

Annual Return 2008/09

Overview

DOCUMENT CONTROL

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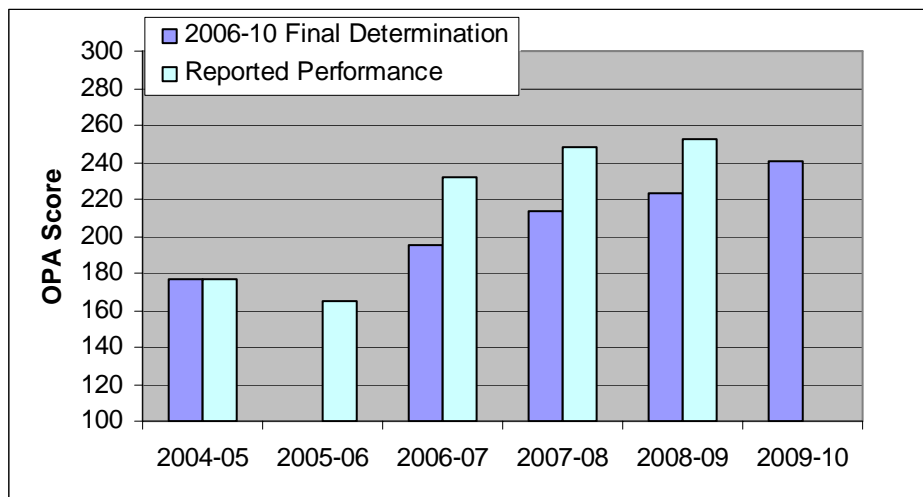
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1. Executive Summary

This overview document reports on Scottish Water's performance and activities in 2008/09, the third year of the 2006 - 10 regulatory period. We are pleased with the progress we have made addressing the challenges we took on when accepting the final determination of the 2006 price review. In particular we are pleased with our OPA performance and output delivery, where we have delivered 81.1% of Q&S3 outputs against a target of 76.7%. Our principal achievements in 2008/09 are highlighted below.

Overall Performance Assessment

We are delivering a major programme to improve performance in most of the twelve measures that comprise the Overall Performance Assessment (OPA). That programme has demonstrated good progress, with the score for 2008/09 of 252 showing a 53% improvement over the corresponding reported performance for 2005/06 despite the removal of a potential nine points as a result of billing contacts no longer being part of our OPA measurement. While our OPA score is sensitive to major events which may reduce our score we believe that we remain on course to out-perform the 241 target for 2009/10.



Leakage

Our reported leakage for this report year is 801.7 MI/d, a 122 MI/d reduction on our reported leakage from 2007/08. Therefore, we have succeeded in meeting our interim leakage target for 2008/09 to reduce leakage to between 855-825 MI/d.

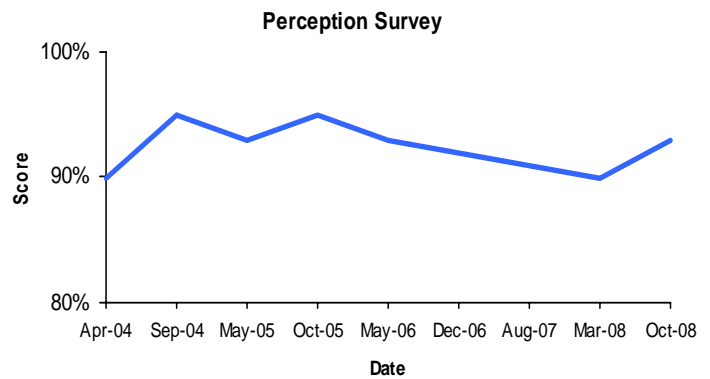
Customer Satisfaction Measures

There are two main measures of satisfaction that we use:

- Perceptions Survey
- Transactional Survey

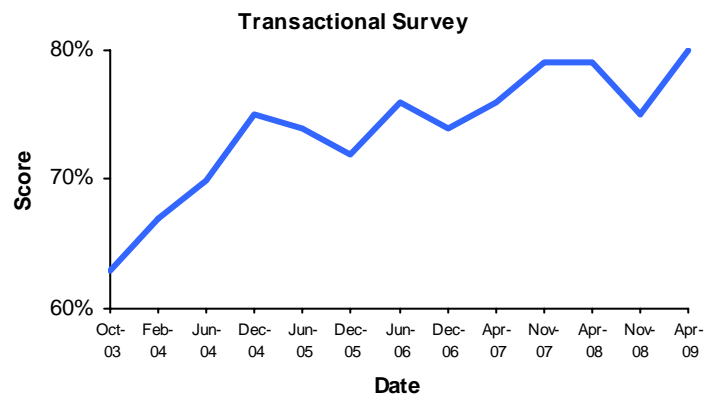
Perceptions Survey

We monitor the needs, expectations and experiences of our customers. This is measured independently twice a year through a survey of a random sample of the Scottish household population. Scottish Water has been consistently recording perception based customer satisfaction at, or above, 90% since April 2004.



Transactional Survey

It is important that we continue to drive improvements in the experiences that we provide to our customers when they have reason to contact us. In general, customers who contact Scottish Water have an issue which we should endeavour to resolve as quickly as possible while keeping them updated on our progress. We track our customers' satisfaction with how effectively we do this, through this independently managed survey. The survey is carried out twice a year with 1,600 customers who have contacted us.



Overall satisfaction with the outcome of customers' contact has reached an all time high of 80% (Apr-09).

Our performance against our published guaranteed standards of service improved from 99.16% in 2007/08 to 99.57% in 2008/09. This compares with 91.4% at the formation of Scottish Water.

We again maintained unconstrained supplies to all our customers during the report year.

We have continued with our programme of community and stakeholder engagement on a wide number of issues.

Compliance

Overall water quality compliance

Overall compliance with water quality standards continues to be of a very high standard for the 2008 calendar year, with 99.81% of all water quality tests conducted in our sampling programme complying with quality standards (2007: 99.81%; 2006: 99.76%).

Compliance at customers' taps (used for calculation of OPA) was again very high at 99.75% in 2008, comparable with 99.76% in 2007.

Wastewater Treatment

The final WWTW compliance figures have been finalised and agreed with SEPA as 24 failing WWTW at 31 March 2009 against a target of 39. This is an improvement of 7 in the year (2007/08 31 failing WWTW). We are continuing to drive WWTW compliance by investing in assets and by making improvements in operating activities and processes.

