

## **M Tables – Regulatory Accounts Commentary**

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### **1. General Comments**

2011/12 is the third financial year that Scottish Water has prepared its statutory financial statements under International Financial Reporting Standards (IFRS). In preparing the financial results reported in the M Tables, all IFRS adjustments have been excluded, including the adjustments arising from IAS 19 'Employee Benefits'. Therefore the results reported in the M Tables are on a basis consistent with the Delivery Plan.

Details and explanations of the IFRS adjustments within the statutory accounts are provided in Appendix 1.

The consolidation tables – M27 and M28 – include the results of Scottish Water Horizons Holdings Limited (SWHH), Scottish Water Horizons Limited (SWH) and Scottish Water International Limited (SWI) along with Business Stream Holdings Limited (SWBSH) in the Non Core/Non Licensed column, while Business Stream is included in the Licensed column.

### **2. Results & Reconciliation**

SW produces statutory consolidated accounts incorporating the results of all subsidiary companies. The consolidated statements also include the balance sheet (and relevant notes) for SW only ('company'). Detailed reconciliations between the statutory accounts and the regulatory tables are detailed in Appendix 2 to this document.

M Table financial information is for SW only, i.e. excluding SWBSH, SWHH, Business Stream, SWH and SWI, and is analysed between Core (= Regulatory business) and the remaining Non Core (= Non regulatory activities) where required. The exceptions to this are:

- tables M18W and M18WW which include the costs of SWH and SWI; and
- tables M27 and M28 which provide reconciliations from the SW Core figures to the group consolidated income statement and balance sheet respectively.

Due to some different descriptions and terminology between the regulatory M tables and the statutory accounts, Appendix 2.1 and 2.2 provide reconciliations from the Table M27 totals and M28 totals to the statutory consolidated income statement and consolidated balance sheet, respectively. Appendix 2.3 shows the reconciliation between Table M2 and the statutory "company" balance sheet.

Regulated / Non Regulated have been accounted for separately in SW's general ledger system enabling the production of regulated/non-regulated profit & loss accounts and

balance sheets. These form the basis for the historical cost figures and analysis, in particular Tables M1, M2, M27 & M28.

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

In previous years the closing CCA fixed asset values have been taken from the H Tables. However, as no H Tables have been prepared for the 2011/12 Annual Return, the CCA fixed asset values at 1 April 2011 (as reported in the 2010/11 M Tables) have been updated by the relevant asset and depreciation movements during 2011/12. Therefore the CCA fixed asset values as at 31 March 2012, for the M Tables, have been calculated using the brought forward balances at 1 April 2011, adjusted by RPI (3.57%), adding the 2011/12 additions, deducting disposals during the year and less the CCA depreciation charge for 2011/12. No revaluation adjustments were required within the fixed asset tables because no revaluation has taken place.

### **3. Assumptions**

#### **Non core tax charge**

It has been assumed that there are no brought forward profits/losses or capital allowances for the non core element. The tax charge is based on the actual profit attributable to the non regulatory businesses in 2011/12. (Tables M1, M2)

#### **CCA adjustments**

RPI of 3.57% has been used in the relevant adjustments, being the rate as at March 2012.

#### **CCA working capital adjustment**

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

#### **CCA fixed asset values**

Opening CCA fixed asset values have been taken from the M Tables for the year ended 31 March 2011, being the MEAV values rolled forward. The RPI adjustment has been calculated on these opening balances. The additions (to assets under construction) and the reclassifications (from assets under construction) are on a historical cost basis. CCA depreciation has been calculated on a consistent basis as in 2010/11, using the % of gross to net book value of 44% per Table M8 as at 31 March 2011.

#### 4.1 Commentary – Tables M1 to M28

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

##### Table M1 – HCA Income & Expenditure Account

The Core information is from the general ledger reports for the Regulated business. The non core information relates to the sundry non regulated activities which remain within Scottish Water.

Scottish Water's regulated operating costs (i.e. excluding depreciation, PFI charges and costs associated with non regulated activities) increased by £12.4m to £340.2m compared to £327.8m in 2010/11. The £12.4m increased cost was due primarily to:

- a £3.0m charge for the new Carbon reduction contribution scheme;
- a £10.0m increase in local authority rates arising from the 2010 rating revaluation; and
- the £11.7m impact of inflation; partly offset by
- a £6.4m reduction in exceptional winter costs, which arose from the extreme weather conditions between November 2010 and January 2011.

Adjusting for these movements, like-for-like controllable operating costs for 2011/12 were £245.9m reflecting a reduction in real terms of £9.6m (3.8%). The table below summarises this movement:

			2011/12	2010/11	Movement
			£m	£m	fav/(adv)
					£m
<b>Core operating expenditure - line M1.2</b>			<b>340.8</b>	<b>328.5</b>	<b>-12.3</b>
Less: Internal PFI costs			-0.6	-0.7	-0.1
<b>SW Regulated operating costs</b>			<b>340.2</b>	<b>327.8</b>	<b>-12.4</b>
Winter costs (a-typical)			-0.5	-6.9	-6.4
VR and other restructure costs			-15.5	-14.4	1.1
Carbon reduction contribution			-3.0	-	3.0
New Opex			-2.0	-	2.0
Average inflation (4.8%)			-	11.7	11.7
			<b>319.2</b>	<b>318.2</b>	<b>-1.0</b>
LA rates (2011: net of a-typical rates credit)			-58.3	-48.3	10.0
SEPA and WIC costs			-15.0	-14.4	0.6
<b>Like-for-like real controllable costs</b>			<b>245.9</b>	<b>255.5</b>	<b>9.6</b>

The cost of the PFI schemes in the year was £146.1m (excluding PFI team costs), £7.9m higher than in 2010/11 mainly because of inflation.

Depreciation, including the infrastructure renewals charge and amortisation charges, increased by £10.3m to £329.0m, predominantly as a consequence of the capital investment programme.

Other operating income of £0.7m (line 1.8) was the gain on disposal of fixed assets, £5.1m lower than in 2010/11.

