

Annual Return 2011/12

Overview

Scottish Water
Castle House
Carnegie Campus
Dunfermline
KY11 8GG



**Scottish
Water**
Always serving Scotland

Table of Contents

- 1. Executive Summary..... 3**
- 2. Key Outputs and Service Delivery..... 9**
 - 2.1 Service Outputs and Performance9
 - 2.2 Drinking Water Service 14
 - 2.3 Wastewater Service 16
 - 2.4 Capital Programme Delivery 17
- 3. Expenditure, Performance and Efficiency 19**
- 4. Supporting Information 23**
- 5. Looking Forward..... 26**

1. Executive Summary

This overview document reports on Scottish Water's performance and activities in 2011/12, the second year of the 2010-15 regulatory period. 2011/12 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, continue to underpin our improved performance.

2011-12 Dashboard

Table 1 shows the 2011-12 year-end position for the key regulatory outputs set out in the Regulatory Contract.

Annual Dashboard – 2011/12			
Measure to be reported	Actual 2011/12	Delivery Plan Target 2011/12	Current RAG Status
Output Delivery			
Investment – completion of Q&SII/IIIa (Number of remaining projects requiring regulatory sign-off)	29	38	G
Investment – Delivery of Q&SIIIb Outputs (OMD Measure)	160	131	G
Levels of Service			
Customer Service – OPA (rolling four quarters)	355	317	G
Leakage (MI/d) (rolling four quarters)	629	670	G
Water into Supply (MI/d) (rolling four quarters)	1,895		
Expenditure			
Total Capital Expenditure (£m)	491	500	
Operating and PFI Costs (£m)	487	495	G
Financial Strength			
Cash Interest Cover	3.5	3.3	G
Funds from operations to net debt	13.7%	12.2%	G
Gearing	49%	52%	G
Net new borrowing (£m)	50 ¹	0	G
Impact of External Factors: Net 'logging' position	See page 21		

Performance Status
Performance below target and not expected to achieve year end target
Performance below target, but expected to achieve year end target
Performance above target or expected to achieve year end target.

Table 1

¹ Net new borrowing for Scottish Water for 2011/12 of £50m was taken as an advance of the 2012/13 borrowing allocation, at the request of the Scottish Government.

Overall Performance Assessment

In 2011/12 our OPA performance increased to 355, exceeding our Delivery Plan target of 317 and representing a 24 point increase on our 2010/11 performance. As shown in figure 1.1 below we remain on course to meet our 2013/14 target of 380.

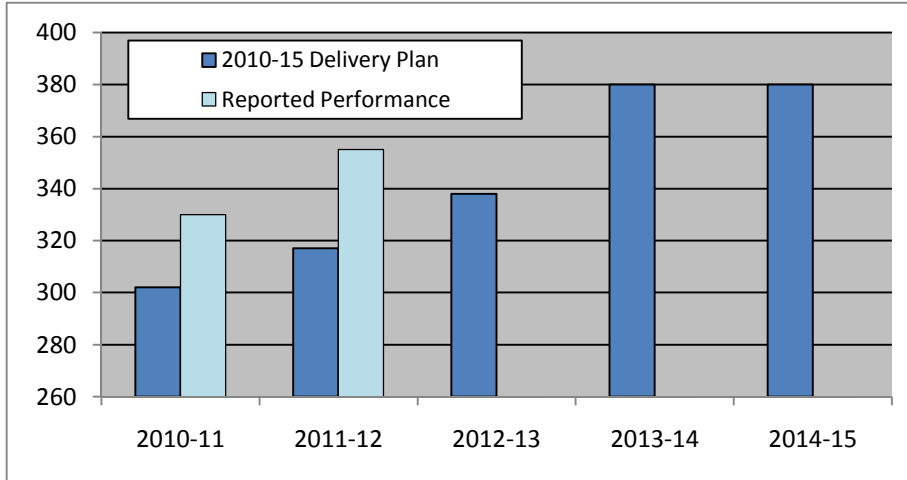


Figure 1 – OPA performance

Leakage

Since the start of 2010/11 we have reported leakage in terms of Maximum Likelihood Estimation (MLE) Leakage. Our MLE reported leakage for 2011/12 is 629 MI/d which is a 70 MI/d reduction on our reported MLE leakage of 699 MI/d for 2010/11 successfully out-performing our 2011/12 Delivery Plan target of 670 MI/d. Table 1.2 below details the leakage reduction we have achieved in recent years.

Description (ML/d)	2008/09	2009/10	2010/11	2011/12
Regulatory Reported leakage (OPA)	801.7	703.6	699.1	629
Leakage Target (OPA)	840	730	720	670
MLE adjusted leakage	816.4	738.2	699.1	629

Table 2

Having reviewed our assessment of the Economic Level of Leakage (ELL) the Commission has confirmed our ELL as 600MI/d.

Customer Satisfaction

Since 2010, when we introduced a postal survey to monitor customer satisfaction throughout the year, over 40,000 customers have taken part, providing satisfaction tracking and insightful comments about their experience. This valuable information is being used to drive service improvements that are most valued by our customers.