Bathing Waters

Scotland had 80 bathing waters officially designated under the EU Bathing Water Directive for the 2008 Bathing Season, with 69 bathing waters that may be directly impacted by Scottish Water assets. The bathing water results were poor in 2008 which has been attributed to the exceptionally wet summer experienced in Scotland. This followed a similar pattern to 2007.

During the 2008 Bathing Season, five of the 69 bathing waters that may be impacted by Scottish Water's discharges failed to achieve the minimum mandatory standard. One of these failures, Portobello Central, was attributed directly to discharges from Scottish Water assets.

Investment

Outputs

Q&SII: Scottish Water delivered the 2008/09 target of 99.55% of outputs at Beneficial Use.

Q&SIII: We outperformed our 2008-09 Delivery Plan target of 76.7% of outputs with an outturn of 81.1%.

Q&SIII and Q&SII Conclusion Programme

We delivered £686.5m of investment, within the Delivery Plan range of £650m-£690m.

The current forecast indicates that the investment programme will be delivered for £2,556.4m against a total funding allowance (Regulatory & Other Sources) of £2,547.9m, giving an overall central forecast of a programme liability of £8.5m. Taking account of the cost and funding opportunities and risks, we expect the out-turn position to be within the range of +/- £40m.

Financials

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £219.8 million for 2008/09. Actual net new borrowings in 2008/09 were £219.8 million, being £161.3 million for Scottish Water and £58.5 million for Scottish Water Business Stream Holdings Ltd.

Board Changes

During the report year the following changes have occurred in Scottish Water's Board.

Peter Farrer joined the Board in October 2008 as Customer Service Delivery Director.

Graeme Crombie, Ian McMillan and Rita Theil left the Board of Scottish Water on 31 March at the end of their respective appointments.

Three new Non-Executive Directors joined the Board on 1 April 2009. These are Dr James M Spowart, Alan Bryce and Andrew Wyllie. Pat Kelly was also reappointed as a Non-Executive Director from 1 April 2009.

Since 31 March 2009, Alistair Buchanan has now resigned from the Board and Lynne Peacock has joined as a Non-Executive Director.

Information Improvements

We have continued to build on the foundations we laid in earlier years improving the completeness, availability, reliability, access to and reporting of information. Our information is dependent on our staff and contractors complying with processes for data collection and processing. In 2008/09, compliance has improved, aided in part by systems improvements that require users to enter data in a specified manner. In addition, we are continuing our development of CISP, our Capital Investment Systems and Process project. This project will address a number of issues for our capital investment reporting including:

- a reduction in the number of non-corporate tools used to support the management and governance of the capital investment programme (spreadsheets, databases etc.);
- improvements in regulatory compliance, and consistency and accuracy, in external reporting; and
- improvements in data confidence grades.

Governance of the Annual Return

The methodologies and processes used for producing the detailed information in Scottish Water's 2007/08 Annual Return to the Water Industry Commission have been further enhanced for this 2008/09 Return by improvements to data collection and reporting systems in specific areas (such as sewer flooding recording). This approach, along with the formal audits carried out by the Regulatory Reporter, has ensured that this submission is based on sound processes and assumptions. The governance of the production of this Return has increased this year with the assurance statements' process being extended beyond Director/General Manager level to include data table owners.

Scottish Water's Board has endorsed this Annual Return Overview and charged the Chief Executive with the responsibility to establish and maintain sound systems of internal control that support the completion of the Annual Return submission to the Water Industry Commission. The Board assurance statement signed by the Chief Executive is included in Appendix 1.

2. Key Outputs and Service Delivery

2.1 Service outputs and performance

Overall Performance Assessment (OPA)

We are delivering a major programme to improve performance in most of the twelve measures that comprise the Overall Performance Assessment (OPA). That programme has demonstrated good progress, with the score for 2008/09 of 252 showing a 53% improvement over the corresponding reported performance for 2005/06 despite the removal of a potential nine points as a result of billing contacts no longer being part of our OPA measurement. While our OPA score is sensitive to major events which may reduce our score we believe that we remain on course to out-perform the 241 target for 2009/10.

OPA Performance by Service

	2006/07	2007/08	2008/09
Water Service	104	114	125
Sewerage Service	68	69	71
Customer Service	25	27	18*
Environmental Performance	35	38	38
Total	232	248	252
WICS Target	195	213	223

* Response to billing contacts was removed completely from the OPA measure at the start of the 2008/09 report year.

Significant Improvements

The areas, in which we made the most significant improvement in 2008/09 are:

- Properties subject to inadequate water pressure reduced from 5,907 (0.24% of properties) to 2,974 (0.12 %) (+8.1 points);
- Leakage 7.5% above target level in 2007-08 improved to 4.5% below target level in 2008-09 (+5 points)

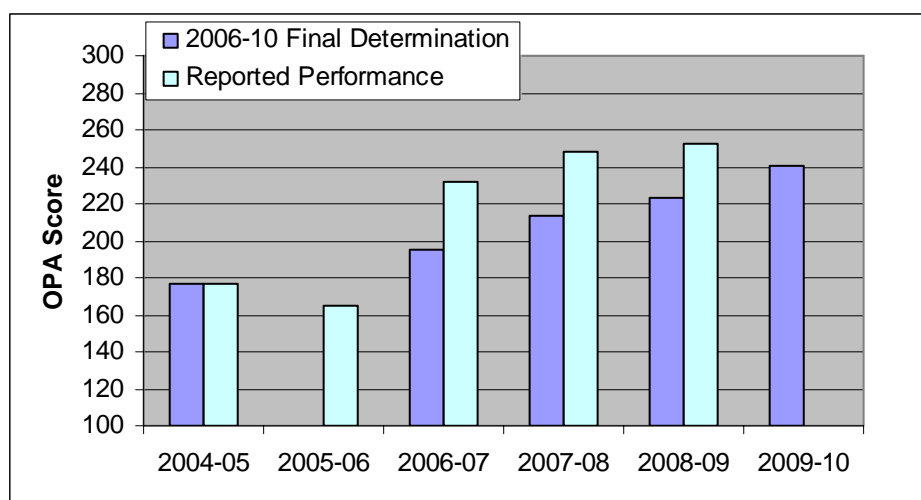


Table 2.1 below shows our performance on each of the measures:

Table 2.1: OPA Performance

Indicator	AR08 OPA performance	AR09 OPA performance	AR08 weighted OPA score	AR09 weighted OPA score	Change
% of water samples that comply with parameters	99.76%	99.75%	43.3	43.0	-0.3
% of properties subject to inadequate water pressure	0.24%	0.12%	21.6	29.5	7.9
Connected properties experiencing unplanned interruptions	0.80%	0.95%	29.6	27.9	-1.8
Hosepipe restrictions	0	0	25.0	25.0	0.0
Leakage	7.49%	-4.78%	15.0	20.0	5.0
% properties suffering sewer flooding incidents caused by overloading	0.00184%	0.00175%	24.8	24.8	0.1
% properties suffering sewer flooding incidents caused by other causes	0.00768%	0.00730%	33.4	33.9	0.5
Sewer flooding (at risk)	0.02232%	0.01639%	11.2	11.9	0.8
Sewage sludge disposal	0.00%	0.00%	12.5	12.5	0.0
% pe served by non-compliant sewerage treatment works	10.11%	10.40%	5.0	5.0	0.0
% written complaints responded to within 10 days	99.95%	100.00%	9.3	9.4	0.1
% telephone calls answered within 30 seconds	97.34%	97.41%	9.0	9.0	0.0
			248.4	251.9	3.5

Each of the OPA elements and their scores are discussed below.

