

Annual Return 2010/11

Overview

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**Scottish
Water**
Always serving Scotland

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1. Executive Summary

This overview document reports on Scottish Water’s performance and activities in 2010/11, the first year of the 2010-15 regulatory period. Despite having its challenges 2010/11 proved to be a very successful year for us with performance exceeding our plans across most activities with many measures reaching new heights. Two major initiatives, PACE and DRIVE, have underpinned our improved performance.

Overall Performance Assessment

In 2010/11 our OPA performance increased to 330 and exceeded our Delivery Plan target of 302. As demonstrated in figure 1.1 below we remain on course to meet our 2013/14 target of 380.

This is the first year where we have been measured against the new “17 indicator” OPA, which replaced the “12 indicator” measure that was used until 2009/10. Our 2010/11 OPA score represents a 24 point improvement compared with the 306 OPA points scored in 2009/10, using the “17 indicator” OPA (291 was the published score using the previous “12 indicator” OPA).

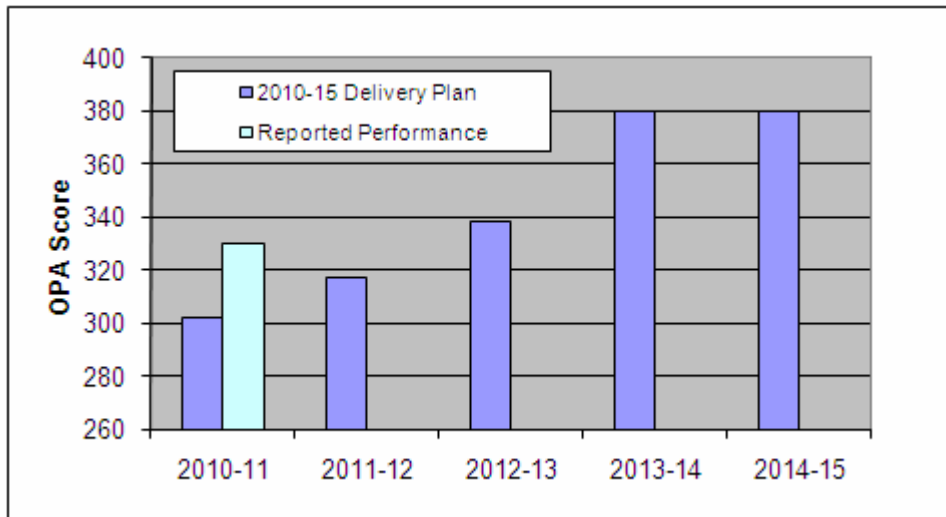


Figure 1.1 – OPA performance

Leakage

Since the start of 2010/11 we have reported leakage in terms of Maximum Likelihood Estimation (MLE) Leakage. Our MLE reported leakage for 2010/11 is 699.1 MI/d which is a 39.1 MI/d reduction on our reported MLE leakage of 738.2 MI/d for 2009/10 and out-performs our 2010/11 Delivery Plan target of 720 MI/d. Table 1.2 below details the leakage reduction we have achieved in recent years.

Description (ML/d)	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Regulatory Reported leakage (OPA)	1104.1	1003.8	924	801.7	703.6	699.1
Leakage Target (OPA)		960	855	840	730	720
MLE adjusted leakage				816.4	738.2	699.1

Table 1.2

Figure 1.2 presented below demonstrates the improvements in leakage over the last four years. The spikes in late 2009 and 2010 correspond with the extreme winter weather that caused extensive disruption across Scotland and caused operational challenges for us. Although we were able to achieve our leakage targets extreme winter weather events do have an adverse impact on leakage.

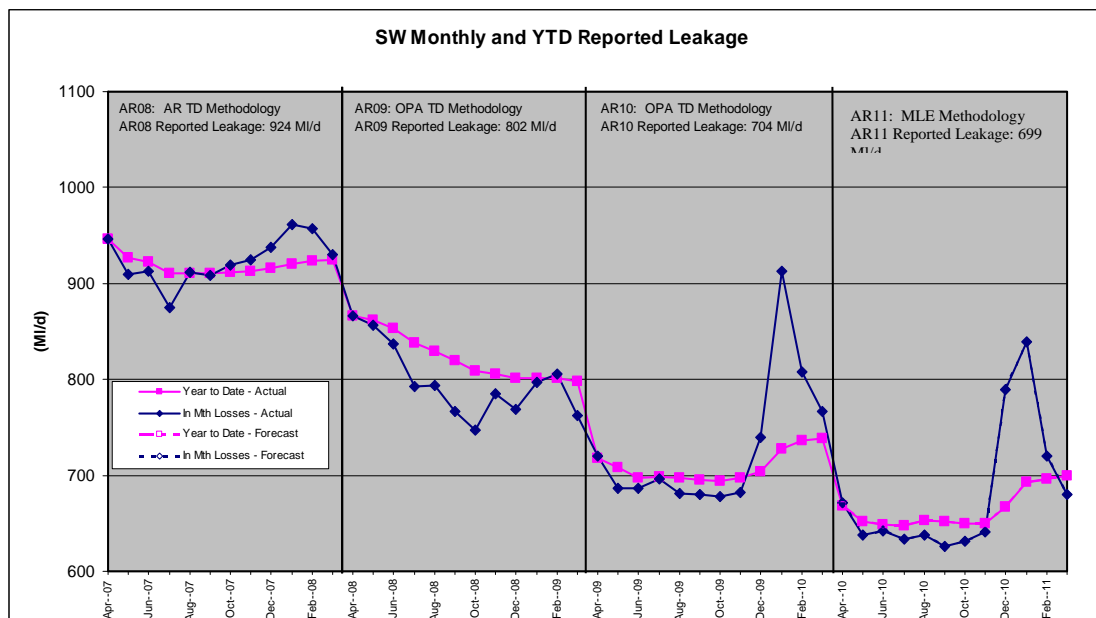


Figure 1.2

Our current assessment of the Economic Level of Leakage (ELL) was reported to the Commission at the end of January 2011. At 596 MI/d, the report presented the case for a marginally lower ELL than previously stated, primarily due to the increased cost of producing and distributing water throughout the network due to higher costs for energy and chemicals. The report has been reviewed by the Commission's Independent Leakage Reviewer.

Customer Satisfaction

As part of our commitment to improve the customer service we have reviewed how we measure customer satisfaction. In 2010 we introduced a postal survey to monitor customer satisfaction all year round. Since its introduction, over 15,000 customers have taken part, providing satisfaction tracking and insightful comments about their experience. This valuable information is being used to drive improvements that are most valued by our customers. Despite a particularly demanding year due to severe weather events, our annual satisfaction score is 80.1%. Given the impact of the weather and the increased number of responses we are very pleased to have maintained our score at this level.