Customer satisfaction has steadily increased again this year and reached a score of 83.1%. This has been achieved through a determined focus across Customer Service on listening to customers, combined with the delivery of a number of considerable improvement projects in our main contact areas.

Compliance

Overall Water Quality Compliance

For the calendar year 2011, overall compliance with water quality standards continued to be of a very high standard with 99.86% of all water quality tests conducted in our sampling programme complying with quality standards.

For OPA purposes, water quality is assessed using the mean zonal compliance of a basket of six parameters. For these parameters performance in 2011 was 99.02% an improvement from 98.98% in 2010.

Wastewater Compliance

Wastewater Treatment Works compliance at 31 March 2012 is reported as 10 failing sites against a Delivery Plan target of 18. This performance, which has been agreed with SEPA, represents a slight improvement on the good performance of 2010/11.

There has been a step change performance improvement regarding the number of Environmental Pollution Incidents (EPIs) which have reduced from 824 in 2010/11 to 518 in 2011/12. The performance has been achieved by completely restructuring and refocusing our approach to EPIs. Using improved data and intelligence from the field we have been able to better allocate resources to avoid EPIs occurring and we continue to work to further reduce the number of incidents.

There are now 38 fewer Unsatisfactory Intermittent Discharges on our sewerage network as a result of our investment programme

During the 2011 bathing season no Scottish Water assets caused failed samples at any of the four bathing waters that failed to achieve the necessary Bathing Water standards.

Capital Programme delivery

During 2011/12 investment totalled £491m, comprising £414m on Q&SIIIb projects and £77m on completion projects.

At the end of March 2012, the Overall Measure of Delivery (OMD) score, which provides a high-level measure of progress in implementing the Q&S3b enhancement investment programme stands at 160 points, 29 points ahead of the baseline target agreed with the Commission. In the last month of the year, significant OMD points were gained through 2 projects Dunfermline Wastewater Treatment Works Sludge and Odour project and the Raw Water Monitoring project meeting key milestones ahead of programme.

At the end of the 2011/12 year, we have reduced the overall number of completion projects remaining to be signed off to 29 which is ahead of our delivery plan target of 38.

Financials

The surplus before tax in the year for Scottish Water was £74.0 million, £40.9 million lower than in 2010/11 (£114.9 million). This surplus was £15 million greater than our Delivery Plan target (2011 update) of £59 million. The regulated surplus before tax was £41.0 million lower at £73.8 million.

Revenue

Regulated revenue for the year totalled £1,045.8 million (2011 - £1,049.8 million).

Revenue from services supplied to household customers increased by only £2.1 million or 0.3% to £745.6 million 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% was c£34 million. Revenue from wholesale services supplied to Licensed Providers reduced by £7.7 million or 2.5% to £294.7 million driven primarily by the reduction in regulated wholesale charges to Licensed Providers. Revenue from other sales increased by £1.6 million to £5.5 million.

Total costs

Total costs of £815.2 million were £35.6 million higher than in 2010/11.

Operating costs of £486.9 million were £20.3 million higher than 2010/11. Within these costs, regulated operating costs of £340.2 million were 3.8% or £12.4 million higher than in 2010/11 while PFI costs were £7.9 million higher at £146.7 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £9.6m or 3.8%. £22.0m of specific additional costs were incurred compared with last year, namely: £3.0m for the carbon reduction commitment; absorption of £11.7m of inflation; and a net increase in local authority rates charges of £10.0m. Table 3 below summarises this movement:

	2010/11	2011/12	(inc)/dec	
	£m	£m	£m	%
Regulated Operating Costs	327.8	340.2	-12.4	-3.80%
Winter costs	-6.9	-0.5	-6.4	
VR costs	-10.5	-5.9	-4.6	
Other restructure costs	-3.9	-9.6	5.7	
Average inflation (4.8%)	11.7		11.7	
Carbon Reduction Commitment		-3	3	
New Opex		-2	2	
Like for Like costs	318.2	319.2	-1	-0.30%
Local Authority rates charges	-55.7	-58.3	2.6	
Add back one-off rates credit	7.4	0	7.4	
SEPA and WIC costs	-14.4	-15	0.6	
Like-for-like real controllable costs	255.5	245.9	9.6	3.80%

Table 3

Depreciation, including infrastructure depreciation, increased by £10.3 million to £329.0 million, primarily as a consequence of the capital investment programme. The gain on sale from asset disposals was £5.0 million lower than in 2010/11 at £0.7 million.

Finance costs

As at 31 March 2012, the weighted average interest cost of the outstanding long-term debt was 5.15%, (2011 – 5.15%). Net interest payable during the year was £156.8 million, £1.4 million higher than in 2010/11.

During the year, net debt increased by £61.3 million to £2,928.0 million (being loans of £3,169.3 million less cash balances of £241.0 million). The increase was driven by a £50.0 million increase in borrowing from the Scottish Government and a £11.3 million reduction in cash balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £50.0 million for 2011/12. Actual net new borrowings in 2011/12 were £50.0 million.