The net interest charge was £156.8m (2010/11: £155.4m) (line 1.11). The increase of £1.4m reflected the drawdown of the new borrowings partly offset by lower interest rates and higher interest received.

SW's total tax credit, on a statutory basis, was £0.5m (2011: £41.1m charge). This was primarily due to the re-measurement of deferred tax balances as a result of the change in the UK corporation tax rate from 26% to 24% that will be effective from April 2012. To date, there has been no cash impact on SW's tax payments as a result of accounting on an IFRS basis.

#### **Table M2 – HCA Balance Sheet**

Core / Non core information is from the general ledger reports. The non core information relates to the sundry non regulated activities which remain within Scottish Water following the transfer of the majority of the non regulated activities to SWH on 1 April 2008.

The main differences from the statutory HCA balance sheet are due to the IFRS adjustments in respect of infrastructure assets and PFI assets. These are explained in more detail in Appendix 1. In addition, the Infrastructure Renewals accrual is recognised separately in the M Tables (£54.0m, line 2.14).

Investment – other (line 2.3) is the investment in SWHH of £37.6m. During 2011/12 the Scottish Water group was restructured with SW's interest in SWBSH (and its subsidiary Business Stream) transferred to SWHH. In exchange, SWHH issued the equivalent number of ordinary shares to SW, thereby increasing its investment to £37.6m.

Debtors increased by £7.2m to £58.6m (line 2.6) due to:

- an increase in non trade debtors (from £13.2m to £20.7m; Table M5, line 5.12) being higher VAT receivable outstanding from HMRC; and
  - higher prepayments and other short term debtors (from £5.3m to £6.3m; Table M11, line 11.6) due to higher service contract and insurance prepayments;
- partly offset by
- lower household trade debtors (from £27.7m to £27.4m; Table M11, line 11.2); and
  - lower other trade debtors (from £5.2m to £4.1m; Table 11, line 11.4).

Cash at bank decreased by £11.3m to £240.9m.

The corporation tax and deferred tax balances are shown on a statutory (IFRS) basis, excluding the deferred tax asset in respect of the IAS 19 pension liability. To date, there has been no cash impact on SW's tax payments as a result of accounting on an IFRS basis.

Post employment liability (line 2.27) is blank due to the IAS 19 pension liability being excluded from the M Tables. This approach is consistent with the exclusion of all other statutory adjustments required under IFRS and consistent with the presentation in previous years.

Other provisions (line 2.28) have decreased by £3.2m to £38.6m due primarily to a net decrease in the reorganisation provision (£4.6m) partly offset by a net increase in the wholesale income uncertainty provisions (£1.4m).

#### **Table M3 – HCA Balance Sheet – Reconciliation to Statutory Accounts**

This provides a summary of the main reconciling items. The Profit and Loss section (lines 3.1-3.5) reconciles the statutory Group consolidated figures to Table M1 Core figures, because no profit and loss figures are provided for SW company in the statutory accounts. However, more details have been given in the appendices – 2.1, 2.2 and 2.3. The balance sheet section (lines 3.8-3.15) reconciles SW Company figures from the statutory accounts to Table M2 Core figures.

#### **Table M4 – CCA Income & Expenditure Account**

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

- CCA depreciation is calculated based on the brought forward CCA net book values. The net/gross % indicates 44% of the average useful life remains.
- The index applied is the RPI at 31 March 2012 of 3.57%.
- The amortisation of deferred income (grants and contributions) is adjusted for indexation.
- The working capital adjustment is the index applied to the opening (operating) working capital (as in Table M11).
- The financing adjustment is the index applied to the opening net finance amount for SW.

#### **Table M5 – CCA Balance Sheet**

Tangible assets balance (line 5.1) equals the calculated rolled forward net MEAV plus the value of assets in the course of construction (£0.8bn).

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

Non trade debtors (line 5.12) is VAT receivable at March.

Other creditors due after one year (line 5.20) consists of payments received in advance (£47.8m).

The other provisions total of £38.6m (line 5.24), a reduction of £3.2m compared to 2010/11, is made up of reorganisation (£33.3m), income uncertainty (£4.8m) and other (£0.5m):

*Reorganisation:* VR and related pension payments made during the year of £12.3m were partly offset by additional VR charges for pension costs and staff redundancies, due to the ongoing restructuring of the business, of £7.8m.

*Income uncertainty:* This provision relates to uncertainty around the wholesale/non-domestic income. Progress has continued to be made in stabilising the settlement process and data during the year. However, some issues still remain, especially with regard to vacant and gap sites, which affect the wholesale charges. The reconciliation process relating to each financial year would normally be finalised 18 months after the end of the relevant financial year. However, at 31 March 2012, the final settlement reports (RFs) for the 2008/09 and 2009/10 financial years had not been agreed by the relevant parties nor billed by SW to the Licensed Providers. Therefore these years still remain 'open'. In March 2012 the CMA issued their RF in respect of 2010/11. Initial reviews have already highlighted the possibility of some major adjustments. Given these facts, the provision has been increased by £1.4m to £4.8m.

The income & expenditure reserve (line 5.28) is the total of the reserve brought forward from 31 March 2011 and the CCA loss for 2011/12.

The movement in the current cost reserve (line 5.29) is due to the CCA inflation adjustments calculated on the opening balances (at 1 April 2011) of fixed assets, working capital, financing and grants and third party contributions. The table below shows the reconciliation.

<b>M Table</b>							
<b>line no.</b>							<b>£m</b>
5.29	Balance at 1 April 2011						37,594.590
	<i>Inflation adjustments:</i>						
8.3/8.10	Fixed assets						1,469.247
7.14	Working capital adjustment						-8.553
4.14	Financing adjustment						-1.837
	Grants & 3rd party contributions adjustments						-0.798
5.29	Balance at 31 March 2012						<u>39,052.649</u>

The detailed calculations for the financing adjustment and grants and third party contributions are provided in the tables below.