2010-11 weather challenges

One of the main challenges we faced was the extremes of weather that were experienced across the year. In the early part of the year a prolonged dry spell threatened water supplies in Dumfries and Galloway. We collaborated with SEPA and the Scottish Government, and took the necessary steps to allow measures to be introduced to safeguard essential supplies. We maintained unconstrained supplies to customers throughout the dry period and timely rainfall meant we did not need to use our emergency powers.

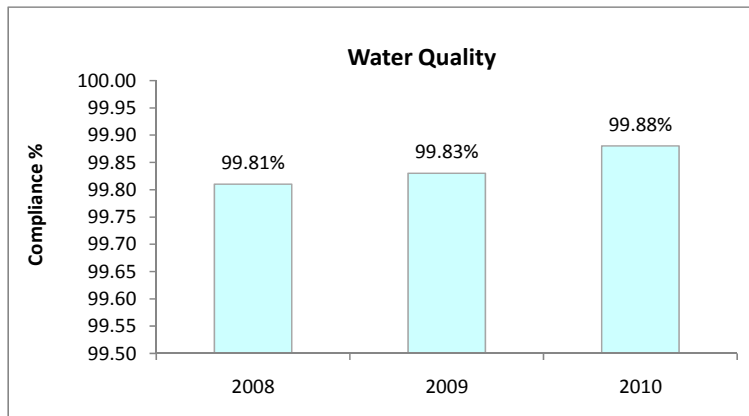
In late November, we again had “extreme” winter weather with extensive snowfall bringing Scotland to a virtual halt. The snow was followed by freezing conditions which interrupted water supplies to customers as individual connections froze and began to affect the bacteriological efficiency of some of our wastewater treatment facilities. As the temperature lifted and the thaw got underway we experienced an increase in the number of reported bursts which had a consequential impact on leakage.

Our contingency planning, delivered by the resilience and commitment of Scottish Water staff to maintain services, meant that the disruption to customers was minimised.

Compliance

Overall Water Quality Compliance

For the calendar year 2010, overall compliance with water quality standards continues to be of a very high standard with 99.88% of all water quality tests conducted in our sampling programme complying with quality standards, continuing the rising trend in compliance.



For OPA purposes, water quality is assessed using the mean zonal compliance of a basket of six parameters. For these parameters performance in 2010 was 98.98% an improvement from 98.94% in 2009/10.

Wastewater Treatment

Wastewater Treatment Works compliance at 31 March 2011 is reported as 11 failing sites against a Delivery Plan target of 18. This performance, which has been agreed with SEPA maintains the good performance of 2009/10.

Scottish Water will continue to focus on improving processes and alignment of operational and investment activities. This will be supported and driven by a functional structure, which will ensure the appropriate focus and continuous improvement in compliance.

Bathing Waters

Scotland had 82 bathing waters officially designated under the EU Bathing Water Directive for the 2010 Season, 70 of which could be directly impacted by Scottish Water Assets. Three bathing waters failed for the season (Elie Harbour, Irvine and Ayr South) due to factors not associated with Scottish Water discharges, the same number as 2009. Scottish Water performance remained good, with no assets having caused failed samples at any of the three failing bathing waters.

Capital Programme delivery

During 2010/11 investment totalled £443.5m, comprising £334.6m on Q&SIIIb projects and £108.9m in completion projects.

2010/11 saw the introduction of the Overall Measure of Delivery (OMD) which provides a high-level measure of progress in implementing the Q&S3b enhancement investment programme during the 2010-15 period. At the end of March 2011, the OMD score stands at 82 points, 19 points ahead of the baseline target agreed with the Commission.

At the end of the 2010/11 year, we have reduced the overall number of completion projects remaining to be signed off to 62 which is ahead of our delivery plan target of 66. This represents an 80% reduction in the number of completion projects outstanding from the start of the year.

Financials

The surplus before tax in the year for Scottish Water was £114.9 million, £59.4 million lower than in 2009/10 (£174.3 million). The regulated surplus before tax was £59.2 million lower at £114.8 million.

Revenue

Regulated revenue for the year totalled £1,049.8 million (2010 - £1,066.2 million).

Revenue from services supplied to household customers increased by £6.1 million or 0.8% to £743.5 million reflecting the increase in connected properties and the tariff freeze effective from 1 April 2010. Revenue from wholesale services supplied to Licensed Providers reduced by £22.2 million or 6.8% to £302.4 million driven primarily by the reduction in regulated wholesale charges to Licensed Providers. Revenue from other sales reduced by £0.3 million to £3.9 million.

At £1,050m revenue for 2010/11 is below the £1,061m expected in the Delivery Plan. The shortfall has occurred in relation to Wholesale revenue and is a significant cause of concern for Scottish Water.

The plan had assumed that routine changes in occupancy status by the registered Licensed Provider would cause the number of billed properties to increase in line with gross domestic product (GDP) as forecast at the time and that the vacancy review project would result in an incremental increase in billed properties and revenue.

Although the vacancy project, which investigated the large number of vacant non-household premises registered at the CMA, identified 8,404 vacant premises that were actually occupied, the net increase in revenue-generating non-household premises was only 1,136 (at September 2010). This reflects the high number of properties where the status has been updated from 'occupied' to 'vacant' by the registered Licensed Provider, which suspends wholesale charges, and a very low number of updates from "vacant" to "occupied". We are discussing this pattern with the Licensed Providers and the Commission to ensure that market data shows the correct status.

Total costs

Total costs of £779.6 million were £42.7 million higher than in 2009/10.

Operating costs of £466.6 million were £29.6 million higher than 2009/10. Within these costs, regulated operating costs of £327.8 million were 8.6% or £25.9 million higher than in 2009/10 while PFI costs were £3.7 million higher at £138.8 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £8.1m or 3.2%. £34.0m of specific additional costs were incurred compared with last year, namely: £3.8m for additional costs (relative to 2009/10) associated with the extreme weather events; £4.0m associated with restructuring the business; absorption of £11.8m of inflation; and a net increase in local authority rates charges of £14.0m. The table below summarises this movement:

	2010/11	2009/10	(inc)/dec	
	£m	£m	£m	%
Regulated Operating Costs (SW only)	327.8	301.9	-25.9	-8.6%
Winter costs	-6.9	-3.1	3.8	
VR costs	-10.5	-8.1	2.4	
Other restructure costs	-3.9	-2.3	1.6	
Average inflation (4.96%)		11.8	11.8	
New Opex	-2.0	-0.9	1.1	
Like for Like costs	304.5	299.3	-5.2	-1.7%
Local Authority rates charges	-55.7	-34.3	21.4	
Add back one-off rates credit	7.4		-7.4	
SEPA and WIC costs	-14.4	-15.1	-0.7	
Like-for-like real controllable costs	241.8	249.9	8.1	3.2%

Depreciation, including infrastructure depreciation, increased by £17.2 million to £318.7 million, primarily as a consequence of the capital investment programme. The gain on sale from asset disposals was £4.1 million higher than in 2009/10 at £5.7 million.