Board Changes

On 31st March 2012 Mr David Gray left the Board at the end of his period of appointment, not being eligible for a further re-appointment. There were no other changes to the composition of Scottish Water's Board during the year.

Governance of the Annual Return

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. Black and Veatch have again audited the information reported in the Annual Return 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 2011/12 our OPA performance increased to 355, exceeding our Delivery Plan target of 317 and representing a 24 point increase on our 2010/11 performance. As shown in figure 2.1 below we remain on course to meet our 2013/14 target of 380.

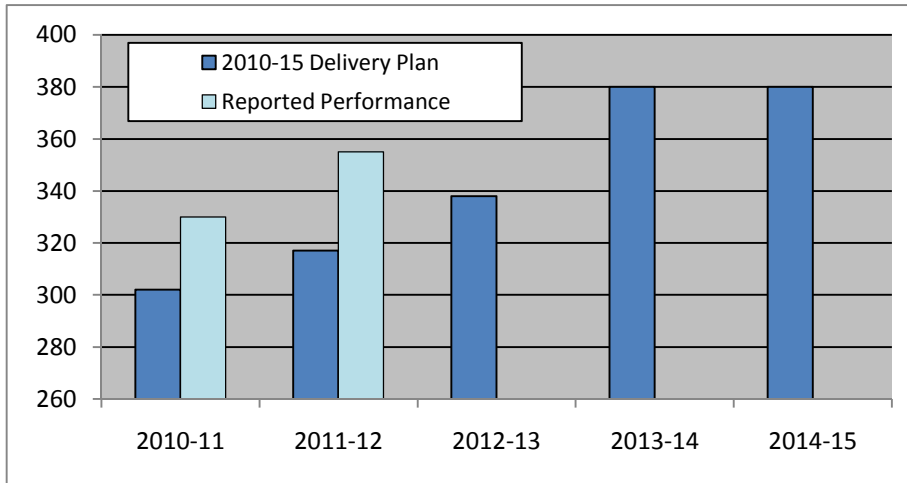


Figure 2.1 – OPA performance

Significant Improvements

The areas, in which we made the most significant improvement in 2011/12, are:

- EPI Sewage category 1&2 improved from 11.4 to 17.9 points (+6.5 points);
- SOSI absolute performance improved from 1.25 to 7.5 points (+6.3 points);
- WWTW Compliance improved from 40.8 to 46.5 points (+5.6 points), and
- EPI Sewage category 3 improved from 3.5 to 7.3 points (+3.8 points).

Table 2.2 below compares our 2010/11 and 2011/12 performance for each of the 17 indicators: In summary:

- 5 items continued to score full points;
- 1 item increased to maximum points, securing 1.3 additional OPA points;
- 8 items showed increased performance, securing 24.7 additional OPA points;
- 3 items slipped back – which reduced OPA by 1.6 points.

Indicator	AR11 OPA	AR12 OPA	AR11 OPA score	AR12 OPA score	Change
% of properties subject to inadequate water pressure	0.05%	0.03%	34.3	35.1	0.9
Connected properties experiencing unplanned interruptions	0.83%	0.84%	29.2	29.1	-0.1
Hosepipe restrictions	0	0	12.5	12.5	0.0
Security of Supply absolute performance	35	71	1.3	7.5	6.3
Security of Supply performance against target	-2.94%	-54.35%	12.5	12.5	0.0
% of water samples that comply with parameters	98.98%	99.02%	21.3	22.4	1.1
Leakage	-2.98%	-6.48%	11.3	12.5	1.3
Water Service (sub-total)			122.3	131.7	9.4
% properties suffering sewer flooding incidents caused by overloading	0.00176 %	0.00171 %	24.8	24.9	0.03
% properties suffering sewer flooding incidents caused by other causes	0.00653 %	0.00663 %	35.0	34.8	-0.1
Sewer flooding (at risk)	0.01088 %	0.01083 %	12.5	12.5	0.0
Sewerage Service (sub-total)			72.3	72.2	-0.1
Customer Contact (Total of complaints and telephone performance)	17.7	18.2	17.7	18.2	0.5
Assessed customer service	8	8	37.5	37.5	0.0
Customer Service (sub-total)			55.2	55.7	0.5
Category 1 & 2 water EPIs	0	1	12.5	11.2	-1.3
Category 3 sewage EPIs	796	481	3.5	7.3	3.8
Category 1 & 2 sewage EPIs	28	18	11.4	17.9	6.5
Sewage sludge disposal	0.00%	0.00%	12.5	12.5	0.0
% pe served by non-compliant sewerage treatment works	1.00%	0.39%	40.8	46.5	5.6
Environmental Performance Service (sub-total)			80.7	95.4	14.6
Total			331	355	24.4

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 420 properties were removed from the low pressure register over the year, reducing the total number from 1,962 (2010/11 reported value) to 1,542. 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 640 properties are excluded, resulting in our 2011/12 reported OPA value reducing to 902.