<b>M Table</b>		<b>1 April 2011</b>	<b>RPI</b>	<b>Financing</b>	<b>M Table</b>
<b>line no.</b>		<b>£m</b>	<b>%</b>	<b>adjustment</b>	<b>line no.</b>
				<b>£m</b>	
5.26	Net assets employed	41,541.982			
5.8	Net operating assets	42,040.043			
		-498.061			
5.22	Deferred tax - add back	446.600			
	Net finance	<u>-51.461</u>	3.57%	<u>-1.837</u>	4.14
				<b>Grants &amp; 3rd</b>	
				<b>party contrib.</b>	
<b>M Table</b>		<b>1 April 2011</b>	<b>RPI</b>	<b>adjustment</b>	
<b>line no.</b>		<b>£m</b>	<b>%</b>	<b>£m</b>	
5.2	Third party contributions	<u>-22.371</u>	3.57%	<u>-0.798</u>	

#### **Table M6 – CCA Cash Flow**

Interest paid (line 6.5) includes intercompany interest paid to Business Stream of £0.1m in relation to the settlement of wholesale billing and reconciliation process.

The gross cost of fixed assets purchased (line 6.9) relates to the additions within the 'Assets in the course of construction' (AUC) column of Table M8. All additions to fixed assets are entered in AUC before being reclassified to the appropriate fixed asset category when they come into beneficial use. As the exact categorisation of fixed assets (including the split between base and enhancement for infrastructure assets) is not determined until they come into beneficial use, it is not possible to analyse the cash payments relating to fixed assets between lines M6.9 and M6.11. Accordingly, all cash payments are shown in line M6.9 and reconcile to the additions to fixed assets in Table M8 (line 8.5) as follows:

		M Table / line ref	£m
	Opening short term capital creditor	M11.10 (10/11)	139.812
Add:	Additions - gross per table below		** 453.734
Less:	Closing short term capital creditor	M11.10 (11/12)	120.863
<b>=&gt;</b>	<b>Cash payments - gross</b>	<b>M 6.9</b>	<b>472.683</b>
	Additions to fixed assets - net cost	M 8.5	448.732
Add:	Infrastructure income & customer contributions		4.114
	Additions to fixed assets - gross cost		452.846
Add:	PFI investment (Seafield & Dalmuir)		0.888
	Total additions		** 453.734

In 2011/12 £0.9m was invested in PFI projects thereby increasing PFI assets. £0.4m was invested in the Seafield odour improvement project and £0.5m was invested at Dalmuir PFI. These investments have been included in the gross cost of fixed assets purchased within the cash flow (line 6.9) as shown in the table above.

#### **Table M7 – Analysis of Turnover and Operating Income**

Turnover from services supplied to household customers increased by only £2.1m to £745.6m reflecting the increase in connected properties and the tariff freeze effective from 1 April 2011. The benefit to household customers of freezing household charges at a time when RPI was 4.5% (as at October 2010) was around £34m.

Turnover from wholesale services provided to Licensed Providers decreased by £7.7m, or 2.5%, to £294.7m driven primarily by the reduction in regulated wholesale charges.

Turnover from other sales increased by £1.6m to £5.5m due primarily to the transfer of housing development building water revenue from Licensed Providers.

#### **Table M8 – CCA Analysis of Fixed Assets by Asset type (Core)**

For Water Services and Sewerage Services columns, the opening (lines 8.1, 8.8 & 8.14) values in Table M8, agree to the values in Table M8 as at 31 March 2011. The additions in the year are at actual net cost. The inflation adjustment figures (lines 8.3 & 8.10) are the indexing of the brought forward values, using RPI of 3.57%. There are no values shown for the investment plan adjustment (lines 8.2 & 8.9) as there has been no revaluation carried out as at 31 March 2012 (i.e. no updated H Tables).

In Table M8 the support services have been allocated between water and waste water based on their HCA values.

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

The CCA depreciation is calculated based on the brought forward CCA net book values. The net/gross % per the M Tables at March 2011 was 44%. The index applied is the RPI of 3.57%. For additions during the year, half of the actual cost (i.e. assuming additions are in use for half of the year, on average) and the relevant average useful lives are the basis, with no indexing. The total CCA depreciation charge reconciles with the forecast charge per Table M22 in the 2010/11 M Tables as follows:

	Line ref	£m
CCA depreciation charge for 2011/12 per 2010/11 Table M22	M22.28 (10/11)	281.1
Indexation at 3.57%		10.0
		291.1
CCA depreciation on additions to fixed assets during 2011/12		16.9
	M4.4 / M8.12	<b>308.0</b>

#### Table M11 – CCA Working capital

Trade debtors decreased by £0.3m to £27.4m. The table below provides a breakdown of the household gross balances and bad debt provisions by age:

	96/07	07/08	08/09	09/10	10/11	11/12	Total
	£m	£m	£m	£m	£m	£m	£m
Gross Debt	188.9	27.4	31.2	34.1	37.2	53.5	372.3
Bad Debt Provision	(186.1)	(26.7)	(30.0)	(31.7)	(32.7)	(37.7)	(344.9)
<b>Net Debt</b>	<b>2.8</b>	<b>0.7</b>	<b>1.2</b>	<b>2.4</b>	<b>4.5</b>	<b>15.8</b>	<b>27.4</b>

Other trade debtors relate to sundry and non primary wholesale billing.

The increase in prepayments and other short term debtors (line 11.6) was due to higher service contract and insurance prepayments.

The wholesale charge prepayment of £24.9m at March 2012 is the total of the provisional invoices for April 2012.

Capital creditors consist of the balances due to SW Solutions and SW Solutions 2 (£2.3m and £32.2m respectively) and capital creditors and accruals relating to third parties (£86.4m).

A separate reconciliation (Appendix 2.4) has been prepared showing reclassifications from the statutory basis of receivables and payables into regulatory CCA working capital (operating items) and non operating debtors and creditors. (Tables M11 & M5).

