

Independent Auditors' report to the Water Industry Commission for Scotland and the Board Members of Scottish Water

We have audited the Regulatory Accounts of Scottish Water for the year ended 31 March 2012, which comprise:

- the regulatory historic cost accounting statements, comprising the historic cost income and expenditure account, historic cost balance sheet, historic cost balance sheet – reconciliation to statutory accounts, statement of total recognised gains and losses, consolidated historic cost income and expenditure account and consolidated historic cost balance sheet (M tables 1, 2, 3, 19, 27 and 28);
- the regulatory current cost accounting statements, comprising the current cost income and expenditure account, current cost balance sheet, current cost cash flow statement and related notes to the current cost accounting statements (M tables 4, 5, 6, 7, 8, 11, 13, 18w, 18ww, 18bw, 18bww and 22,); and
- the Statement of Accounting Policies; and
- Supporting M Table Commentary provided by Management

The Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies.

This report is made, on terms that have been agreed, solely to Scottish Water and the Water Industry Commission for Scotland (“the WICS”) in order to meet the requirements of regulatory accounting rules issued by the WICS under the Water Industry (Scotland) Act 2002. Our audit work has been undertaken so that we might state to Scottish Water and the WICS those matters that we have agreed to state to them in our report, in order to (a) assist Scottish Water to meet its obligations under the regulatory accounting rules issued by the WICS and (b) facilitate the carrying out by the WICS of its regulatory functions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Scottish Water and the WICS, for our audit work, for our report, or for the opinions we have formed.

Respective responsibilities of the WICS, the Board Members, Accountable Officer and Auditors

As explained more fully in the Statement of Board Members' Responsibilities for Regulatory Information set out in The Statement of Board Members' Responsibilities for Regulatory Information, the Board and Chief Executive are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the Regulatory Accounts

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts (M Tables 1, 2, 3, 4, 5, 6, 7, 8, 11, 13, 18w-ww, 18bw-ww, 19, 22, 27 and 28) sufficient to give reasonable assurance that the Regulatory Accounts (which we are responsible for auditing) are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the entity's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Board Members; and the overall presentation of the Regulatory Accounts. In addition, we read the Supporting M table commentary to the Regulatory Accounts to identify material inconsistencies with the audited Regulatory Accounts. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of Scottish Water where these are laid down by the Regulatory Accounting Rules. Where the Regulatory Accounting Rules do not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of Scottish Water. Furthermore, as the nature, form and content of Regulatory Accounts are determined by the WICS, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland). Specifically, the Regulatory Accounts prepared by the Board and Chief Executive exclude statutory balances and transactions relating to IAS 19 Employee Benefits (previously FRS 17 – Retirement Benefits under UK GAAP).

Opinion

In our opinion, the Regulatory Accounts:

- fairly present in accordance with the Regulatory Accounting Rules issued by the WICS, and the accounting policies set out in the Statement of Accounting Policies, the state of Scottish Water's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost surplus and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with the Regulatory Accounting Rules and the accounting policies.

Basis of preparation

Without modifying our opinion, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Regulatory Accounting Rules, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historic cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of Scottish Water and have not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union, as interpreted and adapted by the 2010/11 Government Financial Reporting Manual (FReM). Financial information other than that prepared on the basis of IFRS, as interpreted and adapted by the FReM, does not necessarily represent a true and fair view of the financial performance or financial position of Scottish Water as shown in statutory financial statements prepared in accordance with Water Industry (Scotland) Act 2002. Furthermore, the regulatory historic cost accounting statements set out in M tables 4, 5, 6, 7, 8, 11, 13, 18w, 18ww, 18bw, 18bww and 22 have been drawn up in accordance with Regulatory Accounting Rule 3 in that infrastructure renewals accounting should be applied and accordingly that the relevant sections of International Financial Reporting Standards be disapplied.

Opinion on other matters prescribed by The Water Industry Commission Scotland

Under the terms of our engagement we have assumed responsibility to provide those additional opinions required by the WICS in relation to the accounting records. In our opinion:

- proper accounting records have been kept by Scottish Water as required by the Water Industry (Scotland) Act 2002;
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.;

Other matters

The nature, form and content of Regulatory Accounts are determined by the WICS. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WICS's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of Scottish Water for the year ended 31 March 2012 on which we reported on 8 June 2012, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of Scottish Water (our "Statutory" audit) was made solely to the members of the Board of Scottish Water as a body, the Scottish Parliament and the Auditor General for Scotland in accordance with the Public Finance and Accountability (Scotland) Act 2000. Our Statutory audit work was undertaken so that we might state to the members of the Board of Scottish Water, the Scottish Parliament and the Auditor General for Scotland those matters that we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

13 June 2012

Notes:

1. The maintenance and integrity of the Scottish Water web site is the responsibility of the Board Members and the maintenance and integrity of the Water Industry Commission for Scotland's web site is the responsibility of the Water Industry Commission for Scotland; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.