Connected Properties Experiencing Unplanned Interruptions

Table 2.3 shows the change in the number of properties that experienced unplanned interruptions compared to last year. A total of 21,803 weighted properties, or 0.84% of total population, received a supply interruption greater than 6 hours.

In this reporting year three large incidents caused over 5,000 properties to lose supply for greater than six hours.

In May 2011, 2,534 properties were affected by an incident in Broxburn with supply being restored in 11.5 hours.

In July 2011, 1,427 properties were affected by a burst on a trunk main in Cumbernauld with supply being restored in just under 8 hours.

In August 2011, 1,296 properties were affected by a burst on a trunk main in Wishaw with supply being restored in just over 9.5 hours.

	2010/11	2011/12
Properties interrupted for 6 to 12 hours	10,914	14,083
Properties interrupted for 12 to 24 hours	2,463	3,484
Properties interrupted for more than 24 hours	1,399	188
Total number of properties interrupted for more than 6 hours	14,776	17,755
Total number of properties interrupted for more than 12 hours	3,862	3,672
Total 'weighted' properties interrupted for more than 6 hours	21,436	21,803

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 2011/12, rising from 35 to 71, bringing us into the 50-89 SOSI banding and giving us 7.5 OPA points.

b) SOSI performance against target.

We are also measured in terms of our SOSI performance against our annual target. For 2011/12 our target was 46 points. We scored 71 SOSI points in 2011/12 and exceeded our target. The SOSI score remained at the maximum 12.5 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 629.24 MI/d, a 69.9MI/d reduction on our leakage in 2010/11 and successfully out-performing our target for 2011/12 to reduce leakage to 670 MI/d. 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 2011/12 there were 42 incidents of flooding from overloaded sewers that caused internal flooding of customers' properties. This was an improvement of 1 compared with the number of incidents reported for 2010/11.

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

In 2011/12 there were 163 incidents of flooding from other causes on main sewers that caused internal flooding of customers' properties. This was an increase of 3 incidents from 2010/11.

Sewer Flooding (properties at risk)

The number of properties on the "At-risk of flooding from overloaded sewers" register is 337 in 2011/12. This gives a score of 12.5 OPA points.

	2010/11	2011/12
At risk of flooding twice in ten years	192	196
At risk of flooding once (but less than twice) in ten years	149	141
Total number of properties at risk of flooding at least once in ten years	341	337

Table 2.4: Properties at Risk of Flooding from Sewers

Customer Contact

The Customer Contact measure consolidates 4 sub-elements as described below.

a) Percentage Written Complaints Responded to within 10 days

Our performance for 2011/12 was 100% with all written complaints responded to within 10 days.

b) Percentage Telephone lines busy

A total of 593 lines were reported as busy in 2011/12, down from 981 in 2010/11. This increased performance from 99.83% to 99.87% over the year.

c) Percentage Telephone calls abandoned

During 2011/12 the total number of abandoned calls decreased by 6,845 to 5,335. This increased our performance in this measure from 99.83% to 99.87% over the reporting year.

d) Customer Service Survey

Our telephone customer survey scored 4.56 out of a maximum of 5.00 for 2011/12, an increase from 4.46 in 2010/11.

Assessed Customer Service

With the dissolution of Waterwatch in August 2011, Scottish Water has produced an Assessed Customer Service Report for 2011-12 which has been reviewed by Black and Veatch. Our performance remained at 8 points in 2011/12, securing the maximum 37.5 OPA points.

Environmental Pollution Incidents (EPIs)

All EPIs shown below have been agreed with SEPA.

a) Wastewater Category 1&2 EPIs

We reported a decrease in Category 1 & 2 incidents in 2011/12 from 28 to 18. This increased our OPA performance by 6.5 points.

b) Wastewater Category 3

We reported a decrease in the number of Category 3 incidents in 2011/12, from 796 to 481. This increased our OPA performance by 3.9 points.

c) Water Category 1&2

There was 1 water pollution incident in 2011/12 decreasing our OPA performance by 1.3 points.

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 2011/12. In 2011/12 a maximum of 0.39% of the connected population equivalent was served by a non-compliant works compared with 1% in 2010/11. The 2011/12 position is subject to confirmation by SEPA, and this score may improve further.

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 2011 calendar year, with 99.86% of all water quality tests conducted in our sampling programme complying with quality standards (2010: 99.86%; 2009: 99.83%).

Microbiological Quality

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

a) water leaving treatment works

In 2011, 28,794 samples were taken for faecal and 28,792 for total Coliform analysis. Compliance with the faecal coliform standard was 99.98% and with the total coliform standard was 99.83%.

b) water in service reservoirs

In 2011, 51,952 samples were taken for faecal and total Coliform analysis. Compliance with the faecal coliform standard was 99.97% and the total coliform standard was 99.77%.

c) water at customers' taps

In 2011, 14,225 samples were taken for faecal coliforms and 14,226 for total coliform analysis. Compliance with the faecal coliform standard was 99.99% and the total coliform standard was 99.58%.