Information Improvements

We have continued to build on the foundations we laid in earlier years for improving the completeness, availability, reliability, access to and reporting of information. During 2010/11 the Inventory Team gained ISO9001 accreditation for the Asset Data Return process, the process by which data is captured and loaded into the inventory systems.

Following the implementation of CISP, our Capital Investment Systems and Process project, we have migrated our Q&S2 & 3a completion programme onto CISP consolidating all the data into one corporate system. Through rigorous audit, we have continued to improve the data as part of our governance processes.

Board Changes

During the report year there were no changes to the composition of Scottish Water's Board.

Governance of the Annual Return

Although this year's Annual Return represents a reduced regulatory reporting requirement, we have retained the methodologies and processes used for producing the detailed information in Scottish Water's Annual Return to the Water Industry Commission developed over previous years. Scottish Water re-engaged Black and Veatch to undertake the role of the Reporter for Scottish Water as part of the normal assurance to the Scottish Water Board and consequently the Commission.

This approach has ensured that this submission continues to be based on sound processes and assumptions.

2. Key Outputs and Service Delivery

2.1 Service Outputs and Performance

Overall Performance Assessment (OPA)

In 2010/11 our OPA performance increased to 330 and exceeded our Delivery Plan target of 302. As demonstrated in figure 2.1 below we remain on course to meet our 2013/14 target of 380.

This is the first year where we have been measured against the new “17 indicator” OPA, which replaced the “12 indicator” measure that was used until 2009/10. Our 2010/11 OPA score represents a 24 point improvement compared with the 306 OPA points scored in 2009/10, using the “17 indicator” OPA (291 was the published score using the previous “12 indicator” OPA).

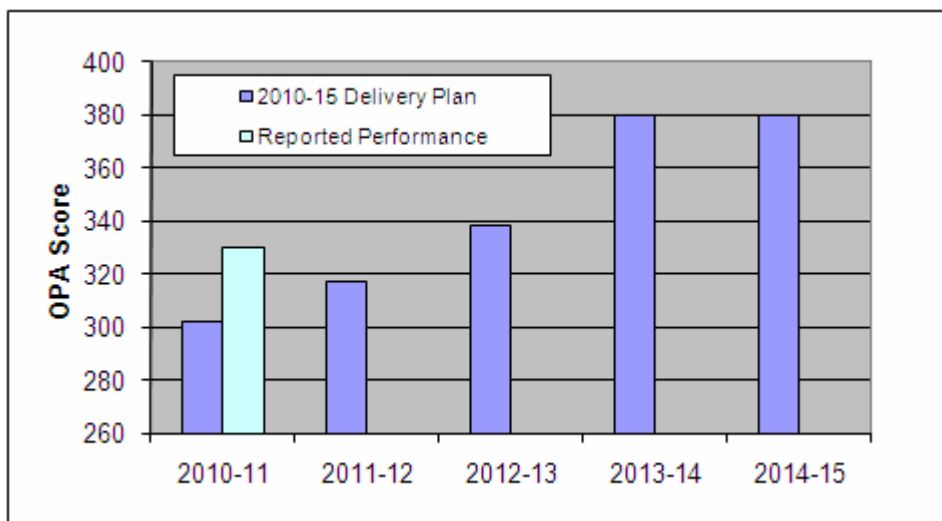


Figure 2.1 – OPA performance

By comparison with the 2006-10 “12 indicator” OPA, the new “17 indicator” OPA:

- Introduces 6 new components:
 - Assessed Customer Service
 - Category 1 & 2 sewage Environmental Pollution Incidents (EPIs)
 - Category 3 sewage EPIs
 - Category 1 & 2 water EPIs
 - Security of Supply Index (SoSI) absolute performance, and
 - SoSI performance against target
- Consolidates Customer Complaints and Telephone Contacts into Customer Contact
- Adopts revised definitions for
 - Water Quality (different basket of parameters), and
 - Low pressure (excludes properties within 10.5m (level) of service reservoirs)
- Uses revised OPA weightings for
 - Hosepipe restrictions, and
 - Leakage.

Significant Improvements

The areas, in which we made the most significant improvement in 2010//11 are:

- Drinking Water Quality improved from 6.4 to 21.3 points (+14.9 points);
- Assessed Customer Service improved from 33.3 to the maximum of 37.5 points (+4.2 points);
- SOSI performance against target improved from 10 to the maximum of 12.5 points (+2.5 points), and
- Unplanned interruptions improved from 25.9 to 29.2 points (+3.3 points).

Table 2.2 below compares our 2009/10 and 2010/11 performance for each of the 17 indicators: In summary:

- 2 items continued to score full points;
- 4 items increased to maximum points, securing 9.1 additional OPA points;
- 4 items showed increased performance, securing 19.3 additional OPA points;
- 1 item was unchanged, and
- 6 items slipped back – which reduced OPA by 4.1 points.

Indicator	AR10 OPA	AR11 OPA	AR10 OPA score	AR11 OPA score	Change
% of properties subject to inadequate water pressure	0.06%	0.05%	33.6	34.3	0.7
Connected properties experiencing unplanned interruptions	1.12%	0.83%	25.9	29.2	3.3
Hosepipe restrictions	0	0	12.5	12.5	0.0
Security of Supply absolute performance	32	35	1.3	1.3	-0.1
Security of Supply performance against target	5.88%	-2.94%	10.0	12.5	2.5
% of water samples that comply with parameters	98.43%	98.98%	6.4	21.3	14.9
Leakage	-3.65%	-2.98%	11.3	11.3	0
Water Service (sub-total)			101.0	122.3	21.4
% properties suffering sewer flooding incidents caused by overloading	0.0024%	0.00176%	24.4	24.8	0.4
% properties suffering sewer flooding incidents caused by other causes	0.00638%	0.00653%	35.2	35.0	-0.2
Sewer flooding (at risk)	0.02047%	0.01088%	11.4	12.5	1.1
Sewerage Service (sub-total)			71.0	72.3	1.3
Customer Contact (Total of complaints and telephone performance)	18.75	17.7	18.8	17.7	-1.0
Assessed customer service	11	8	33.3	37.5	4.2
Customer Service (sub-total)			52.0	55.2	3.2
Category 1 & 2 water EPIs	1	0	11.2	12.5	1.3
Category 3 sewage EPIs	778	796	3.8	3.5	-0.3
Category 1 & 2 sewage EPIs	26	28	12.9	11.4	-1.5
Sewage sludge disposal	0.00%	0.00%	12.5	12.5	0.0
% pe served by non-compliant sewerage treatment works	0.89%	1.00%	41.9	40.8	-1.0
Environmental Performance Service (sub-total)			82.3	80.7	-1.5
Total			306	330	24

Table 2.2: OPA Performance

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

Percentage of Properties Subject to Inadequate Water Pressure

A total of 534 properties were removed from the low pressure register over the year, reducing the total number from 2,496 (2009/10 reported value) to 1,962. However, properties that are within 10.5m of the bottom water level of the supplying service reservoir have been excluded from OPA calculation, in line with England & Wales reporting, and as such 732 properties are excluded. This reduces our 2010/11 reported OPA value to 1,230.

