total	M18 W	M18WW	M - E	Total
Employment	**150.8**		**288.2**	160.5	127.8		**260.9**
Other	**136.1**						
Opex	**286.9**	**(1.3)**	**288.2**	**160.5**	**127.8**	**27.3**	**260.9**
PFI	**127.5**	**(2.8)**	**130.3**	0.0	130.3	**0.0**	**130.3**
IMC	**90.0**	**0.0**	**90.0**	54.7	35.3	**0.0**	**90.0**
Depreciation	**160.8**		**153.2**	69.7	83.4		**152.6**
Grant Amortisation	**(1.1)**	**(0.0)**	**(1.1)**	(0.7)	(0.4)	**0.4**	**(0.9)**
Amort PFI	**1.6**		**0.0**				**0.0**
Gain on assets	**(9.3)**		**0.0**				**0.0**
Expenditure	**656.5**	**(4.1)**	**660.6**	**284.2**	**376.4**	**27.7**	**632.9**
Explained by							
Charges to SWBS for support		4.1					

Table above has been amended from the original submission to reflect removal of Non Regulated expenditure from Tables E1 and E2.

The line differences above are explained as follows:

- £2.8m difference between our Board report and M Table is due to transfer of costs from Customer Operations for Intersite Sludge Tankering from Scottish Water wastewater treatment works to PFI works (£2.4m), terminal pumping station costs pumping to PFI works (£0.3m) and support costs for the PFI team (£0.1m).
- £4.1m of Scottish Water expenditure has been charged to Business Stream under Service Agreements. This cost has been netted off Scottish Water's expenditure in line with group inter-company transaction reporting. However, for the purposes of regulatory reporting this expenditure has been added back to report the full costs of providing these third party services.
- £130.3m PFI costs (including £2.8m above) is not reported in table E1 and E2.
- £27.7m non regulated expenditure not included in 2007/8 E tables

Commentary

Total operating costs excluding PFI costs and exceptional items increased by £(23.4)m to £530.3m.

	2007/08	2006/07	Variance
	£m	£m	£m
Functional costs - Water M18w.34	117.716	115.792	(1.924)
Operating costs - Water M18w.43	42.736	44.461	+1.725
Capital maintenance - Water M18w.54	123.752	115.360	(8.392)
Functional costs - Waste M18ww.35	231.849	225.185	(6.664)
Operating costs - Waste M18ww.44	26.238	25.204	(1.034)
Capital maintenance - Waste M18ww.55	118.347	108.738	(9.609)
	660.638	**634.740**	**(25.898)**
exclude PFI included in M18ww.35	130.320	127.802	(2.518)
	530.318	**506.938**	**(23.380)**
Remove Exceptional costs	0.000	0.000	+0.000
	530.318	**506.938**	(23.380)

Detailed commentary on wholesale operating costs and efficiencies is provided in support of table E and is not repeated in this document.

More detailed commentary on Non Regulated and Retail activities is provided in this document.

Activity Analysis

	2007/08	2006/07	Variance
	£m	£m	£m
Non Regulated	27.740	28.343	+0.603
Wholesale (excluding PFI)	465.440	435.450	(29.990)
Retail	37.138	43.145	+6.007
	530.318	**506.938**	(23.380)

Non Regulated activity costs have reduced by £0.6m from 2006/07 to £27.7m. Direct costs have reduced by £1.4m, General & Support by £0.8m and other operating expenditure has increased by £(1.6)m.

The key movements in Non Regulated Operating Costs from 2006/07 were:

- Reduction due to reclassification of Non Domestic Septic Tank Emptying from Non Regulated to 3rd Party Core £0.8m;
- There has been an increase in bad debt provision on non regulated activity of £(2.2)m due to an increase in the value and age of customer debt on these activities, associated with the transfer of sundry billing from Business Stream to Scottish Water;
- Waste Services have grown the breadth of services offered to customers and increased the number of sites that SW Waste Services operate from, resulting in increased costs, offset by income, of £(0.5)m;
- Reduction in other non regulated activity of £2.5m, mainly due to switch on infrastructure work carried out by Scottish Water Solutions to internal delivery.

Wholesale activity cost movements are explained in support of E Tables and are not repeated in this document.

Retail activity costs have decreased by £6.0m. This includes two atypical cost movements:

- £(0.5)m increase in CMA set up costs from £1.5m in 2006/07 to £2.0m in 2007/08; and
- £11.6m release in household bad debt provision (£6.0m in 2006/07).