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 2008 to 2011 based on regulation samples:

		2008 fails	2008 compliance	2009 fails	2009 compliance	2010 fails	2010 compliance	2011 fails	2011 compliance
Treatment Works	Coliforms	76	99.76%	30	99.90%	44	99.85%	49	99.83%
	Faecal Coliforms	10	99.97%	6	99.98%	8	99.97%	5	99.98%
Service Reservoirs	Coliforms	137	99.75%	138	99.74%	107	99.79%	122	99.77%
	Faecal Coliforms	11	99.98%	12	99.98%	9	99.98%	13	99.97%
Customer Taps	Coliforms	79	99.45%	66	99.54%	69	99.52%	60	99.58%
	Faecal Coliforms	2	99.99%	4	99.97%	2	99.99%	2	99.99%

Table 2.5: Microbiological quality of water

Chemical Sampling

Physical and chemical standards apply to water supplied at customers' taps. 116,396 tests were carried out at customers' taps for all parameters during 2011. Of these 99.84% (99.85% in 2010) complied with the regulatory standards.

The following summary table highlights the performance of the key chemical parameters for 2008 to 2011.

	2008 fails	2008 compliance	2009 fails	2009 compliance	2010 fails	2010 compliance	2011 fails	2011 compliance
THM Total	81	95.19%	89	94.59%	59	96.39%	42	97.39%
Iron	70	98.67%	49	99.06%	32	99.38%	46	99.09%
Colour	15	99.72%	12	99.77%	7	99.87%	3	99.94%
Manganese	41	99.22%	24	99.54%	31	99.40%	28	99.45%
Aluminium	13	99.75%	7	99.87%	12	99.77%	11	99.78%

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 2011 was 99.02%, an improvement from 98.98% in 2010.

Abstraction Licensing

This is the third year we have submitted our annual Water Resource data return to SEPA. This covers 372 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 continue to work with SEPA to analyse the data in the coming months through 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 exceeded our Delivery Plan target by delivering 76 outputs. The overall programme (78 WRZ) is on track to deliver the agreed output profile. At Newmore & Assynt WRZ we are currently resolving licensing issues with SEPA, and at Afton, Bradan, Penwhapple WRZ we have agreed with SEPA what we need to do and are currently designing a solution. We are expecting to deliver both of these projects this financial year.

2.3 Wastewater Service

Compliance - Wastewater Serviceability

Wastewater Treatment

Wastewater Treatment Works compliance figures at 31 March 2012 are reported as 10 failing sites against a Delivery Plan target of 18. This performance, which has been agreed with SEPA, is a slight improvement on the 11 failing works in 2010/11.

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

Bathing Waters

Scotland had 83 bathing waters officially designated under the EU Bathing Water Directive for the 2011 Season, 71 of which could be directly impacted by Scottish Water Assets. Four bathing waters failed for the season (Sandyhills, Irvine, Lossiemouth (East) and Eyemouth) due to factors not associated with Scottish Water discharges. Scottish Water performance remained good, with no assets having caused failed samples at any of the four failing bathing waters.

Pollution Incidents

There has been a step change in performance in regard to Environmental Pollution Incidents (EPI). This covers Category 1, 2 and 3 incidents.

During 2011/12 as agreed with SEPA there were a total of 518 EPI events compared with 824 in 2010-11. There is close liaison between Scottish Water and SEPA on a monthly basis to agree EPI numbers

Within this, there were

- 18 Category 1 or 2 incidents and 481 Category 3 incidents at wastewater assets
- 1 Category 1 and 9 category 3 incidents at water assets; and
- 9 wastewater/water compliance incidents.

The performance has been achieved by completely restructuring and refocusing our approach to EPIs. Using improved data and intelligence from the field we have been able to better allocate resources to avoid EPIs occurring and we continue to work to further reduce the number of incidents.

Unsatisfactory Intermittent Discharges (UIDs)

During 2011/12, Scottish Water has delivered a further 9 Q&S3a UID outputs. A total of 288 UIDs have now been improved, leaving only 18 to be delivered under this programme. The outputs comprise physical improvement, operational interventions, and those where modelling has confirmed no need for physical intervention. A further 35 UIDs have been resolved in 2011/12 through the Q&S3b programme bringing the total improved under this programme to 38.

2.4 Capital Programme Delivery

The capital programme is monitored quarterly by the Outputs Monitoring Group, and the associated Working Group, with progress reported to Scottish Ministers.

Investment

During 2011/12 investment totalled £491m, comprising £414m on Q&SIIIb projects and £77m on completion (Q&S2 and Q&S3a) projects.

Completion Programme (Q&S2 and Q&S3a)

At the start of the 2010-15 regulatory period a total of 314 Q&S2 and Q&S3a projects were still to be completed. A further 33 projects have been completed or removed over the year, reducing the number of projects still outstanding to 29, 9 projects fewer than our Delivery Plan target of only 38 projects remaining at this stage.