Percentage of water samples that comply with parameters

Our water quality performance is discussed in Section 2.2 below.

Percentage of properties subject to inadequate water pressure

During 2006/07 we put in place new systems and processes to record properties that have reported inadequate water pressure. This gave us a comprehensive, live corporate system with the address of every property in Scotland which has a historic report of inadequate pressure. This improved reporting, combined with targeted capital improvements during the report year and operational changes has led to a reduction of the number of properties on the register from 5,907 to 2,974.

Connected properties experiencing unplanned interruptions

Table 2.2 shows the improvement in reducing the number of properties that experience unplanned interruptions. We have placed great emphasis on the speed of restoration following an unplanned interruption with a strong focus on maximising the number of restorations that can be achieved in less than six hours. During this period we have had two major incidents affecting 5,318 properties (6 to 12 hours) in Baillieston, Glasgow and 3,884 properties (12 to 24 hours) in Helensburgh. This has affected the overall performance of this indicator during the past 12 months.

Table 2.2: Unplanned interruptions to supply

	2007/08	2008/09
Properties interrupted for 6 to 12 hours	15,474	12,064
Properties interrupted for 12 to 24 hours	934	5,748
Properties interrupted for more than 24 hours	666	71
Total number of properties interrupted for more than 6 hours	17,074	17,883
Total number of properties interrupted for more than 12 hours	1,600	5,819

Hosepipe restrictions

We have not required any hosepipe restrictions since Scottish Water was formed in 2002.

Leakage

Our reported leakage for this report year is 801.7 MI/d, a 122 MI/d reduction on our reported leakage from 2007/08. Therefore, we have succeeded in meeting our interim leakage target for 2008/09 to reduce leakage to between 855-825 MI/d.

Number of incidents of sewer flooding caused by overloading of main sewers

In 2008/09 there were 56 incidents of flooding from overloaded mains sewers that caused internal flooding of customers' properties. This was an increase of 12 incidents from the number of incidents reported for 2007/08. This should be considered against the exceptional weather experienced during August 2008 which saw 31 incidents in what has been reported as the 'Wettest Summer' on record.

Our work in 2008/09 has improved the compliance with our new systems and processes, such that in February and March 2009 compliance was consistently greater than 90%. Therefore, we have not re-introduced the off-line uplift of data which was used in previous Returns and now report sewer flooding information directly from corporate systems.

Number of incidents of sewer flooding from other causes on main sewers

In 2008/09 there were 175 incidents of flooding from other causes on main sewers that caused internal flooding of customers' properties. This was a decrease of 9 incidents from 2007/08. Again, this was against a backdrop of 40 incidents in August 2008.

Sewer flooding (properties at risk)

Our register of properties at risk of flooding from overloaded sewers has reduced from 563 in 2007/08 to 383 in 2008/09. This reduction has resulted from a combination of reviews of information, to remove properties where there has been no record of flooding, and investment projects to upgrade the sewer networks.

Table 2.3: Properties at risk of flooding from sewers

	2007/08	2008/09
At risk of flooding twice in ten years	307	203
At risk of flooding once (but less than twice) in ten years	256	180
Total number of properties at risk of flooding at least once in ten years	563	383

Sewage sludge disposal

All sewage sludge from Scottish Water is disposed of through approved routes in compliance with all relevant legislation.

Percentage of population equivalent served by non-compliant sewerage treatment works

The compliance of Scottish Water's waste water treatment works remains unsatisfactory. In 2008/09, 10.4% of the population equivalent in Scotland was served by waste water treatment works that were non-compliant. This is poorer than the typical performance in England and Wales. We have a major programme of works in hand to improve performance to less than 5% non-compliance (exc Dalmeir) by March 2010. Almost half of the waste water load in Scotland is treated at waste water treatment works operated under PFI contracts. Two PFI works are non-compliant (Dalmeir and Fraserburgh) and contribute significantly (8.31% non-compliant) to the poor performance on this measure. Our programme of works includes investment and actions at many works to improve performance.

Percentage written complaints responded to within 10 days

Performance on this measure has shown an improvement to the maximum value of 100% in 2008/09 from 99.95% in 2007/08.

Percentage telephone calls answered within 30 seconds

We answered telephone calls more quickly in 2008/09 than in 2007/08. A total of 97.4% of calls were answered within thirty seconds, compared with 97.3% in 2007/08.

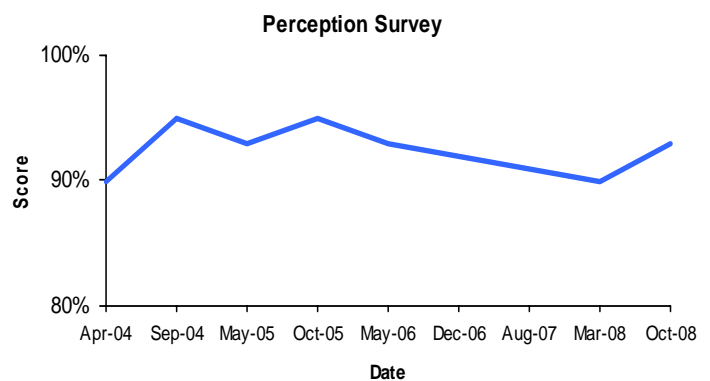
Other Customer Service measures

There are two main measures of satisfaction that we use:

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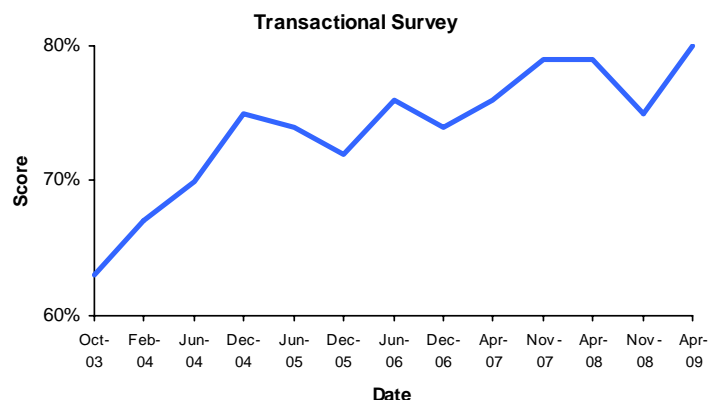
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Transactional Survey

It is important that we continue to drive improvements in the experiences that we provide to our customers when they have reason to contact us. In general, customers who contact Scottish Water have an issue which we should endeavour to resolve as quickly as possible while keeping them updated on our progress. We track our customers' satisfaction with how effectively we do this, through this independently managed survey. The survey is carried out twice a year with 1,600 customers who have contacted us.



Within this survey we track customers' experience against different points in their journey; these are initial contact, visit from a representative and work carried out. Overall satisfaction with the outcome of the customer's contact has reached an all time high of 80% (Apr-09).

Our performance against our published guaranteed standards of service improved from 99.16% in 2007/08 to 99.57% in 2008/09. This compares with 91.4% at the formation of Scottish Water.

We again maintained unconstrained supplies to all our customers during the report year.

We have continued with our programme of community and stakeholder engagement on a wide number of issues.

2.2 Drinking Water Service

Compliance - Water quality compliance

Overall water quality compliance

Overall compliance with water quality standards continues to be of a very high standard for the 2008 calendar year, with 99.81% of all water quality tests conducted in our sampling programme complying with quality standards (2007: 99.81%; 2006: 99.76%).

Compliance at customers' taps (used for calculation of OPA) was again very high at 99.75% in 2008, comparable with 99.76% in 2007.

Microbiological quality

Microbiological standards apply to water leaving treatment works, in service reservoirs and supplied at customers' taps.

a) water leaving treatment works

In 2008, 31,487 samples were taken for faecal coliforms and 31,488 samples were taken for total coliform analysis. Compliance with the faecal coliform standard was 99.97% (99.97% in 2007) and with the total coliform standard was 99.76% (down from 99.90% in 2007, partly due to raw water quality issues).

b) water in service reservoirs

In 2008, 55,134 samples were taken for faecal coliforms and 55,136 were taken for total coliform analysis. Compliance with the faecal coliform standard was 99.98% (up from 99.97% in 2007) and the total coliform standard was 99.75% (down from 99.77% in 2007).

c) water at customers' taps

In 2008, 14,468 samples were taken for faecal coliforms and total coliform analysis. Compliance with the faecal coliform standard was 99.99% (up from 99.97% in 2007) and the total coliform standard was 99.45% (down from 99.46% in 2007).

While compliance with the total coliform standard remained high there has been a small deterioration in quality, compared with the very high performance in 2007. Several factors, including raw water quality and sample point issues, have contributed to this minor deterioration and we continue to examine all the data to fully understand what improvements can be made.

The following summary table highlights performance in water quality for microbiological quality from 2005 to 2008 based on regulation samples:

Table 3.1: Microbiological quality of water

		2005 fails	2005 compliance	2006 fails	2006 compliance	2007 fails	2007 compliance	2008 fails	2008 compliance
Treatment Works	Coliforms	130	99.61%	70	99.79%	33	99.90%	76	99.76%
	Faecal Coliforms	57	99.85%	24	99.93%	10	99.97%	10	99.97%
Service Reservoirs	Coliforms	224	99.60%	123	99.78%	128	99.77%	137	99.75%
	Faecal Coliforms	35	99.94%	32	99.94%	16	99.97%	11	99.98%
Customer Taps	Coliforms	138	99.03%	114	99.22%	78	99.46%	79	99.45%
	Faecal Coliforms	21	99.85%	9	99.94%	5	99.97%	2	99.99%

Chemical sampling

Physical and chemical standards apply to water supplied at customers' taps. 121,517 tests were carried out at customers' taps for all parameters during 2008. Of these 99.75% (99.76% in 2007) complied with the regulatory standards.

The following summary table highlights the performance of the key chemical parameters for 2005 to 2008.

Table 3.2: Chemical quality of water

	2005 fails	2005 compliance	2006 fails	2006 compliance	2007 fails	2007 compliance	2008 fails	2008 compliance
THM Total	101	94.20%	93	94.75%	77	95.57%	81	95.19%
Iron	79	98.52%	70	98.70%	50	99.07%	70	98.67%
Colour	81	98.49%	46	99.15%	28	99.48%	15	99.72%
Manganese	44	99.18%	43	99.20%	45	99.16%	41	99.22%
Aluminium	33	99.38%	28	99.48%	16	99.70%	13	99.75%

Abstraction Licensing

From 1 April 2006 all of Scottish Water's operational abstractions and impoundments together with non operational impoundments >1m high were authorised under the Water Environment (Controlled Activities) (Scotland) Regulations 2005 (CAR). We have the relevant authorisations for all of our abstraction and impoundment activities which cover 358 Direct Operational raw water sources (not including our indirect raw water sources). In addition we have authorisations for a further 191 non-operational sites.

With the introduction of the Controlled Activity Regulations, Scottish Water is required through the WR5 driver to install measurement and monitoring equipment to facilitate reporting of licence conditions to SEPA. As part of WR5, Monitoring Plans have been submitted to SEPA which detail where and how Scottish Water proposes to measure and record the parameters stipulated in the CAR authorisation. These Monitoring Plans will have the status of an Appendix to the Water Use Licence. Installation of measurement and recording equipment was completed by March 2009 with data available on telemetry for all sites by mid 2009.

During 2009/10 it is the intention to establish a baseline of Scottish Water's compliance against the conditions laid out in the Water Use Licences with a view to setting internal compliance targets for the period after 2010.

Water Resource Strategic Studies

We have been progressing with the development of water resource strategic studies in 78 Water Resource Zones to inform our investment programme during the current period. These studies are focused on understanding the limitations that the new standards associated with Water Framework Directive have on our abstraction activity. This work has been progressed in partnership with SEPA and SNH.

In the reporting year we have completed the Value Management process for 21 Water Resource Zones. There are still 6 WRZ where final agreement has not been reached due to concerns over data or the cost effectiveness of the scheme. In addition we have made significant progress in securing variations to abstraction licences or agreeing that no capital intervention is required to comply with SEPA's requirements. This has resulted in a total of 45 cumulative outputs being submitted for Regulatory Sign-off by 31 March 2009 (42 already signed off by SEPA).