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

The working capital movement (line 13.3) is the movement in the working capital totals (Table M11) excluding the short term capital creditors – see table below:

	M Table Line ref	2010/11 £m	2011/12 £m	Mvmt £m
Total working capital	M11.13	-239.6	-233.4	-6.2
Short-term capital creditors	M11.10	139.8	120.8	19.0
Movement in working capital	M13.3			<b>12.8</b>

#### Table M18B W – Analysis of fixed assets – Water Service

The information presented here is a more detailed analysis of the non infrastructure and infrastructure water assets provided in Table M8. The opening (lines 18b.1, 18b.7 & 18b.16) balances agree to the values in Table M18B W at 31 March 2011. Support service assets are not included in Table M18b.



Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.57% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). There are no values shown for the investment plan adjustment (lines 18b.2 & 18b.8) as there has been no revaluation carried out as at 31 March 2012 (i.e. no updated H Tables).

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

The information presented here is a more detailed analysis of the non infrastructure and infrastructure waste water assets provided in Table M8. The opening (lines 18b.1, 18b.7 & 18b.16) balances agree to the values in Table M18B WW at 31 March 2011. Support service assets are not included in Table M18b.

Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.57% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). There are no values shown for the investment plan adjustment (lines 18b.2 & 18b.8) as there has been no revaluation carried out as at 31 March 2012 (i.e. no updated H Tables).

**Table M19 – Statement of total recognised gains and losses (core)**

As all IFRS adjustments have been excluded in the preparation of the M Tables, Table 19 only includes the profit for the year. There are no other recognised gains or losses which need to be noted here in a regulatory accounting context.

**Table M22 – Fixed asset additions and expected depreciation (CCA)**

The non infrastructure additions (line 22.8) are the amounts reclassified from AUC, as described above. These figures agree to the reclassifications in Table M8 (line 8.6) for non-infrastructure assets and support services, as split between water and sewerage services. The following table provides the reconciliation of the reclassifications in Table M8 (line 8.6) to the ‘additions’ in Table M22:

	Line ref	Col ref	Water £m	Waste water £m	Total £m
Non infrastructure assets	M8.6	F / J	267.126	170.489	
Support services	M8.6	H / L	7.897	6.627	
<b>Additions per Table M22</b>	<b>M22.8</b>	<b>I / J</b>	<b>275.023</b>	<b>177.116</b>	<b>452.139</b>
Infrastructure assets - enhancement	M8.6	G / K	14.645	51.238	
Total	M8.6	I / M	289.668	228.354	518.022
<b>Infrastructure assets - base</b>	<b>M22.20</b>				<b>82.433</b>
<b>Total reclassifications from AUC</b>	<b>M8.6</b>	<b>N</b>			<b>600.455</b>

The figures in the section “Infrastructure renewals charges, expenditure and provision”, (lines 22.20 – 22.22), are the movements during 2010/11 and 2011/12. Therefore the resulting total is not the closing balance as given in the balance sheets at 31 March 2012. The table below shows the full reconciliation:

Infrastructure renewals	31 March 2011	2011/12 movements	M22 refs	31 March 2012	M2 / M5 refs
- Expenditure	1,002.053	82.433	22.20	1,084.486	
- Charges	-1,031.000	-107.500	22.21	-1,138.500	
Prepayment / (accrual)	-28.947	-25.067	22.22	-54.014	2.14 / 5.7

In the section “Expected depreciation on closing assets as of 31 March 2012”, (lines 22.23 – 22.28), the gross book values and net book values are taken from Table M8. The forecast depreciation charges are calculated using the NBV at 31 March 2012 and 44% of the average useful lives remaining.

#### **Table M27 – Consolidated HCA Income & Expenditure Account**

The intercompany items being visibly eliminated (in col 3) on this table are the intercompany wholesale income in SW and the intercompany cost of sales in Business Stream. Due to an adjustment to Business Stream’s cost of sales relating to the reconciliation process, there is an intercompany profit elimination along with the related tax impact. The intercompany interest between SW and Business Stream already eliminates across line 27.11.

Non core / non licensed includes the remaining non regulatory business within SW (as per table M1), the results for the 2 holdings companies (SWBSH & SWHH - interest and taxation), SWH and SWI.

For 2011/12 Business Stream declared a dividend of £15.0m, payable to SWBSH. This eliminates across row 27.18.

Appendix 2.1 provides a reconciliation between Table M27 and the statutory consolidated income statement. The differences are due to the IFRS entries, along with different terminology and descriptions being used.

#### **Table M28 – Consolidated HCA Balance Sheet**

The intercompany items being visibly eliminated are:

- intercompany debtor and creditor balances (lines 2.6 & 2.15);
- intercompany profit elimination and related tax impact; and
- investments in subsidiary companies and the relevant share capitals (lines 2.3 & 2.30).

The intercompany loans eliminate across line 2.2.

Non core / non licensed includes the remaining non regulatory business within SW (as per table M2), the balance sheets for the 2 holdings companies (SWBSH & SWHH – intercompany loans, investment in subsidiary, intercompany debtors and creditors, taxation, share capital and reserves), SWH and SWI.

Appendix 2.2 provides a reconciliation between Table M28 and the statutory consolidated balance sheet. The differences are due to the IFRS adjustments in addition to reclassifications and grouping of various items.

## 4.2 M Table 18W & 18WW detailed commentary

### Methodology & Cost Allocation

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

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

### Trading Results & Reconciliation

Scottish Water Business Stream Limited (Business Stream) is a fully owned subsidiary of Scottish Water Business Stream Holdings Limited. Scottish Water produces consolidated accounts incorporating the results of Business Stream. However E & M18 table financials are produced for Scottish Water Regulated and Non Regulated activity, excluding Business Stream.

To aid comparison, the table below summarises Scottish Water consolidated results, Scottish Water company, Scottish Water Horizons and Scottish Water International results.