	Projects remaining at end of 2009/10	Projects remaining at end of 2010/11	Projects remaining at end of 2011/12
Q&S2	62	16	6
Q&S3a	251	46	23
Total	313	62	29

Table 2.7

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 2012, the OMD score stands at 160.3 points. This is 30 points ahead of the baseline agreed with the Commission. In the last month of the year, significant OMD points were gained through meeting key milestones; the principal contributing projects were Dunfermline STW Sludge and Odour project (MS4 achieved) and Raw Water Monitoring project (MS1 achieved).

As shown in table 2.8 below we have consistently out-performed against our quarterly OMD target throughout 2011/12.

OMD Measure	Q1	Q2	Q3	Q4
Target	82.4	100.2	117.4	130.4
Actual	91.0	117.1	132.1	160.3

Table 2.8

Our Delivery Plan forecast the delivery of outputs across 18 programmes by the end of 2011/12. At the end of 2011/12 we had delivered outputs on 24 programmes. 15 of the original 18 programmes had delivered more outputs than forecast, with 2 of these - Number of sites covered by drinking water safety plans and Number of tanker fill points installed - being complete ahead of time, while only 3 delivered fewer outputs than forecast. Table 2.9 shows the output sign-off position of each of the 33 programmes.

OMGWG Grouping	Quarterly monitored programme areas	Q4 2011-12 Target	Q4 2011-12 Actual	Q4 2011-12 Position
Drinking Water Quality	Km of mains rehabilitated to improve drinking water quality	32	100	Ahead of target
	Number of WTW receiving improved disinfection control	3	12	Ahead of target
	Number of WTW improved to meet quality standards	0	0	No outputs forecast
	Number of sites with reduced risk from cryptosporidium	0	0	No outputs forecast
	Number of zones with reduced lead levels	13	28	Ahead of target
	Number of DMA subject to investigations	143	126	Behind Target
	Type A Raw water supplies provided with treatment	0	1	Ahead of target
	Number of raw water sample points installed	0	0	No outputs forecast
	Number of lead comms pipes removed	0	0	No outputs forecast
	Number of backflow prevention devices installed	52	177	Ahead of target
	Number of sites covered by drinking water safety plans	161	196	Complete
	Number of tanker fill points installed	13	14	Complete
	Number of sites with increased security	22	119	Ahead of target
	Number of WRZs receiving company standard for security of supply (under 7 stage)	0	0	No outputs forecast
	Number of WRZs receiving company standard for security of supply	0	0	No outputs forecast
Environmental Protection	Improvements to the Wastewater Network (properties)	0	0	No outputs forecast
	Number of properties with environmental improvements to support the 2014 Commonwealth Games	0	31	Ahead of target
	Number of UIDs improved (under 7 stage)	0	33	Ahead of target
	Number of UIDs improved (excluding 7 stage)	22	5	Behind Target
	Number of dual manhole systems upgraded	0	2	Ahead of target
	Number of WWTW discharges improved to meet new licence requirements	21	27	Ahead of target
	Number of WWTW upgraded to meet existing licence requirements	4	10	Ahead of target
	Number of WWPS upgraded to comply with existing licence requirements	1	5	Ahead of target
	Number of WWTW brought into compliance with licence non-sanitary requirements	0	6	Ahead of target
	Number of wastewater network assets made compliant with licence requirements	4	15	Ahead of target
	Number of surface water systems upgraded	0	0	No outputs forecast
	Number of environmental studies undertaken	26	45	Ahead of target
Malodour	Number of sites where malodour is reduced	0	3	Ahead of target
Customer Service	Properties removed from low pressure register	993	1475	Ahead of target
	Properties removed from low pressure register (Exclusions under 1980 Act)	86	152	Ahead of target
Flood Management	Number of assets protected from flood risk	0	7	Ahead of target
	Number of models to support the Flooding Bill	1	0	Behind Target
	Number of flooding asset risk assessments	212	216	Ahead of target

Table 2.9 Q&S3b Output sign-off

As a result of agreement with OMG our April 2012 Delivery Plan includes revised delivery profiles for the Number of UIDs improved (excluding 7 stage) and Number of models to support the Flooding Bill. The final 17 outputs in the "Number of DMA subject to investigations have been delayed to allow revised operational practices to be introduced to minimise the number of customer contacts regarding water quality associated with investigations of this nature.