2.3 Wastewater Service

Compliance - Wastewater Serviceability

Wastewater Treatment

The final WWTW compliance figures have been finalised and agreed with SEPA as 24 failing WWTW at 31 March 2009 against a target of 39. This is an improvement of 7 in the year (2007/08 31 failing WWTW). We are continuing to drive WWTW compliance by investing in "not fit for purpose" assets and by making improvements in operating activities and processes.

Bathing Waters

Scotland had 80 bathing waters officially designated under the EU Bathing Water Directive for the 2008 Bathing Season, with 69 bathing waters that may be directly impacted by Scottish Water assets. The bathing water results were poor in 2008 which has been attributed to the exceptionally wet summer experienced in Scotland. This followed a similar pattern to 2007.

During the 2008 Bathing Season, five of the 69 bathing waters that may be impacted by Scottish Water's discharges failed to achieve the minimum mandatory standard. One of these failures, Portobello Central, was attributed directly to discharges from Scottish Water assets.

Pollution Incidents

The submission of the 2007/08 Wastewater Quality Compliance Table 1 return to the Commission by SEPA, reporting 939 pollution incidents, provided the basis for setting the baseline of Scottish Water's 'wastewater' pollution incident performance on which to reset the 'no deterioration' serviceability indicator target. Prior to this they were as set out in the Ministerial Directions at [555].

Scottish Water and SEPA have agreed the number of Pollution Incidents for the report year 2008/09 as 830.

As this is only the second year data has been collected it is difficult to comment on trends, however it is noted the pattern throughout the year is similar to 2007/08, although numbers in the first quarter of 2008/09 were significantly reduced from 2007/08 and the numbers in the last quarter appear to be slightly increased from 2007/08.

During this year we carried out work to raise the profile of pollution incidents within Scottish Water and further educate staff involved in dealing with pollution incidents, including a series of roadshows across Scotland. We are working continuously with SEPA to agree new and/or improved processes to aid more robust reporting of pollution incidents arising from Scottish Water assets. We have also jointly undertaken close scrutiny of the pollution incident records for the report year such that Scottish Water's 'baseline' performance is more accurately understood and reflected.

Unsatisfactory Intermittent Discharges (UIDs)

During 2008/09, Scottish Water has delivered 108 UID outputs, with a total of 162 number UIDs being improved during the period 1 April 2006 to 31 March 2009. The outputs comprise physical improvement, operational interventions, and those where modelling has confirmed no need for physical intervention.

It is currently anticipated that the Q&SIIIa UID programme will comprise 251 outputs as opposed to the original 277.

2.4 Progress on Q&SII and Q&S III Capital Investment Programme

Q&SII OUTPUT DELIVERY

The outputs delivered to date against the WIC18 Ver 3.6 baseline targets, are detailed in the table below. Scottish Water delivered the 2008/09 target of 99.55% of outputs at Beneficial Use. 1,039 projects out of the reported total of 1,161 projects within the Quality programmes, or 89%, obtained sign-off from the Quality Regulators by March 2009.

Q&SII PROGRAMME			WIC18 Target	Delivered Outputs to End March 2009	% To date
DW – FT	Properties receiving FT provision of water	nr	408	408	100%
DW – P	Removal of properties from the poor pressure register	nr	1391	1391	100%
DW – WQ	Drinking Water drivers addressed	nr	592	583	98.5%
WM – R	Mains rehabilitated	km	3051	3051	100%
WW – C	Continuous discharges removed	nr	582	574	98.6%
WW – FR	Removal of properties from 'at risk' flooding register	nr	829	829	100%
WW – FT	Properties receiving FT provision of sewerage	nr	667	667	100%
WW – R	Sewers rehabilitated	km	409	409	100%
WW – uCSO	uCSOs removed	nr	428	423	98.8%
				Overall	99.55%

- The target for DW-WQ has been adjusted to account for the agreed removal of the outputs associated with Shildaig.
- The target for WW-C has been reduced from 585 to 582 to account for the agreed removal / deferral of the following projects: Blackridge, Cairndow and Lochgair.
- The target for WW-uCSOs has been reduced by 1 to 428 to account for the agreed removal of Edderton ST SWO, which will be delivered by the Q&S3 growth programme.
- Scottish Water has still to deliver the outstanding flooding projects at Creetown and Campbeltown, from the original flooding programme, which will deliver a further 26 outputs. However, two projects with 24 outputs were accelerated to deliver in 2006/07, to ensure the target was achieved with a total of 830 properties removed from the Flooding Register against the target of 829.

A total of 22 outputs remain to be delivered, 16 of which are forecast to deliver in 2009/10, a further 4 in 2010/11, and the remaining 2 in 2011/12.

Q&SIII OUTPUT DELIVERY

We outperformed our 2008-09 Delivery Plan target of 76.7% of outputs with an outturn of 81.1%. Early delivery of customer and environmental benefits was achieved across much of the programme (see table below). For example, we delivered 10 outputs against a March

2009 target of 9 for 'the Number of works where odour problem is addressed'. We delivered early benefits in the 'Number of unsatisfactory intermittent discharges improved' with 162 being improved against the target of 145, and we delivered 18 outputs against a target of 16 for the 'Number of wastewater treatment works' discharges improved to meet new consent requirements.

Q&SIII PROGRAMME			Delivery Plan Target 2006-09	Delivered Outputs to End March 2009	Q&SIIIa Target	% To 31/3/09
Customer Service	Number of works where odour problem is addressed	nr	9	10	14	71.4
WQ	Improve drinking water quality for 1.5m people (m)	nr	2.49	2.5	3.00	83.3
WQ	Improve disinfection control for 4m people	nr	2.54	2.54	4.31	58.9
WQ	Number of water resource zones with reduced abstraction	nr	40	45	78	57.7
WQ	Number of water sources provided with flow monitoring and recording	nr	521	521	521	100
WQ	Number of flood studies undertaken	nr	23	23	30	76.7
WQ	Number of backflow prevention devices installed	nr	235	235	235	100
WQ	Number of cross connections made redundant	nr	4500	4937	5500	89.8
WQ	Number of sites with increased security	nr	898	901	1016	88.7
WQ	% of population covered by water safety plans	%	46	47.54	50	94
WWQ	Number of unsatisfactory intermittent discharges improved	nr	145	162	304	53.3
WWQ	Number of WW treatment works discharges improved to meet new consent requirements	nr	16	18	27	66.7
WWQ	Number of First Time Provision projects to meet environmental objectives in the Directions (cumulative)	nr	5	5	9	55.6
WWQ	Number of WW treatment works upgraded to meet existing consent requirements	nr	14	14	18	77.8
WWQ	Number of management and monitoring systems at works to meet IPPC Regulations	nr	1	1	1	100
WWQ	Number of landfill sites contained, monitored and decommissioned	nr	15	15	17	88.2
Relieving development constraints	Provide strategic capacity at WW treatment works (pe)	nr	28000	55505	42094	131.9
Relieving development constraints	Provide strategic capacity at W treatment works (pe)	nr	81888	114364	174693	65.5
				Overall		81.1%

Good progress has been made during the year across many programme areas on output sign-off. At March 2009, 41% of the programme had received regulatory sign-off with a further 4.5% currently submitted to the Regulators.