Other movements year on year were:

- £(1.0)m due to inflationary increases in the council billing and collection services;
- £6.7m reduction in expenditure, due to the full year effect of business retail activity transferring to Business Stream (£6.1m functional and £0.6m reduction in bad debt);
- £(1.5)m increase in household debt provision to reflect caused by tariff increases;
- £0.8m reduction to depreciation, mainly IT, due to the transfer of Business Stream;
- £(0.6)m increase due to additional separation and wholesale revenue management activity, most notably additional vacant property surveys;
- £4.1m increase due to inclusion of the costs of services provided to Business Stream under service agreements, offset by a reduction of £1.1m in other costs, mainly business activities depreciation due to the transfer of business retail activity to Business Stream. These costs were netted off Scottish Water's expenditure for the purpose of group reporting. However, for the purposes of regulatory reporting this expenditure has been added back to report the full cost of providing these third party services. In 2006/07 the costs for the 5 months of Business Stream trading (£1.7m) were not added back to regulatory results.

Retail costs by segment

	2007/08 £m	**2006/07** £m	**Variance** £m
Domestic	28.165	31.609	+3.444
Non Domestic - Measured	4.061	7.564	+3.502
Non Domestic - Non Measured	2.977	2.676	(0.300)
	35.203	**41.849**	+6.646

Domestic customer retail total functional and operating expenditure has reduced by £3.4m. The main movements from 2006/07 were:

- Atypical release of bad debt provision £5.6m (£11.6m in 2007/08 combined with £6.0m in 2006/07);
- £(1.5)m increase in household debt provision to reflect tariff increases;
- Inflationary increase in the cost of council billing and collection services £(1.0)m;
- Reduction in costs of internal regulation £0.2m.

Non domestic customer retail total functional and operating expenditure has reduced by £3.2m to £7.0m (£4.1m measured and £3.0m unmeasured). The main movements from 2006/07 were:

- £6.7m reduction in expenditure, due to the full year effect of business retail activity transferring to Business Stream (by £6.1m functional expenditure and £0.6m in bad debt costs);

- £(0.6)m increase due to additional separation and wholesale revenue management activity, most notably additional vacant property surveys;
- £(0.5)m increase in CMA set up costs from £1.5m in 2006/07 to £2.0m in 2007/08; offset by reduced internal regulation costs £0.2m;
- £(2.7)m increase due to change in regulatory reporting year on year to include the costs of services provided to Business Stream under service agreements.

Since the transfer of business retail activity to Business Stream, the majority of Non Domestic costs are incurred in 3 main areas:

- Scottish Water's Wholesale Revenue Management team responsible for wholesale billing and account management, and interface with Licensed Providers and the Central Market Agency (CMA);
- The CMA costs charged to Scottish Water for set up and operation of the CMA systems and processes;
- The cost of providing services to Business Stream under service agreements.

Scottish Water does not have access to business customer details. However, Scottish Water does have knowledge of properties and services. Therefore the costs of activities are allocated to customer and service, primarily on the basis of properties and services volumes, except where activities are clearly attributable to one service, e.g. trade effluent billing service.
The cost of handling customer calls has been split by service based on the number of calls. Licensed Providers are now responsible for handling calls from business customers. The cost of initial customer contact related to wholesale activities will be incurred by Licensed Providers. However, where Licensed Providers require information or action from the wholesaler, this is the responsibility of the wholesaler. In this case the costs of calls are included under wholesale activities, e.g. water distribution includes the cost of all customer contact on this type of activity, e.g. low pressure calls, water rising calls. Therefore, no cost is shown in line M18WW.29 and M18W.30 under retail.

Water / Wastewater Analysis

Non Regulated	**2007/08**	**2006/07**	**Variance**
	£m	£m	£m
Water	17.633	18.325	+0.692
Waste	9.648	9.265	(0.383)
	27.281	**27.590**	+0.309

The movement in Non Regulated functional and operating expenditure at water and wastewater level, is due to:

- A reclassification of Non Domestic Septic Tank Emptying from Non Regulated to 3rd Party Core (£0.8m).
- There has been an increase in bad debt provision on non regulated activity of £(2.1)m due to an increase in the value and age of customer debt on these activities (Water £0.8m, Wastewater £1.3m).
- Waste Services have grown the breadth of services offered to customers and increased the number of sites that SW Waste Services operate from, resulting in increased costs, offset by income, of £(0.5)m.

- Reduction in other non regulated activity of £2.5m, mainly due to switch on infrastructure work carried out by Scottish Water Solutions to internal capital (Water £1.5m, Wastewater £1.1m).

Retail	**2007/08** £m	**2007/08** %	**2006/07** £m	**2006/07** %
Water - Domestic	14.123	38%	15.742	36%
Water - Non Domestic	4.616	12%	5.207	12%
Wastewater - Domestic	14.237	38%	16.021	37%
Wastewater - Non Domestic	4.162	11%	6.175	14%
	37.138		**43.145**	

The split of Retail operating costs between water and wastewater level has remained broadly consistent with 2006/07 (50% water, 2007/08 versus 49%, 2006/7).