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 2012 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	2011/12	Change
	£m	£m	£m
Turnover	1,049.8	1,045.8	-4.0
Operating costs	466.6	486.9	-20.3
Depreciation / amortisation	318.7	329.0	-10.3
Gain on sale of assets	-5.7	-0.7	-5.0
Total costs	779.6	815.2	-35.6
Operating surplus before interest	270.2	230.6	-39.6
Net interest	155.4	156.8	-1.4
Profit before tax – Regulated	114.8	73.8	-41.0
Profit before tax – Non Regulated	0.1	0.2	0.1
Profit before tax – Scottish Water	114.9	74.0	-40.9
Taxation charge / (credit)	41.1	-0.5	41.6
Profit after tax	73.8	74.5	0.7

Table 3.1

For the year ending 31 March 2012 Scottish Water's costs (excluding subsidiaries and statutory adjustments under IAS) totalled £815.2 million. Costs included in tables E1 (£396.0 million), E2 (£269.4 million) and E3 (£151.0 million) total £816.4 million. The £1.2 million difference relates to costs recharged to Business Stream under Service Agreements. These costs have been netted off Scottish Water's expenditure in line with group inter-company transaction reporting.

The surplus before tax in the year for Scottish Water was £74.0 million, £40.9 million lower than in 2010/11 (£114.9 million). The regulated surplus before tax was £41.0 million lower at £73.8 million.

Revenue

Regulated revenue for the year totalled £1,045.8 million (2011 - £1,049.8 million) and is analysed by category in table 3.2 below:

	2010/11	2011/12	Change
	£m	£m	£m
Household	743.5	745.6	2.1
Wholesale	302.4	294.7	-7.7
Other	3.9	5.5	1.6
Total regulated revenue	1049.8	1045.8	-4.0

Table 3.2

Revenue from services supplied to household customers increased by only £2.1 million or 0.3% to £745.6 million 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% was c£34 million. Revenue from wholesale services supplied to Licensed Providers reduced by £7.7 million or 2.5% to £294.7 million driven primarily by the reduction in regulated wholesale charges to Licensed Providers. Revenue from other sales increased by £1.6 million to £5.5 million.

Total costs

Total costs of £815.2 million were £35.6 million higher than in 2010/11.

Operating costs of £486.9 million were £20.3 million higher than 2010/11. Within these costs, regulated operating costs of £340.2 million were 3.8% or £12.4 million higher than in 2010/11 while PFI costs were £7.9 million higher at £146.7 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £9.6m or 3.8%. £22.0m of specific additional costs were incurred compared with last year, namely: £3.0m for the carbon reduction commitment; absorption of £11.7m of inflation; and a net increase in local authority rates charges of £10.0m. Table 3.3 below summarises this movement:

	2010/11	2011/12	(inc)/dec	
	£m	£m	£m	%
Regulated Operating Costs	327.8	340.2	-12.4	-3.80%
Winter costs	-6.9	-0.5	-6.4	
VR costs	-10.5	-5.9	-4.6	
Other restructure costs	-3.9	-9.6	5.7	
Average inflation (4.8%)	11.7		11.7	
Carbon Reduction Commitment		-3	3	
New Opex		-2	2	
Like for Like costs	318.2	319.2	-1	-0.30%
Local Authority rates charges	-55.7	-58.3	2.6	
Add back one-off rates credit	7.4	0	7.4	
SEPA and WIC costs	-14.4	-15	0.6	
Like-for-like real controllable costs	255.5	245.9	9.6	3.80%

Table 3.3

Depreciation, including infrastructure depreciation, increased by £10.3 million to £329.0 million, primarily as a consequence of the capital investment programme. The gain on sale from asset disposals was £5.0 million lower than in 2010/11 at £0.7 million.

The average number of employees during the year decreased by 132, or 3.9% to 3,224 (including SWS / SWS2 secondees).

Finance costs

As at 31 March 2012, the weighted average interest cost of the outstanding long-term debt was 5.15%, (2011 – 5.15%). Net interest payable during the year was £156.8 million, £1.4 million higher than in 2010/11.

During the year, net debt increased by £61.3 million to £2,928.0 million (being loans of £3,169.3 million less cash balances of £241.0 million). The increase was driven by a £50.0 million increase in borrowing from the Scottish Government and a £11.3 million reduction in cash balances.

Taxation

Scottish Water's tax credit was £0.5 million (2011 – £41.1 million). This was due primarily to the favourable impact of the change in UK corporation tax rate from 26% to 24% that will be effective from 1 April 2012 which meant the re-measurement of deferred tax balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £50.0 million for 2011/12. Actual net new borrowings in 2011/12 were £50.0 million.

Potential Regulatory Financing adjustment

In June 2011 we outlined the potential for a minor regulatory financing adjustment to take account of circumstances that differ from those set out in the Final Determination. We have updated our submission to take account of changes in 2011/12. Many of these circumstances are still 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 2012 the principal items that may need to be considered are:

- **Freezing of household charges in 2012/13** – as a result of this decision by the Scottish Government, we expect to deliver out-performance back to customers early by not using our full entitlement to increase household prices by the household K factor of -5% across 2010-15.
- **Movements in Indexation** - there continues to be movements and future uncertainty in indexation.
- **Non-Domestic Rates Revaluation** - The impact of the 2010 rates revaluation which increases operating costs by £132m for the 2010-15 period. An increased Opex charge of £129m and increased PFI costs of £3m has been included in the Delivery Plan March 2012 Refresh.