Connected Properties Experiencing Unplanned Interruptions

Table 2.3 shows the change in the number of properties that experienced unplanned interruptions compared to last year. Our OPA score has been impacted by the severe weather experienced throughout the country in December and January. We still outperformed the stretch target of 24,000 properties by 2,564. A total of 21,436 weighted properties, or 0.83% of total population, received a supply interruption greater than 6 hours.

In March 2011 a major burst in Erskine resulted in 3,406 properties suffering a loss of supply. The length of the Erskine incident was just greater than 6 hours.

	2009/10	2010/11
Properties interrupted for 6 to 12 hours	17,252	14,776
Properties interrupted for 12 to 24 hours	5,534	2,463
Properties interrupted for more than 24 hours	90	1,399
Total number of properties interrupted for more than 6 hours	22,876	18,638
Total number of properties interrupted for more than 12 hours	5,624	3,862
Total 'weighted' properties interrupted for more than 6 hours	28,680	21,436

Table 2.3: Unplanned Interruptions to Supply

Hosepipe Restrictions

We have maintained unconstrained supplies to customers and have not required any hosepipe restrictions since Scottish Water was formed in 2002.

Security of Supply Index (SOSI)

a) SOSI absolute performance.

Absolute performance is measured on total SOSI score. Our score improved in 2010/11, rising from 32 to 35, but remains in the lowest band (<50) and so minimum points are scored.

b) SOSI performance against target.

We are also measured in terms of our SOSI performance against our annual target. For 2010/11 our target was 34 points. We scored 35 SOSI points in 2010/11 and exceeded our target. Our SOSI score resulted in an increase from 10.0 to 12.5 OPA points.

Percentage of Water Samples that Comply with Parameters

Our water quality performance is discussed in Section 2.2 below.

Leakage

Our reported leakage for this report year is 699.1 MI/d, a 39.1MI/d reduction on our leakage in 2009/10 and successfully out-performing our target for 2010/11 to reduce leakage to 720 MI/d. Our current assessment of the Economic Level of Leakage (ELL) was reported to the Commission at the end of January 2011. The report has been reviewed by the Commission's Independent Leakage Reviewer.

Our leakage performance is discussed more fully on page 24.

Number of Incidents of Sewer Flooding Caused by Overloading of Main Sewers

In 2010/11 there were 43 incidents of flooding from overloaded mains sewers that caused internal flooding of customers' properties. This was a large decrease of 15 incidents from the number of incidents reported for 2009/10.

Number of Incidents of Sewer Flooding from Other Causes on Main Sewers

In 2010/11 there were 160 incidents of flooding from other causes on main sewers that caused internal flooding of customers' properties. This was an increase of 4 incidents from 2009/10.

Sewer Flooding (properties at risk)

The number of properties on the "At-risk of flooding from overloaded sewers" register is 341 in 2010/11. This gives a score of 12.5 OPA points.

	2010/11
At risk of flooding twice in ten years	192
At risk of flooding once (but less than twice) in ten years	149
Total number of properties at risk of flooding at least once in ten years	341

Table 2.4: Properties at Risk of Flooding from Sewers

Customer Contact

The revised OPA introduces a new Customer Contact measure which consolidates 3 sub-elements of the previous OPA into one. The sub-elements are described below.

a) Percentage Written Complaints Responded to within 10 days

Performance on this measure has shown a significant improvement with all written complaints responded to within the internal target of 5 days. In 2010/11 we were also 100% compliant with the 5-day Guaranteed Service Standard in the Code of Practice.

b) Percentage Telephone lines busy

A total of 981 lines were reported as busy in 2010/11, up from just 13 in 2009/10. This reduced performance from 100% to 99.83% over the year. There was a network fault in October 2010 which resulted in the busy tone being received by 963 calls. Excluding this network failure, our performance was broadly in line with previous years.

c) Percentage Telephone calls abandoned

During 2010/11 the total number of abandoned calls increased by 2,107 to 12,180. This decreased our performance in this measure from 98.21% to 97.85%. The adverse weather impact in December and January increased the call volumes and performance decreased.

Assessed Customer Service

This is a new measure for 2010/11. Our performance improved from 11 to 8 points in 2010/11, with improvements coming in complaint handling (2 to 1) and supply pipe repair policy (3 to 1). This score was approved by WaterWatch Scotland in its Audit of February 2011 and results in an increase in OPA points from 33.3 to 37.5, the maximum number of points available.

Environmental Pollution Incidents (EPIs)

EPIs are new to the OPA in 2010/11. All EPIs shown below have been agreed with SEPA.

a) Wastewater Category 1&2 EPIs

We reported an increase in Category 1&2 incidents in 2010/11. The total number increased from 26 to 28 over the year and OPA performance was lower than a year earlier.

b) Wastewater Category 3

We reported an increase in the number of Category 3 incidents in 2010/11, rising from 776 to 796. This reduced our OPA performance to 3.5 points.

c) Water Category 1&2

There were no reported incidents in 2010/11.

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 Sewage Treatment Works

The compliance of Scottish Water's waste water treatment works improved significantly in 2010/11. In 2010/11 exactly 1% of the connected population equivalent was served by a non-compliant works. This number is subject to confirmation by SEPA.

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 2010 calendar year, with 99.86% of all water quality tests conducted in our sampling programme complying with quality standards (2009: 99.83%; 2008: 99.81%).

Microbiological Quality

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

a) water leaving treatment works

In 2010, 20,972 samples were taken for faecal and total Coliform analysis. Compliance with the faecal coliform standard was 99.97% and with the total coliform standard was 99.85%.

b) water in service reservoirs

In 2010, 49,896 samples were taken for faecal and total Coliform analysis. Compliance with the faecal coliform standard was 99.98% and the total coliform standard was 99.79%.

c) water at customers' taps

In 2010, 14,305 samples were taken for faecal coliforms and total coliform analysis. Compliance with the faecal coliform standard was 99.99% and the total coliform standard was 99.52%.

Microbiological compliance at service reservoirs and customers taps remains very high. Despite a slight dip in performance in 2010 at water treatment works compared with 2009, there has been an overall improving trend in compliance, as can be seen in table 2.5.