Q&SIII and Q&SII Conclusion Programme Financial Profiles

We delivered £686.5m of investment, within the Delivery Plan range of £650m-£690m.

The current forecast indicates that the investment programme will be delivered for £2,556.4m against a total funding allowance (Regulatory & Other Sources) of £2,547.9m, giving an overall central forecast of a programme liability of £8.5m. Taking account of the cost and funding opportunities and risks, we expect the out-turn position to be within the range of +/- £40m.

3. Expenditure, Financial Performance and Efficiency

HCA financial results

The table below compares the Historical Cost Accounting results for Scottish Water's activities to March 2009 excluding subsidiaries. The financial results reflect Financial Reporting Standard No 17 "Retirement Benefits" (FRS 17).

£'M HCA	2008/09	2007/08	Variance
Turnover	1,029.7	986.7	43.0
Operating Costs	422.8	386.5	-36.3
Depreciation/amortisation	266.5	251.6	-14.9
Gain on Sale of Assets	-1.5	-9.3	-7.8
FRS17 Adjustment	-3.3	3.7	7.0
Total costs	684.5	632.5	-52.0
Operating Surplus before Interest	345.2	354.2	-9.0
FRS17 Adjustment – Finance adjustment	1.3	-5.3	-6.6
Net Interest	149.5	140.3	-9.2
Profit before tax – Regulated	194.4	219.2	-24.8
Profit before tax – Non Regulated	0.8	3.0	-2.2
Profit before tax – Scottish Water	195.2	222.2	-27.0
Taxation Charge	59.1	38.1	-21.0
Profit after tax	136.1	184.1	-48.0

For the year ending 31 March 2009 Scottish Water's costs (excluding subsidiaries and FRS 17 costs) totalled £687.8 million. Costs included in tables E1 (£318.8 million), E2 (£234.5 million) and E3 (£136.1 million) total £689.4 million. The £1.6 million difference relates to costs recharged to Business Stream under Service Agreements. These costs have been netted off against Scottish Water's expenditure in line with group inter-company transaction reporting.

The surplus before tax in the year for Scottish Water was £195.2 million, £27.0 million lower than in 2007/08 (2008 - £222.2 million). The regulated surplus before tax was £24.8 million lower at £194.4 million (2008 – £219.2 million). The surplus for non regulated activities was £2.2 million lower at £0.8 million. This was due to many of the non regulated activities now being carried out by Horizons.

Turnover

Regulated turnover for the year totalled £1,029.7 million (2008 - £986.7 million) and is analysed by category in the table below:

	2008/09	2007/08	Change
	£m	£m	£m
Household	704.7	673.7	31.0
Wholesale	319.9	305.5	14.4
Other	5.1	7.5	-2.4
Total regulated turnover	1,029.7	986.7	43.0

Turnover from services supplied to household customers increased by £31.0 million or 4.6% to £704.7 million driven mainly by the tariff increase effective from 1 April 2008. Turnover from wholesale services supplied to Licensed Providers increased by £14.4 million or 4.7%

to £319.9 million. Turnover from other sales reduced by £2.4 million to £5.1 million reflecting the transfer of building water services to Business Stream during 2008/09.

Total costs

Total costs of £684.5 million were £52.0 million higher than in 2007/08.

The main operating cost increases were due to higher levels of network maintenance in order to improve customer service and reduce leakage of £12.5 million, higher bad debt charges of £9.1 million, new operating costs associated with new assets coming into operation of £3.0 million and increased local authority rates and SEPA charges of £4.9 million. The cost of the PFI schemes in the year was £132.6 million, £5.1 million higher than in 2007/08 due primarily to contract indexation which on one scheme was impacted significantly by increases in gas prices.

Depreciation, including infrastructure depreciation, increased by £14.9 million to £266.5 million. The main reason for the increase was a higher Infrastructure Maintenance Charge to reflect the level of long term forecast infrastructure investment. The gain on sale from asset disposals was £7.8 million lower than in 2007/08 at £1.5 million.

However, these increases were partially offset by a £7.0 million reduction in FRS 17 pension costs.

From a regulatory cost perspective, nominal operating costs (i.e. excluding depreciation, PFI charges, FRS 17 pension charges and costs associated with non regulated activities) increased by £31.2 million to £290.2 million compared to £259.0 million in 2007/08. On a like-for-like basis regulated operating costs increased by £7.5m, a 2.9% nominal increase. The table below summarises this movement:

	2008/09 £m	2007/08 £m	(inc)/dec £m	%
Regulated Operating Costs (SW only)	290.2	259.0	-31.2	
CMA start-up / running costs	-0.6	-2.0	-1.4	
A typical bad debt credit	8.1	17.6	9.5	
VR costs	-3.5	-3.4	0.1	
Leakage reduction costs	-20.8	-8.3	12.5	
New Opex	-3.0		3.0	
Like-for-like nominal costs	270.4	262.9	-7.5	-2.9%
Average inflation (2.97%)		7.8	7.8	
Like-for-like nominal costs (real)	270.4	270.7	0.3	0.1%

Like-for-like operating costs for 2008/09 of £270.4 million include the absorption of increased local authority rates and SEPA costs of £4.9 million. In real terms, like-for-like costs were £0.3 million lower than in 2007/08.

The average number of employees during the year increased by 26, or 0.7%, to 3,583 (including SWS secondees). However, the number of employees in total at March 2009 (3,572), reduced by 11 from the March 2008 figure (3,583).

Finance costs

As at 31 March 2009, the weighted average interest cost of the £2,794.5 million outstanding debt was 5.50% (2008 – 5.83%). Net interest payable during the year was £149.5 million, £9.2 million higher than in 2007/08.

Other finance costs, being the expected return on pension scheme assets less interest on pension scheme liabilities, increased by £6.6 million to £1.3 million (2008 - an income of £5.3 million).