#### SW Group Statutory Accounts

	£m	£m
Cost of Sales	718.7	
Admin Expenses	<u>125.5</u>	
<b>SW Group Expenditure</b>		<b>844.2</b>
Less Business Stream		(40.2)
IFRS adjustments		<u>29.7</u>
<b>Total Expenditure</b> (excluding Business Stream and IFRS)		<b><u>833.7</u></b>
<b>Represented by</b>		
SW Regulated		815.2
SW Non Regulated		1.5
Horizons		16.6
International		0.4

E & M18W & WW Tables include the costs of Scottish Water (Core / Regulated), Scottish Water (Non Regulated), Scottish Water Horizons (Non Regulated), and Scottish Water International (Non Regulated). The costs of business retail activity undertaken by Business Stream are not reported in Scottish Water's E or M tables.

Scottish Water company, Scottish Water Horizons and Scottish Water International combined results are summarised and reconciled below, to E tables and the regulatory account tables M18 (W & WW).

(£m)	SW SWH & SWI*	Diff SW/SWH - M18	M18W/WW Tables			Diff M18 - E1/2/3a	E1/2/3a Tables Total
			Total	M18 W	M18 WW		
Employment	150.2						
Other	208.3		355.4	212.7	142.7		337.8
<b>Opex</b>	<b>358.5</b>	<b>3.0</b>	<b>355.4</b>	<b>212.7</b>	<b>142.7</b>	<b>17.6</b>	<b>337.8</b>
PFI	146.7	(4.2)	151.0	0.0	151.0	0.0	151.0
IMC	107.5	0.1	107.4	74.8	32.6	0.0	107.4
Depreciation	220.2		222.0	119.9	102.0		221.2
Grant Amortisation	(0.9)	(0.1)	(0.9)	(0.7)	(0.2)	0.8	(0.9)
Amort PFI	2.3		0.0				0.0
Gain on assets	(0.6)		0.0				0.0
<b>Expenditure</b>	<b>833.7</b>	<b>(1.2)</b>	<b>834.9</b>	<b>406.8</b>	<b>428.1</b>	<b>18.4</b>	<b>816.5</b>
Explained by							
Charges to SWBS for support		1.2					

\* Excludes Business Stream, IFRS & IAS19

The line differences are table presentation differences explained as follows:

- £4.2m difference between our Board report and M18 Tables re PFI costs is due to transfer of costs from Customer Operations for Intersite Sludge Tankering from Scottish Water waste water treatment works to PFI works (£3.1m), terminal pumping station costs pumping to PFI works (£0.7m) and support costs for the PFI team (£0.4m).
- £1.2m of Scottish Water expenditure has been charged to Business Stream under Service Agreements. This cost has been netted off Scottish Water's expenditure in line with group inter-company transaction reporting. However, for the purposes of regulatory reporting this expenditure has been added back to report the full costs of providing these third party services.
- £18.4m Non Regulated expenditure is included in M18 Tables but is excluded from E Tables.

## Commentary

Total operating costs excluding PFI costs and exceptional items increased by £26.2m (4.0%) to £683.9m.

	2011/12 £m	2010/11 £m	Variance £m
Operating expenditure - Water M18w.43	212.745	200.646	(12.099)
Capital maintenance - Water M18w.54	194.087	167.120	(26.967)
Operating expenditure - Waste M18ww.44	293.682	286.284	(7.398)
Capital maintenance - Water M18ww.55	134.410	145.917	+11.507
	<b>834.924</b>	<b>799.967</b>	<b>(34.957)</b>
Exclude PFI included in M18ww.35	(150.986)	(142.236)	+8.750
	<b>683.938</b>	<b>657.731</b>	<b>(26.207)</b>

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

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

## Activity Analysis

	2011/12 £m	2010/11 £m	Variance £m
Non Regulated	18.392	19.135	+0.743
Wholesale (excluding PFI)	616.374	589.474	(26.900)
Retail	49.172	49.122	(0.050)
	<b>683.938</b>	<b>657.731</b>	<b>(26.207)</b>

**Non Regulated** activity costs have decreased by £0.7m (3.9%) from 2010/11 to £18.4m (£1.4m Scottish Water, £16.6m Horizons, and £0.4m International). Non Regulated turnover increased by £0.5m from £19.7m in 2010/11 to £20.2m in 2011/12.

Direct costs have increased by £0.8m (6.0%), General & Support decreased by £1.1m (30.5%) and other operating expenditure has decreased by £0.4m (42.2%).

The key movements in Non Regulated Operating Costs from 2010/11 were:

- Following the restructure in 2010/11 with Horizons no longer active in the traditional contracting arena, reduction of direct costs by £4.5m (£1.5m employment; £1.6m hired and contracted; and £0.7m materials and consumables); and VR and Restructuring costs of £0.7m in prior year;
- Third Party Waste costs have increased by £1.0m due to new and increased Food and Green Waste collection contract work for councils (employment £0.2m; hired and contracted £0.7m; and other direct costs £0.2m); and £0.1m due to anaerobic digestion plant at the Deerdykes composting centre (power; and materials and consumables);

- External developer consultancy has increased by £2.6m (employment £0.3m; and hired and contracted £2.2m) mainly due to a few large projects;
- The level of recoverable works has decreased by £0.6m (employment £0.2m; and hired and contracted £0.4m), due to reduced third party damage;
- The new International company increased costs by £0.4m; and
- The bad debt charge has decreased by £0.3m relative to an increased charge in 2010/11 for a fibre in pipes project of £0.2m.

**Wholesale** activity cost movements are explained in support of Annual Return Table E and are not repeated in this document

**Retail** activity costs have increased by £0.1m (0.1%) to 49.2m.

	2011/12 £m	2010/11 £m	Variance £m
Domestic	41.929	41.209	(0.720)
Non Domestic - Measured	4.075	4.198	+0.123
Non Domestic - Non Measured	3.168	3.715	+0.547
	<b>49.172</b>	<b>49.122</b>	<b>(0.050)</b>

**Domestic** customer retail total operating costs have increased by £0.7m (1.7%).

The key movements from 2010/11 were:

- Increase in council domestic billing and collection service of £0.9m; partly offset by a small decrease in internal costs of £0.1m;

**Non domestic** customer retail total operating costs have decreased by £0.7m (17.7%) to £7.2m (£4.1m measured and £3.1m unmeasured).