The following summary table highlights performance in water quality for microbiological quality from 2007 to 2010 based on regulation samples:

		2007 fails	2007 compliance	2008 fails	2008 compliance	2009 fails	2009 compliance	2010 fails	2010 compliance
Treatment Works	Coliforms	33	99.90%	76	99.76%	30	99.90%	44	99.85%
	Faecal Coliforms	10	99.97%	10	99.97%	6	99.98%	8	99.97%
Service Reservoirs	Coliforms	128	99.77%	137	99.75%	138	99.74%	107	99.79%
	Faecal Coliforms	16	99.97%	11	99.98%	12	99.98%	9	99.98%
Customer Taps	Coliforms	78	99.46%	79	99.45%	66	99.54%	69	99.52%
	Faecal Coliforms	5	99.97%	2	99.99%	4	99.97%	2	99.99%

Table 2.5: Microbiological quality of water

Chemical Sampling

Physical and chemical standards apply to water supplied at customers' taps. 120,179 tests were carried out at customers' taps for all parameters during 2010. Of these 99.85% (99.79% in 2009) complied with the regulatory standards.

The following summary table highlights the performance of the key chemical parameters for 2007 to 2010.

	2007 fails	2007 compliance	2008 fails	2008 compliance	2009 fails	2009 compliance	2010 fails	2010 compliance
THM Total	77	95.57%	81	95.19%	89	94.59%	59	96.39%
Iron	50	99.07%	70	98.67%	49	99.06%	32	99.38%
Colour	28	99.48%	15	99.72%	12	99.77%	7	99.87%
Manganese	45	99.16%	41	99.22%	24	99.54%	31	99.40%
Aluminium	16	99.70%	13	99.75%	7	99.87%	12	99.77%

Table 2.6 Chemical Quality of Water

For OPA purposes, water quality is now assessed using the mean zonal compliance of a basket of six parameters. For these parameters performance in 2010 was 98.98% an improvement from 98.94% in 2009/10.

Abstraction Licensing

This is the second year we have submitted our annual Water Resource data return to SEPA. This covers 407 abstraction and impoundment activities authorised under the Controlled Activities Regulations (CAR) in approximately 300 Water Use Licences. It is a legal requirement of the Water Use Licence to provide SEPA with our abstraction and compensation data to enable SEPA to monitor our compliance against the conditions of the licence – typically maximum abstraction limits from our sources and minimum compensation flow requirements from our reservoirs.

We will be working with SEPA to analyse the data in the coming months and have established a joint SW-SEPA water resources Task and Finish Group to address a number of issues.

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 the Water Framework Directive have on our abstraction activity. This work has been progressed in partnership with SEPA and Scottish Natural Heritage.

We have met our Delivery Plan target by delivering 70 outputs. The overall programme (78 WRZ in total) is on track to deliver the agreed output profile. Of the eight remaining WRZs we have yet to reach agreement with SEPA on the approach to be adopted for 2 zones because of concerns over data, cost effectiveness or the appropriateness of the scheme.

2.3 Wastewater Service

Compliance - Wastewater Serviceability

Wastewater Treatment

Wastewater Treatment Works compliance figures at 31 March 2011 are reported as 11 failing sites against a Delivery Plan target of 18. This performance, which has been agreed with SEPA, maintains the good performance of 2009/10.

Scottish Water will continue to focus on improving processes and alignment of operational and investment activities. This will be supported and driven by a functional structure, which will ensure the appropriate focus and continuous improvement in compliance.

Bathing Waters

Scotland had 82 bathing waters officially designated under the EU Bathing Water Directive for the 2010 Season, 70 of which could be directly impacted by Scottish Water Assets. Three bathing waters failed for the season (Elie Harbour, Irvine and Ayr South) due to factors not associated with Scottish Water discharges, the same number as 2009. Scottish Water performance remained good, with no assets having caused failed samples at any of the three failing bathing waters.

Pollution Incidents

Our target is to reduce the number of Environmental Pollution Incidents (EPIs) associated with our sewerage infrastructure to 548 by 2014/15. During 2010/11 SEPA confirmed that there were 824 sewerage EPIs of which 28 were in categories 1 & 2 and 796 were in category 3.

Scottish Water will continue to work closely with SEPA to improve the reporting of pollution incidents arising from Scottish Water assets and to ensure both investment and asset maintenance is correctly targeted.

Unsatisfactory Intermittent Discharges (UIDs)

During 2010/11, Scottish Water has delivered a further 15 Q&S3a UID outputs. A total of 279 UIDs have now been improved. The outputs comprise physical improvement, operational interventions, and those where modelling has confirmed no need for physical intervention. 27 Q&SIIIa UID outputs remain to be delivered.

2.4 Capital Programme Delivery

During 2010/11 investment totalled £443.5m, comprising £334.6m on Q&SIIIb projects and £108.9m in completion projects.

Completion Programme (Q&S2 and Q&S3a)

At the start of the 2010-15 regulatory period a total of 313 Q&S2 and Q&S3a projects were still to be completed. A total of 251 projects have been completed or removed over the year, reducing the number of projects still outstanding to 62. This represents an 80% reduction in the number of completion projects outstanding and puts us ahead of our Delivery Plan target, which was for 66 projects still remaining.

	Projects remaining at Q4 2009/10	Projects remaining at Q4 2010/11	Projects signed off during 2010/11	% total
Q&S2	62	16	46	74.2
Q&S3a	251	46	205	81.7
Total	313	62	251	80.2

Table 2.7

Actual investment in the completion programme to the end of 2010/11 is £142m against a Delivery Plan forecast of £141m.

Q&S3b

2010/11 saw the introduction of the Overall Measure of Delivery (OMD) which provides a high-level measure of progress in implementing the Q&S3b enhancement investment programme financed in the 2010-15 period. At the end of March 2011, the OMD score stands at 82 points. This is 19 points ahead of the baseline agreed with the Commission. As shown in table 2.8 below we have consistently out-performed against our quarterly OMD target throughout 2010/11.

OMD Measure	Q1	Q2	Q3	Q4
Target	20.1	33.3	46.1	63.4
Actual	28.8	43.6	48.7	82.1

Table 2.8

Principally OMD is driven by actual performance of five milestone dates (MS 1 to 5) for each project measured against the dates incorporated in the agreed baseline. Table 2.9 below shows that we are ahead of the targets for each milestone.

OMD Measure	MS1	MS2	MS3	MS4	MS5	Total
Target	35.7	18.4	6.4	1.0	2.0	63.4
Actual	39.3	21.1	15.1	3.6	3.1	82.1

Table 2.9

Table 2.10 shows the output sign-off position of each of the 33 programmes.