During the year, net debt increased by £175.3 million to £2,778.6 million (being loans of £2,794.5 million less cash balances of £15.9 million). The increase was driven by a £161.3 million increase in borrowings from the Scottish Government and a £14.0 million reduction in cash balances.

Taxation

SW's tax charge was £59.1 million, (2008 - £38.1 million), an effective rate of 30.3%, (2007 – 17.1%) in respect of deferred taxation. The effective rate for the year was impacted by the requirement to revisit changes introduced by the Finance Act 2007 in relation to assets classed as industrial buildings. This required a cumulative catch-up in the 2008/09 deferred tax computation. In 2007/08, as a result of the change in the UK corporation tax rate from 30% to 28% which was effective from 1 April 2008, deferred tax balances were re-measured as at 31 March 2008. Deferred tax expected to reverse in the future was measured using the effective rate of 28%. This and the abolition of balancing adjustments for industrial buildings allowances resulted in the lower deferred tax charge and the associated effective tax rate in 2008.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £219.8 million for 2008/09. Actual net new borrowings in 2008/09 were £219.8 million, being £161.3 million for Scottish Water and £58.5 million for Scottish Water Business Stream Holdings Ltd.

4. Key Supporting Information

Modern Equivalent Asset Valuation (MEAV)

In comparison with the previous reporting year (AR08), we have made five principal changes to the methodology to derive data for completion of the MEAV; this is in line with Scottish Water's 2nd Draft Business Plan (2DBP).

The reasons for movement in the valuation are as follows:

- Updated asset information from the inventories
- Revised cost curves and on-costs (including application of site specific costs)
- Revised methodology for assessing the cost of manholes in sewers
- Increased cost index value (COPI) - the COPI index has been revised from that applied in AR08
- Revised land calculation - on-costs have been removed from the valuation of land because the acquisition of land alone (rather than building any assets on that land) does not require material overheads.

Revised cost curves

Since AR08 and in line with the 2DBP, SW has improved the accuracy of our cost curves by incorporating data from the current investment programme (Q&S IIIa). This allows the retirement of old data, where possible, thus ensuring the cost curves are more representative of modern equivalent costs.

In addition the following enhancements have been applied since 2DBP:

- Improved cost curves for sea outfalls and combined sewer and emergency overflow.
- Site specific curves for flow meters and control and monitoring have been modified to ensure that the COPI is not applied twice.

Summary of gross MEAV

Scottish Water's reported Annual Return 2009 (AR09) gross asset inventory valuation is £43.8 billion. The gross valuation is dominated by the infrastructure valuation of £36.3 billion, comprising 83% of the total. The non-infrastructure total valuation is £7.4 billion, which is 17% of the total valuation. Support services' reported valuation is approximately £183 million representing only 0.4% of the gross asset inventory valuation.

Asset Type	AR08 Gross MEAV (£m)	% of total	AR09 Gross MEAV (£m)	% of total	% change
Water Infrastructure	£11,556.39	31.88%	£12,116.56	27.64%	4.85%
Water Non - Infrastructure	£3,028.91	8.36%	£3,970.21	9.06%	31.08%
Wastewater Infrastructure	£18,692.58	51.57%	£24,150.96	55.10%	29.20%
Wastewater Non-Infrastructure	£2,784.21	7.68%	£3,408.40	7.78%	22.42%
Support Services	£183.93	0.51%	£183.19	0.42%	-0.40%
Total	£36,246.03	100.00%	£43,829.32	100.00%	20.92%

The combined gross valuation of water and wastewater infrastructure assets has increased by £6.02 billion (20%) of the value reported in AR08. There has been an increase in the gross valuation for non-infrastructure assets of £1.57 billion (27%).

Water Resources, Supply and Demand and Security of Supply Index

In 2008/09, we have further developed our draft Water Resource Plan (WRP) which was issued to SEPA in April 2009 following a full public and stakeholder consultation period in 2008. We have also fully aligned the WRP09 with our 2nd Draft Business Plan for the 2010-14 period.

The aim of the water resource planning process is to enable us to move towards the optimum balance of supply and demand across Scotland and, where investment is required to restore this balance, it is planned and prioritised to meet the needs of customers and the environment. The draft WRP defines our water resource strategy and provides the basis of our water resource investment programme for the 2010-14 planning period.

This year we have continued to provide unconstrained services with none of the population affected by hosepipe restrictions.

The reporting of our Security of Supply Index (SOSI) is a relatively new requirement for Scottish Water. The SOSI is an indicator of the extent to which a company is able to guarantee provision of its planned level of service. This measure is used in England and Wales (E&W) to assess a company's security of supply to its customers but also to track changes in the service offered to customers over time.

Our SOSI score is improving year on year as a result of the positive effects of the leakage reduction programme, growth and other water quality projects but is still in the lowest banding for SOSI indicating that there are "large deficits against target headroom". The application of the full supply demand balance assessment across Scotland has identified that about 30% of our customers are in zones which would require investment or leakage reduction to ensure consistent supply against exceptional circumstances (1 in 40 year drought) and peak demand.

In our 2nd Draft Business Plan we are promoting additional investment (over and above reducing leakage to the economic level) to meet the challenge of securing the long term supplies in selected zones. This will have a resultant positive impact on the SOSI and OPA scores.

5. Competition

On 1 April 2008, the non-household market opened to retail competition. In readiness for that date, Scottish Water had completed the actions necessary to support inter-working with the Central Market Agency as provided for in the Market Code; and to support the operational processes between itself and Licensed Providers as set out in the Operational Code and the Disconnections Document.

The prime role of the Central Market Agency (CMA) is to administer the transfer of customers between Licensed Providers and to calculate the monies due to Scottish Water from Licensed Providers for the supply of water and sewerage services in line with the Wholesale Scheme of Charges. All eligible premises, or supply points, are required to be registered at the CMA and market participants provide the CMA with regular information flows to keep the information updated and to allow the CMA to undertake its functions. The information provided includes, for example, meter reading data or details of a new meter installations or disconnections.

All the data provided by Scottish Water in the Annual Return relating to the supply of water and sewerage services to eligible premises is based on the settlement reports supplied to it by the CMA. Scottish Water additionally invoices Licensed Providers directly for certain transactional services, such as new connections or disconnections. The data supporting those activities is derived from Scottish Water's systems.

At 31 March 2009, Scottish Water had in place agreements for the supply of services with three Licensed Providers. One Licensed Provider exited the market in the year and its customers were allocated to the other licensees trading at the time, following the Provider of Last Resort Process set out in the Market Code and administered by the CMA.