The key movements from 2010/11 were:

- Cost of Regulation has increased by £1.0m mainly due to a increase in CMA costs of £0.6m; and wholesale CMA fines of £0.3m; and
- Decrease in depreciation of £1.5m as wholesale billing systems investment becomes fully depreciated.
- Cost of services provided to Business Stream under service agreements has remained unchanged. This cost has been netted off Scottish Water's expenditure for the purposes of group reporting. However, for the purposes of regulatory reporting this expenditure has been added back to report the full costs of providing these third party services.

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

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

Scottish Water does not have access to business customer details. However, Scottish Water does have knowledge of properties and services. Therefore the costs of activities are allocated to customer and service, primarily on the basis of properties and services volumes, except where activities are clearly attributable to one service.

The cost of handling customer calls has been split by service based on the number of calls. Licensed Providers are responsible for handling calls from business customers. The cost of initial customer contact related to wholesale activities will be incurred by Licensed Providers. However, where Licensed Providers require information or action from the wholesaler, this is the responsibility of the wholesaler. In this case the costs of calls are included under wholesale activities, e.g. water distribution includes the cost of all customer contact on this type of activity, e.g. low pressure calls, water rising calls. Therefore, no cost is shown in line M18WW.29 and M18W.28 under retail.

<b>Retail</b>	<b>2011/12</b>	<b>2011/12</b>	<b>2010/11</b>	<b>2010/11</b>
	£m	%	£m	%
Water - Domestic	20.954	42.6%	20.351	41.4%
Water - Non Domestic	3.896	7.9%	3.839	7.8%
Wastewater - Domestic	20.975	42.7%	20.858	42.5%
Wastewater - Non Domestic	3.347	6.8%	4.074	8.3%
	<b><u>49.172</u></b>		<b><u>49.122</u></b>	

The split of Retail operating costs between water and waste water level has remained consistent with 2010/11 (50.5% water, 2011/12 versus 49.2%, 2010/11).

## Scottish Water IFRS adjustments

### Introduction

Since March 2009 Scottish Water has prepared its statutory financial statements under International Financial Reporting Standards (IFRS). In preparing the financial results reported in the M Tables, the IFRS adjustments have been backed out and are summarised below. These adjustments form the reconciling adjustments in Appendix 2.1.

<i>Favourable / (unfavourable) impact on surplus before tax</i>		£m	Note ref.
IAS 19	Pension & holiday pay adjustments	8.4	1.
IAS 16	Infrastructure assets - depreciation & maintenance	(7.7)	2.
IFRIC 12	PFI costs - depreciation & lease liability	(0.7)	3.
<b>Scottish Water - IFRS adjustments</b>		-	
Business Stream - IAS 19 adjustments (net)		-	
<b>IFRS adjustments per Appendix 2.1</b>		-	

### Notes

In the following notes the bracketing convention means:

- favourable / (unfavourable) impact on the surplus in the income statement; and
- debit / (credit) in the balance sheet.

#### 1. IAS 19 'Employee benefits'

Pension charges are calculated under IAS 19. In the statutory income statement, the adjustments impact on cost of sales and finance costs. In the balance sheet, retirement benefit obligations are shown within non-current liabilities. IAS 19 also requires the calculation of a holiday pay accrual to provide for the potential cost of annual leave not taken by employees by the end of the financial year. The tables below provide details of the IAS 19 adjustments within Scottish Water.

<i>Adjustments in statutory accounts:</i>		£m
<i>Income statement</i>		
Cost of sales	Staff costs - holiday pay charge	-
CoS / Admin	Staff costs - pension costs	11.8
Finance costs - net		(3.4)
Impact on surplus before tax		8.4

<i>Balance sheet (see Appendix 2.3)</i>		
Retirement benefit obligations (/Post employment liabilities)		(281.7)
Deferred taxation on retirement benefit obligations		67.6
Retirement benefit obligations - net		(214.1)
Trade & other payables - holiday pay accrual		(1.9)



## 2. IAS 16 'Property, plant & equipment'

In previous years the main difference between the fixed assets in the statutory accounts and the M Tables has been the recognition of the Infrastructure Renewals Prepayment/Accrual in a separate line. Under IAS 16 infrastructure renewals accounting is not permitted and infrastructure assets are depreciated over the estimated economic lives of the identified components of the network. Expenditure which is judged to enhance the asset base, or where it is probable that future economic benefits will flow to Scottish Water, is capitalised. All other expenditure is charged as an operating cost.

<i>Adjustments in statutory accounts:</i>			£m
<i>Income statement</i>			
Cost of sales	Repairs & maintenance		5.6
	Depreciation		(13.3)
Impact on surplus before tax			(7.7)
<i>Balance sheet (see Appendix 2.3)</i>			
Property, plant & equipment			
	Cumulative adjustment as at 31 March 2012		(29.8)

## 3. IAS17 'Leases' & IFRIC 12 'Service concession arrangements'

Under IFRIC 12, the PFI service concession agreements have been classified as finance leases resulting in the PFI assets being brought on to Scottish Water's statutory balance sheet. Assets held under finance leases are recognised as part of the property, plant and equipment of the company and depreciated accordingly. The corresponding finance lease liability is included in the balance sheet as a finance lease obligation, within other loans and borrowings. The PFI costs incurred are broken down into three categories: operating costs, finance costs and reduction of the finance lease obligation. The operating and finance costs are charged directly to the income statement.