OMGWG Grouping	Quarterly monitored programme areas	Q4 2010-11 Target	Q4 2010-11 Actual	Q4 2010-11 Position	Year End 2010-11
Drinking Water Quality	Km of mains rehabilitated to improve drinking water quality	0	0	On Target	Green
	Number of WTW receiving improved disinfection control	0	0	On Target	Green
	Number of WTW improved to meet quality standards	0	0	On Target	Green
	Number of sites with reduced risk from cryptosporidium	0	0	On Target	Green
	Number of zones with reduced lead levels	6	7	On Target	Green
	Number of DMA subject to investigations	50	61	On Target	Green
	Type A Raw water supplies provided with treatment	0	0	On Target	Green
	Number of raw water sample points installed	0	0	On Target	Green
	Number of lead comms pipes removed	0	0	On Target	Green
	Number of backflow prevention devices installed	0	4	On Target	Green
	Number of sites covered by drinking water safety plans	80	109	On Target	Green
	Number of tanker fill points installed	0	0	On Target	Green
	Number of sites with increased security	0	0	On Target	Green
	Number of WRZs receiving company standard for security of supply (under 7 stage)	0	0	On Target	Green
	Number of WRZs receiving company standard for security of supply	0	0	On Target	Green
Environmental Protection	Improvements to the Wastewater Network (properties)	0	0	On Target	Green
	Number of properties with environmental improvements to support the 2014 Commonwealth Games	0	0	On Target	Green
	Number of UIDs improved (under 7 stage)	0	0	On Target	Green
	Number of UIDs improved (excluding 7 stage)	0	3	On Target	Green
	Number of dual manhole systems upgraded	0	0	On Target	Green
	Number of WWTW discharges improved to meet new licence requirements	0	1	On Target	Green
	Number of WWTW upgraded to meet existing licence requirements	0	0	On Target	Green
	Number of WWPS upgraded to comply with existing licence requirements	0	0	On Target	Green
	Number of WWTW brought into compliance with licence non-sanitary requirements	0	0	On Target	Green
	Number of wastewater network assets made compliant with licence requirements	0	0	On Target	Green
	Number of surface water systems upgraded	0	0	On Target	Green
Number of environmental studies undertaken	11	14	On Target	Green	
Malodour	Number of sites where malodour is reduced	0	0	On Target	Green
Customer Service	Properties removed from low pressure register	221	484	On Target	Green
	Properties removed from low pressure register (Exclusions under 1980 Act)	25	50	On Target	Green
Flood Management	Number of assets protected from flood risk	0	0	On Target	Green
	Number of models to support the Flooding Bill	0	0	On Target	Green
	Number of flooding asset risk assessments	0	0	On Target	Green

Table 2.10 Q&S3b Output sign-off

3. Expenditure, Performance and Efficiency

HCA financial results

The table below compares the Historical Cost Accounting results for Scottish Water's activities to 31 March 2011 excluding subsidiaries. The financial results below exclude all of the statutory adjustments required under the International Accounting Standards (IAS), including IAS 19 'Employee Benefits'.

	2010/11	2009/10	Change
	£m	£m	£m
Turnover	1,049.8	1,066.2	-16.4
Operating costs	466.6	437.0	-29.6
Depreciation / amortisation	318.7	301.5	-17.2
Gain on sale of assets	-5.7	-1.6	4.1
Total costs	779.6	736.9	-42.7
Operating surplus before interest	270.2	329.3	-59.1
Net interest	155.4	155.3	-0.1
Profit before tax – Regulated	114.8	174.0	-59.2
Profit before tax – Non Regulated	0.1	0.3	-0.2
Profit before tax – Scottish Water	114.9	174.3	-59.4
Taxation charge	23.1	33.3	10.2
Profit after tax	91.8	141.0	-49.2

The surplus before tax in the year for Scottish Water was £114.9 million, £59.4 million lower than in 2009/10 (£174.3 million). The regulated surplus before tax was £59.2 million lower at £114.8 million.

Revenue

Regulated revenue for the year totalled £1,049.8 million (2010 - £1,066.2 million) and is analysed by category in the table below:

	2010/11	2009/10	Change
	£m	£m	£m
Household	743.5	737.4	6.1
Wholesale	302.4	324.6	-22.2
Other	3.9	4.2	-0.3
Total regulated revenue	1049.8	1066.2	-16.4

Revenue from services supplied to household customers increased by £6.1 million or 0.8% to £743.5 million reflecting the increase in connected properties and the tariff freeze effective from 1 April 2010. Revenue from wholesale services supplied to Licensed Providers reduced by £22.2 million or 6.8% to £302.4 million driven

primarily by the reduction in regulated wholesale charges to Licensed Providers. Revenue from other sales reduced by £0.3 million to £3.9 million.

At £1,050m revenue for 2010/11 is below the £1,061m expected in the Delivery Plan. The shortfall has occurred in relation to Wholesale revenue and is a significant cause of concern for Scottish Water.

The plan had assumed that routine changes in occupancy status by the registered Licensed Provider would cause the number of billed properties to increase in line with gross domestic product (GDP) as forecast at the time and that the vacancy review project would result in an incremental increase in billed properties and revenue.

Although the vacancy project, which investigated the large number of vacant non-household premises registered at the CMA, identified 8,404 vacant premises that were actually occupied, the net increase in revenue-generating non-household premises was only 1,136 (at September 2010). This reflects the high number of properties where the status has been update from 'occupied' to 'vacant' by the registered Licensed Provider, which suspends wholesale charges, and a very low number of updates from "vacant" to "occupied". We are discussing this pattern with the Licensed Providers and the Commission to ensure that market data shows the correct status.

Other contributing factors to the lower than expected number of non-household premises included issues with the new connections processes which resulted in properties not entering charge correctly and incorrect Scottish Water and Licensed Provider data in the CMA's systems as identified by the CMA Market Audit. Both of these issues are currently being addressed.

Total costs

Total costs of £779.6 million were £42.7 million higher than in 2009/10.

Operating costs of £466.6 million were £29.6 million higher than 2009/10. Within these costs, regulated operating costs of £327.8 million were 8.6% or £25.9 million higher than in 2009/10 while PFI costs were £3.7 million higher at £138.8 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £8.1m or 3.2%. £34.0m of specific additional costs were incurred compared with last year, namely: £3.8m for additional costs (relative to 2009/10) associated with the extreme weather events; £4.0m associated with restructuring the business; absorption of £11.8m of inflation; and a net increase in local authority rates charges of £14.0m. The table below summarises this movement:

	2010/11	2009/10	(inc)/dec	
	£m	£m	£m	%
Regulated Operating Costs (SW only)	327.8	301.9	-25.9	-8.6%
Winter costs	-6.9	-3.1	3.8	
VR costs	-10.5	-8.1	2.4	
Other restructure costs	-3.9	-2.3	1.6	
Average inflation (4.96%)		11.8	11.8	
New Opex	-2.0	-0.9	1.1	
Like for Like costs	304.5	299.3	-5.2	-1.7%
Local Authority rates charges	-55.7	-34.3	21.4	
Add back one-off rates credit	7.4		-7.4	
SEPA and WIC costs	-14.4	-15.1	-0.7	
Like-for-like real controllable costs	241.8	249.9	8.1	3.2%

Depreciation, including infrastructure depreciation, increased by £17.2 million to £318.7 million, primarily as a consequence of the capital investment programme. The gain on sale from asset disposals was £4.1 million higher than in 2009/10 at £5.7 million.