6. Further information

Board Changes

During the report year the following changes have occurred in Scottish Water's Board.

Peter Farrer joined the Board in October 2008 as Customer Service Delivery Director.

Graeme Crombie, Ian McMillan and Rita Theil left the Board of Scottish water on 31 March at the end of their respective appointments.

Three new non-executive directors joined the Board on 1 April 2009. These are Dr James M Spowart, Alan Bryce and Andrew Wyllie. Pat Kelly was also reappointed as a non-executive director from 1 April 2009.

Since the year end, Alistair Buchanan has now resigned from the Board and Lynne Peacock has joined as a non-executive director.

Information improvements

We have continued to build on the foundations we laid in earlier years improving the completeness, availability, reliability, access to and reporting of information. Our information is dependent on our staff and contractors complying with processes for data collection and processing. In 2008/09, compliance has improved, aided in part by systems improvements that require users to enter data in a specified manner. In particular, the confidence grades for the number of incidents of internal sewer flooding have improved from C5 in 2005/06 (i.e. +/- 50%) through B3 last year to B2 for 2008/09 (i.e. +/- 5%). We now extract the information directly from corporate systems, rather than having to adjust information for missing data and known non-compliances. In addition, we are continuing our development of CISP, our Capital Investment Systems and Process project. This project will address a number of issues for our capital investment reporting including:

- A reduction in the number of non-corporate tools used to support the management and governance of the capital investment programme (spreadsheets, databases etc.);
- Improvements in regulatory compliance and consistency and accuracy in external reporting; and
- Improvements in data confidence grades

Climate Change

We will need to adapt to a changing climate to ensure the long term sustainability of our service as this may be the most critical long-term issue by 2018. In the addendum to our 2nd raft Business Plan, we have set out the investment required for relevant information gathering to inform longer term investment needs.

The Scottish Government is committed to reducing Scotland's greenhouse gas emissions by 80% by 2050. To reduce our carbon emissions we will reduce demand through reasonable challenge of further quality enhancements, pursuing energy efficiency and leakage reduction opportunities. During 2008 we undertook further studies to evaluate the renewable energy potential of our assets and these studies indicate that investment in renewable energy (e.g. hydro) and combined heat and power is necessary to make marked reductions in the carbon intensity of water services. Some of these schemes have been included in the Addendum to our 2nd Draft Business Plan.

Scottish Water's Carbon Footprint

2007 saw the completion of our first Greenhouse Gas Emissions footprint covering all the major greenhouse gases (CO₂, CH₄, N₂O). We have committed to measuring this annually in order to begin to manage our emissions. Data is available for 2007/08 and shows Scottish Water's figure as 475,142 tonnes of carbon dioxide equivalents.

In recent years Scottish Water has followed a rising emissions trend and the 2007/08 figure is 1.4% higher than for 2006/07. Between 2002 and 2010 we will have invested around £4bn in new assets and infrastructure to meet enhanced quality targets and to improve service. Meeting new quality standards often means a step change in treatment intensity with attendant increases in energy demand.

7. Looking forward

2010 - 2014

We submitted our second draft regulatory business plan for 2010-14 on 12 March 2009. This plan replaces our first draft and takes account of the discussions we had with the Commission's staff in respect of our first draft submission.

2010-14 is likely to be the period of greatest economic uncertainty and change since the introduction of economic regulation in the water industry. Our plan was informed by independent macroeconomic forecasts, which may change significantly over the coming months because of the uncertain economic outlook. We will monitor these forecasts and provide updated projections, where necessary, throughout the period until final price limits are determined.

Sustainable Procurement

We are well advanced with the development of our capital delivery model for the 2010 - 2014 investment period. The delivery model for the 2010 - 14 period will be a combination of integrated in-house delivery capability for areas of the programme that are not well defined (e.g. infrastructure, capital maintenance and strategic studies), and a Joint Venture partnering model to deliver the programme where outputs are well defined for quality enhancement and capital maintenance. The delivery model will be underpinned by the establishment of frameworks covering construction delivery partners, consultancy service providers and kit and plant suppliers.

Governance

The methodologies and processes used for producing the detailed information in Scottish Water's 2007/08 Annual Return to the Water Industry Commission have been further enhanced this year by improvements to data collection and reporting systems in specific areas (such as sewer flooding recording). This approach, along with the formal audits carried out by the Regulatory Reporter has ensured that this submission is based on sound processes and assumptions. The governance of the production of this Return has increased this year with the assurance statements process being rolled out beyond Director/General Manager level to include data table owners.

Scottish Water's Board has endorsed this Annual Return Overview and charged the Chief Executive with the responsibility to establish and maintain sound systems of internal control that support the completion of the Annual Return submission to the Water Industry Commission. The Board assurance statement signed by the Chief Executive is included in Appendix 1.

Annual Return 2008/09 ASSURANCE STATEMENT

Background

The Board is required to confirm that it has endorsed the Overview to the Annual Return.

The Board has charged the Chief Executive, with the responsibility to establish and maintain sound systems of internal control that support the completion of the Annual Return submission to the Water Industry Commission.

The systems of internal control that support completion of the Annual Return are designed to ensure:

- The accuracy and consistency of reporting
- That soundly based assumptions and judgements are used
- Audit trails are maintained for origination and approval of all data in the Annual return
- The identification, understanding and reporting on material data exceptions
- The reliability of information for decision making and for performance assessment.
- Compliance with applicable regulatory and legislative reporting requirements.

The systems of control are designed to reduce the risk of material error and to provide effective assurance on the completion of the Annual return.

Process

The Board gains assurance as to the effectiveness of internal control through:

- the controls and assurance process put in place by the Executive Directors to ensure that the Annual Return is consistent with the requirements of regulatory reporting;
- a signed assurance statement from the Chief Executive concerning the operation of the systems of internal control;
- reporting from Executive Directors on associated matters;
- the results of both internal and external audit, and other internal and external review agencies;
- the adequacy of management response to issues identified by audit and review activity; assurances relating to the corporate governance requirements for the organisation; and
- the operation of anti-fraud policies, whistle-blowing processes, and arrangements for special investigations.

Outcomes

Based on the Board's knowledge of the effectiveness of the systems of internal control that support the completion of the Annual Return, the Board has endorsed the overview to the Annual Return. The Board has been assured that the assumptions, judgements and confidence grades used are appropriate, reasonable and consistent with the requirements of regulatory reporting.

SIGNED

(on behalf of the Board of Scottish Water)

CHIEF EXECUTIVE OFFICER

Date

8 June 2009