<i>Adjustments in statutory accounts:</i>			£m
<i>Income statement</i>			
Cost of sales	PFI costs reallocated		40.9
	Depreciation		(15.3)
Finance costs - net			(26.3)
Impact on surplus before tax			(0.7)
<i>Balance sheet (see Appendix 2.3)</i>			
Property, plant & equipment			
	Leased assets		375.6
	Owned assets	<i>(reclassification)</i>	40.2
			415.8
Other loans & borrowings			
	Finance lease liability	< 1 year	(15.5)
		> 1 year	(415.5)
		total	(431.0)

The following tables provide a reconciliation of the IFRS adjustments detailed above to the IFRS adjustment totals shown in Appendix 2.1.

			£m	Note ref.
<i>IFRS adjustments to Cost of sales and Administrative expenses</i>				
IAS 19	Staff costs - holiday pay charge (SW)		-	1.
	Staff costs - pension costs (SW)		11.8	1.
	Staff costs - pension costs (Business Stream)		-	
IAS 16	Repairs & maintenance		5.6	2.
	Depreciation		(13.3)	2.
IFRIC 12	PFI costs reallocated		40.9	3.
	Depreciation		(15.3)	3.
			<b>29.7</b>	
<i>IFRS adjustments to Finance costs</i>				
IAS 19	Pension scheme - interest on liabilities, less return on assets		(3.4)	1.
IFRIC 12	Finance lease finance costs		(26.3)	3.
			<b>(29.7)</b>	

Scottish Water  
Year ended 31 March 2012  
Reconciliation of Regulatory Accounts / M Tables to Consolidated Statutory Accounts

<b>TABLE M27</b>			<b>IFRS</b>		<b>Statutory Accounts (IFRS)</b>
<b>Line</b>	<b>Description</b>	<b>Consolidated</b>	<b>adjustments</b>	<b>Consolidated</b>	
		<b>£m (3dp)</b>	<b>£m (1dp)</b>	<b>£m (1dp)</b>	
27.1	Turnover	1,138.491	-	1,138.5	Revenue
27.2	Operating costs	(397.871)			
27.3	PPP costs	(146.104)			
27.4	Historical Cost Depreciation	(221.484)		(718.7)	Cost of sales
27.5	Infrastructure Renewals charge	(107.500)			
27.6	Amortisation of PFI assets	(2.341)		(125.5)	Administrative expenses
27.7	Amortisation of deferred income	0.904			
27.8	Operating income	0.492			
		(873.904)	29.7	(844.2)	
27.9	Operating profit	264.587	29.7	294.3	Operating surplus
				64.9	Finance income
				(252.2)	Finance costs
27.11	Net interest receivable less payable	(157.590)	(29.7)	(187.3)	
27.12	Profit on ordinary activities before taxation	106.997	-	107.0	Surplus before taxation
27.13	Taxation - current	(9.113)			
27.14	Taxation - deferred	1.003			
		(8.110)	(0.4)	(8.5)	Taxation
27.19	Retained profit for year	98.887	(0.4)	98.5	Surplus for the year

TABLE M28			IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Consolidated	IAS19	IAS16	IFRIC12	Infra	Deferred /	Split		
			Pension /	Infrastructure	PFI assets/	Renewals	Current tax			
		£m (3dp)	holiday pay	assets/depm	finance lease	Prepayment	presentation		Consolidated	£m (1dp)
	<i>Fixed Assets</i>									
2.1	Tangible Assets	4,864.130		(29.8)	415.8	(54.0)			5,196.1	<i>Non-current assets</i>
2.2	Investment - loan to group company	-								Property, plant & equipment
2.3	Investment - Other	0.088								
2.4	Total fixed assets	4,864.218							5,196.1	
	<i>Current Assets</i>									<i>Current assets</i>
2.5	Stocks	1.865							1.9	Inventories
2.6	Debtors	185.462							185.5	Trade & other receivables
2.7	Cash at bank and in hand	355.240					1.0		1.0	Current tax asset
2.8	Short term deposits	-							355.2	Cash & cash equivalents
2.9	Gilts reserve	-								
2.10	Assets transferred to PPP contractors	40.212			(40.2)					
2.11	Infrastructure Renewals prepayment	-								
2.12	Total current assets	582.779							543.6	
	<i>Creditors: amounts falling due within one year</i>									<i>Current liabilities</i>
2.13	Overdrafts	-								
2.14	Infrastructure Renewals accrual	(54.014)				54.0				
2.15	Creditors	(399.460)	(2.1)					(2.5)	(i)	(404.0)
2.16	Borrowings (excl. Govt. loans)	(1.700)			(15.5)					(17.2)
2.17	Corporation tax payable	(3.414)					(1.0)			(4.4)
2.18	Customer retained earnings payable	-						(5.4)	(ii)	(5.4)
2.19	Total creditors	(458.588)								(431.0)
2.20	Net current assets	124.191								112.6
2.21	Total assets less current liabilities	4,988.409								5,308.7
	<i>Creditors: amounts falling due after one year</i>									<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(2.435)			(415.5)					(417.9)
2.23	Other creditors	(47.820)						(22.8)	(i)	(70.6)
2.24	Total creditors	(50.255)								(488.5)
	<i>Provision for liabilities &amp; charges</i>									
2.25	Deferred tax provision	(447.177)	67.5					-		(379.7)
2.26	Deferred income - grants and contributions	(25.327)						25.3	(i)	(281.1)
2.27	Post employment assets / (liabilities)	-	(281.1)							(281.1)
2.28	Other provisions	(38.893)	32.4					5.4	(ii)	(1.1)
2.29	Net Assets employed	4,426.757	(183.3)	(29.8)	(55.4)	-	-	-		4,158.3
	<i>Capital and reserves</i>									<i>Equity</i>
2.30	Govt. loans	3,223.640								3,223.7
2.31	Income and Expenditure account	1,069.687	(183.3)	(29.8)	(55.4)			-		801.2
2.32	Other reserves	133.430								133.4
2.33	Capital & reserves	4,426.757	(183.3)	(29.8)	(55.4)	-	-	-		4,158.3

Scottish Water

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Reconciliation of Regulatory Accounts / M Tables to Consolidated Statutory Accounts (Company only)