The average number of employees during the year decreased by 178, or 5%, to 3,356 (including SWS / SWS2 secondees). The number of employees in total at March 2011 (3,259) reduced by 213 from the March 2010 figure (3,472).

Finance costs

As at 31 March 2011, the weighted average interest cost of the £3,119.3 million outstanding debt was 5.15%, (2010 – 5.20%). Net interest payable during the year was £155.4 million, £0.1 million higher than in 2009/10.

During the year, net debt increased by £7.2 million to £2,867.0 million (being loans of £3,119.3 million less cash balances of £252.3 million). The increase was driven by a £106.0 million increase in borrowing from the Scottish Government off-set by a £98.8 million increase in cash balances.

Taxation

Scottish Water's tax charge was £23.1 million, (2010 – £33.3 million), an effective rate of 20.1% (2010 – 19.1%) in respect of deferred taxation. The effective rate for the year was favourably impacted by the change in UK corporation tax rate from 28% to 26% that will be effective from 1 April 2011 which meant the re-measurement of deferred tax balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £106.0 million for 2010/11. Actual net new borrowings in 2010/11 were £106.0 million.

Potential Regulatory Financing adjustment

There currently exists the potential for a minor regulatory financing adjustment to take account of circumstances that differ from those set out in the Final Determination. Many of these circumstances are subject to further change and we currently envisage that any required adjustment will be undertaken as part of the 2015-2020 strategic review of charges.

At 31 March 2011 the principal items that may need to be considered are:

- Movements in the capital programme indexation relative to the Final Determination assumptions on COPI over 2009/10 and 2010/10 noting that future forecast of COPI out to 2014/15 remain uncertain.
- The impact of the 2010 rates revaluation which increases operating costs by £120m (2007/08 prices) for the 2010-15 period.
- Carbon Reduction Commitment Costs which have been introduced for 2011/12 and may impact by around £3m per year out to 2014.15.
- Changes in Corporation Tax rates and capital allowances introduced in the June 2010 budget.
- Changes to the investment programme as set out in the OMGWG change register.

4. Supporting Information

Water Resources, Supply and Demand and Security of Supply Index

This year we have continued to provide unconstrained services with none of the population affected by hosepipe restrictions, although we were in the final stages of applying for emergency powers to address growing concerns in Dumfries and Galloway as a result of the prolonged dry spell in the early part of the year.

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 has been improving year on year as a result of the positive effects of the leakage reduction programme, growth and other water quality projects. Despite the severe winter weather our SoSI score improved from 32 to 35. However our score remains in the lowest banding for SOSI indicating that there are "large deficits against target headroom".

Leakage

Since the start of 2010/11, in line with UK Water Industry 'Best Practice' and in agreement with the Commission we have reported leakage in terms of Maximum Likelihood Estimation (MLE) Leakage. To be able to report MLE Leakage, the reconciliation difference between top-down (traditional) and bottom-up leakage needs to be within 5% of Distribution Input. As a result of improved confidence in the calculation of bottom-up leakage the reconciliation error for 2010/11 is 3.2%.

Our MLE reported leakage for 2010/11 is 699.1 MI/d, a 39.1 MI/d reduction on our reported MLE leakage of 738.2 MI/d for 2009/10, successfully out-performing our 2010/11 target of 720 MI/d. Table 4.1 below details the leakage reduction we have achieved in recent years.

Description (ML/d)	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Regulatory Reported leakage (OPA)	1104.1	1003.8	924	801.7	703.6	699.1
Leakage Target (OPA)		960	855	840	730	720
MLE adjusted leakage				816.4	738.2	699.1

Table 4.1

The Figure 4.1 presented below demonstrates the improvements in leakage over the last four years. The spikes in late 2009 and 2010 correspond with the extreme winter weather that caused extensive disruption across Scotland and caused operational challenges for us. Although we were able to achieve our leakage targets extreme winter weather events do have an adverse impact on leakage.

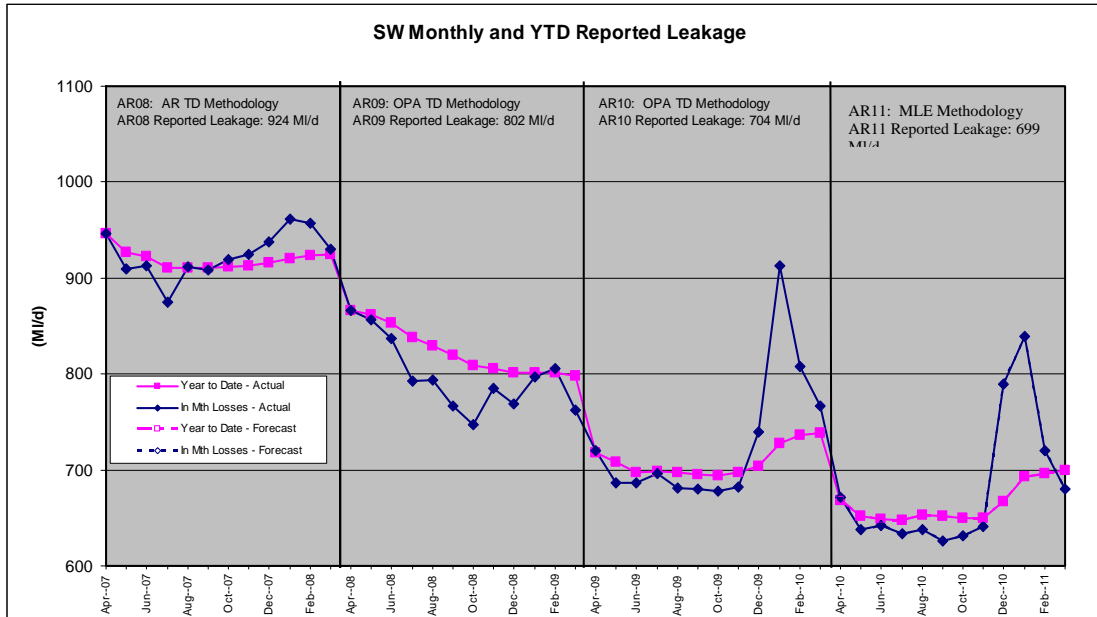


Figure 4.1

Our current assessment of the Economic Level of Leakage (ELL) was reported to the Commission at the end of January 2011. At 596 MI/d the report presented the case for a marginally lower ELL than previously stated, primarily due to the increased cost of producing and distributing water throughout the network due to higher costs for energy and chemicals. The report has been reviewed by the Commission's Independent Leakage Reviewer.

Board Changes

During 2010/11 there have been no changes to Scottish Water's Board.

Customer Satisfaction

As part of our commitment to improve the customer service we have reviewed how we measure customer satisfaction. In the past we conducted 1500 telephone interviews every 6 months to determine customer satisfaction levels. Whilst this provided valuable information and assisted in achieving improvements to our service, it had limitations. In particular, developing and tracking the success of improvement plans.

In 2010 we introduced a postal survey to monitor customer satisfaction all year round. Since its introduction, over 15,000 customers have taken part, providing satisfaction tracking and insightful comments about their experience. This valuable information is being used to drive improvements that are most valued by our customers. Despite a particularly demanding year due to severe weather events, our annual satisfaction score is 80.1%. Given the impact of the weather and the increased number of responses we are very pleased to have maintained our score at this level.

Information Improvements

We have continued to build on the foundations we laid in earlier years for improving the completeness, availability, reliability, access to and reporting of information. During 2010/11 the Inventory Team gained ISO9001 accreditation for the Asset Data Return process, the process by which data is captured and loaded into the inventory systems.

Following the implementation of CISP, our Capital Investment Systems and Process project, we have migrated our Q&S2 & 3a completion programme onto CISP consolidating all the data into one corporate system. Through rigorous challenge, we have continued to improve the data including running of audit checks as part of our governance processes.

Climate Change

The Climate Change (Scotland) Act sets an expectation on all public bodies that we will contribute towards the Government's goals for carbon reduction and adapting to climate change. We have continued to take action over the past year to meet these expectations.

Our Delivery Plan for 2010-15 includes a number of projects focussed on carbon mitigation and climate change adaptation, notably to install 25GWh of hydropower, pilot projects to investigate varying wastewater treatment intensity to save carbon, and examining sustainable treatment options.

Our latest carbon footprint report for 2009/10 takes account of a number of changes in accounting rules that makes it difficult to directly compare bottom line figures year to year. However, on a like-for-like basis we are pleased to report a fall of almost 9000 tonnes Carbon Dioxide equivalents (CO₂e) to a new bottom line figure of approximately 447,000 tonnes. As previously, this was produced in house and verified by Carbon Trust accredited consultants.

We have a comparable operational carbon footprint to the rest of the water industry.

We are continuing to progress the carbon mitigation and adaptation projects funded within SR10 and working closely with SEPA to explore regulatory opportunities to reduce carbon. These include issues such as dynamic licensing and seeking opportunities for sustainable treatment.

In late summer 2010 we published our first Carbon Plan on our website. This engaged all parts of Scottish Water in setting out what they could do to address carbon within their areas. Although modest in its overall contribution, the key objective of this plan was to engage the business. We are currently working with the Carbon Trust to develop phase 2 of the plan.

5. Looking Forward

During 2010 we completed a business restructure to transform the way we deliver service to customers and to drive through further improvements to our services during 2010-15.

Delivery Plan Update 2010-15

Scottish Ministers have confirmed their acceptance of Scottish Water's Delivery Plan Update for the remainder of the 2010-15 regulatory period as approved by the Scottish Water Board on 23 February 2011.

We are committed to delivering and outperforming the 2010-15 regulatory contract and remain confident about the pace and effectiveness of our delivery. Achieving out-performance will enable Scottish Water to progress considerably towards our vision. Improvements are being driven through three major initiatives.

Pace

Pace aims to benefit our customers, our people and our business by improving our overall performance and reducing our costs while delivering outstanding customer service. Pace will increase operational effectiveness and efficiency and help to achieve our Vision.

Pace has four key activities. These are:

- Intelligent control centre – designing Scottish Water's new control centre.
- Customer Service management – looking at initiatives to ensure we deliver a positive customer experience at every point of the customer journey.
- Work Optimisation – Creating the best process to get it right for customers first time; working smarter to make sure they receive an improved quality of service.
- Contractor Management – Looking at managing contract and contractors more efficiently to deliver best value for money and performance.

The **DRIVE** programme has 11 projects currently running. Our Flagship projects are:

- **Asset Lifecycle Planning** – which will improve the approach we take to planning and maintaining our asset stock. It will deliver processes to support decision making, develop a format for asset lifecycle plans, and create a portal which will provide comprehensive, well-presented asset information.
- **Frontier** - which will enable us to deliver our capital investment programme within financing limits, i.e. meet our SR10 affordability targets, and which seeks to place us in the upper quartile for capital efficiency by 2015.
- **LIMS** – which will deliver an upgraded Laboratory System, to enable our Scientific Services team to drive efficiencies and grow its income.

Frontier

Our Frontier project will enable the Q&S3b programme to deliver efficiencies within the SR10 programme and aims to place Scottish Water in the upper quartile for capital efficiency in the UK water industry by 2015. The project is identifying opportunities to reduce costs & increase efficiency and we aim to sustain these behaviours into the future, embedding them in the culture. Work is ongoing across a number of capital programme areas all of which are challenging the established ways of working.

Incentivising Developers

During 2010/11 we have undertaken research and development activities to incentivise developers to adopt water efficiency measures in new and refurbished housing.

As part of this research and development work, the following activities are being undertaken;

- The Building Research Establishment (BRE) are engaged on a suite of four work packages commencing February 2011 including utilising their Ravenscraig 'Innovation Park' (currently under construction) as an exemplar site for water efficiency technology. In addition to utilising the BRE Innovation Park to showcase water efficiency technologies, these work packages cover research and evidence gathering, technical support and peer review support as well as helping facilitate engagement with the development community in Scotland to gain support for our water efficiency activities.
- We are working with the Scottish Government to influence emerging Building Standards policy to ensure that these consider the need for water efficiency measures in new-build housing.
- We are in discussion with around twenty leading house builders in Scotland to identify how we can support improved water efficiency specification for new-build and refurbished housing projects. We have had interest from a number of developers both within the private and social housing sectors and are continuing to pursue and encourage others to get involved
- We are collaborating with Glasgow Housing Association and Link Housing Association, to undertake work within the social housing sector. This work is aimed at developing an optimum specification for water efficiency fixtures and fittings within the social housing sector which will not only maximise water efficiency opportunities but also contribute towards energy efficiency through reducing hot water usage.
- We are engaged with Waterwise who are providing technical support and peer review of our proposed water efficiency activities

Governance

Although this year's Annual Return represents a reduced regulatory reporting requirement, we have retained the methodologies and processes used for producing the detailed information in Scottish Water's Annual Return to the Water Industry Commission developed over previous years. In the absence of a replacement for the Reporter whose role was removed in December 2010, Scottish Water re-engaged Black and Veatch to undertake the role of the Reporter for Scottish Water as part of the normal assurance to the Scottish Water Board and consequently the Commission.

This approach has ensured that this submission continues to be based on sound processes and assumptions.

Please find our Board assurance statement at Appendix 1.

Appendix 1

Annual Return 2010/11 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:

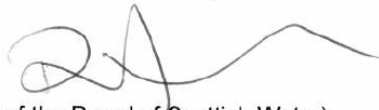
- the controls and assurance process put in place by the Executive Directors to ensure that the Annual Return is consistent with the requirements of regulatory reporting;
- a signed assurance statement from the Chief Executive concerning the operation of the systems of internal control;
- reporting from 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

10/6/2011