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Total	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/depm	IFRIC12 PFI assets/ finance lease	Infra Renewals Prepayment	Deferred / Current tax presentation	Split < > 1yr	Company	
		£m (3dp)							£m (1dp)	
	Fixed Assets									<i>Non-current assets</i>
2.1	Tangible Assets	4,845.038		(29.8)	415.8	(54.0)			5,177.0	Property, plant & equipment
2.2	Investment - loan to group company	-								
2.3	Investment - Other	37.688							37.6	Investments
2.4	Total fixed assets	4,882.726							5,214.6	
	Current Assets									<i>Current assets</i>
2.5	Stocks	1.719							1.7	Inventories
2.6	Debtors	58.830							58.9	Trade & other receivables
							0.9		0.9	Current tax asset
2.7	Cash at bank and in hand	240.978							241.0	Cash & cash equivalents
2.8	Short term deposits	-								
2.9	Gilts reserve	-								
2.10	Assets transferred to PPP contractors	40.212			(40.2)					
2.11	Infrastructure Renewals prepayment	-								
2.12	Total current assets	341.739							302.5	
	Creditors: amounts falling due within one year									<i>Current liabilities</i>
2.13	Overdrafts	-								
2.14	Infrastructure Renewals accrual	(54.014)				54.0				
2.15	Creditors	(318.219)	(1.9)					(1.1)	(321.3)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	(1.700)			(15.5)				(17.2)	Other loans & borrowings
2.17	Corporation tax payable	0.850					(0.9)			
								(5.1)	(5.1)	Provisions for liabilities
2.18	Customer retained earnings payable	-								
2.19	Total creditors	(373.083)							(343.6)	
2.20	Net current assets	(31.344)							(41.1)	
2.21	Total assets less current liabilities	4,851.382							5,173.5	
	Creditors: amounts falling due after one year									<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(2.435)			(415.5)				(417.9)	Other loans & borrowings
2.23	Other creditors	(47.820)						(16.6)	(64.4)	Trade & other payables
2.24	Total creditors	(50.255)							(482.3)	
	Provision for liabilities & charges									
2.25	Deferred tax provision	(446.654)	67.6						(379.0)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(17.688)						17.7	(281.7)	Retirement benefit obligations
2.27	Post employment assets / (liabilities)	-	(281.7)						(1.1)	Provisions for liabilities
2.28	Other provisions	(38.622)	32.4					5.1		
2.29	Net Assets employed	4,298.163	(183.6)	(29.8)	(55.4)	-	-	-	4,029.4	<i>Net assets</i>
	Capital and reserves									<i>Equity</i>
2.30	Govt. loans	3,165.140							3,165.2	Government loans
2.31	Income and Expenditure account	999.593	(183.6)	(29.8)	(55.4)				730.8	Retained earnings
2.32	Other reserves	133.430							133.4	Other reserves
2.33	Capital & reserves	4,298.163	(183.6)	(29.8)	(55.4)	-	-	-	4,029.4	

Scottish Water

Year ended 31 March 2012

Reconciliation of Regulatory Accounts / M Tables to Consolidated Statutory Accounts (Company only)

Statutory Accounts (IFRS) Company	Expand detail	Reallocations / Reclassifications:				IFRS Adjs	CCA Adj	Less - Non Reg	Regulatory Tables		Line	Description
		£m	£m	<> 1 year	Interco				M11	M5		
<b>Note 11</b>												
Inventories	1.7								1.7		11.1	Stocks
<b>Note 12 Trade &amp; other receivables</b>												
Trade receivables (net)	30.9	(30.9)										
Other receivables	21.0	(21.0)										
Prepayments & accrued income	5.5		0.1		0.7				6.3		11.6	Prepayments & other short term debtors
Amounts due from subsidiaries	1.5				(1.5)							
Trade debtors - household		27.4							27.4		11.2	Trade debtors - household
Other trade debtors		3.5	0.2		0.8			(0.3)	4.2		11.4	Other trade debtors
Other debtors - operating		0.3	(0.3)									
Other debtors - non operating		20.7								20.7	5.12	Non trade debtors
	58.9											
						40.2				40.2	5.11	Asset transferred to PPP contractors
<b>Note 14 Trade &amp; other payables</b>												
<i>Current</i>												
Trade payables	(23.9)				(2.7)				(26.6)		11.7	Trade creditors
Non trade payables & accruals	(86.4)				(34.5)				(120.9)		11.10	Short-term capital creditors
Accruals	(133.6)	133.6										
Payments received in advance	(8.9)		8.9									
Other payables	(5.5)		5.5									
Deferred income	(1.1)			1.1								
Other taxes & social security	(2.5)		2.5									
Amounts due to subsidiaries	(24.9)				27.2			(2.2)				
Amounts due to SWS	(34.5)				34.5							
Wholesale charge prepayment			(0.4)		(24.5)				(24.9)		11.8	
Credit note provision		(24.8)							(24.8)		11.11	
Accruals - operating		(75.3)	(2.5)			1.9			(75.8)		11.12	Accruals & other creditors
Other creditors - non operating		(33.5)	(14.0)					0.4		(47.1)	5.13	Non trade creditors due < 1 year
	(321.3)											
<i>Non current</i>												
Other payables	(47.8)									(47.8)	5.20	Other creditors
Deferred income	(16.6)			(1.1)			(4.5)			(22.2)	5.2	Third party contributions
	(64.4)											
<b>Note 17 Other loans &amp; borrowings</b>												
<i>Current</i>												
Non-government loans	(1.7)									(1.7)	5.9	Borrowings (excl Govt loans) (<1year)
Obligations under finance leases	(15.5)					15.5						
	(17.2)											
<i>Non current</i>												
Non-government loans	(2.4)									(2.4)	5.19	Borrowings (excl Govt loans) (>1year)
Obligations under finance leases	(415.5)					415.5						
	(417.9)											
Check total	(760.2)	-	-	-	-	473.1	(4.5)	(2.1)	(233.4)	(60.3)		