- **Carbon Reduction Commitment Charges** - Carbon Reduction Commitment Costs have been introduced for 2011/12 and may impact by around £3m per year out to 2014/15. An additional charge of £10m was included in the Delivery Plan March 2012 Refresh to reflect this item.
- **Taxation Changes** - Changes in Corporation Tax rates and capital allowances were introduced in the June 2010 budget and adjustments were made in the Financial Statements in the Delivery Plan Update.
- **Changes in the OMGWG Register** - Changes to the investment programme as set out in the OMGWG change register.
- **Capital Investment** – while we forecast that part of the regulatory investment programme will be delivered after March 2015, we are exploring the potential for additional regulatory investment in 2014/15.

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.

The reporting of our Security of Supply Index (SOSI) is still 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 continued to improve year on year as a result of the positive effects of the leakage reduction programme, growth and other water quality projects. Our SoSI score is now reported as 71.

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 2011/12 is 2.3%.

Our MLE reported leakage for 2011/12 is 629 MI/d, a 70 MI/d reduction on our reported MLE leakage of 699 MI/d for 2010/11, successfully out-performing our 2011/12 Delivery Plan target of 670 MI/d. Table 4.1 below details the leakage reduction we have achieved in recent years.

Description (ML/d)	2008/09	2009/10	2010/11	2011/12
Regulatory Reported leakage (OPA)	801.7	703.6	699.1	629.2
Leakage Target (OPA)	840	730	720	670
MLE adjusted leakage	816.4	738.2	699.1	629.2

Table 4.1

The Figure 4.1 presented below demonstrates the improvements in leakage over previous 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.

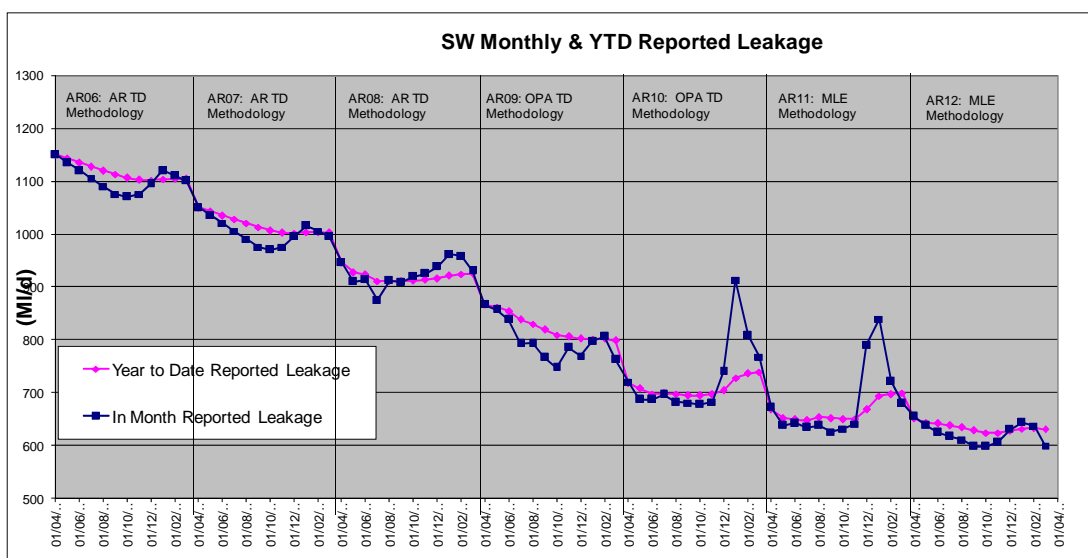


Figure 4.1

Having reviewed our assessment of the Economic Level of Leakage (ELL) the Commission has confirmed our ELL to be 600Ml/d.

Board Changes

On 31st March 2012 Mr David Gray left the Board at the end of his period of appointment, not being eligible for a further re-appointment. There were no other changes to the composition of Scottish Water's Board during the year. The current Board therefore consists of:

- Ronnie Mercer - Chair
- Richard Ackroyd - CEO
- Andrew Wylie – Non-Executive Director
- Alan Bryce - Non-Executive Director
- James Spowart - Non-Executive Director
- Donald Emslie - Non-Executive Director
- Mrs Lynne Peacock - Non-Executive Director
- Mr Pat Kelly - Non-Executive Director
- Douglas Millican – Finance and Regulation Director
- Chris Banks – Commercial Director
- Peter Farrer – Customer Service Delivery Director
- Geoff Aitkenhead – Asset Management Director
- Tom Axford – Company Secretary and Head of Legal

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 40,000 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. Customer satisfaction has steadily increased this year to secure a score of

83.1%. This has been achieved through a determined focus across Customer Service on what customers are saying, combined with the delivery of a number of considerable improvement projects in our main contact areas.

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.

Scottish Water's operational carbon footprint (CFP) for 2010/11, the most recently reported year, was 448,186 tonnes of carbon dioxide equivalent (tCO₂e), an increase of 0.13% on the previous year. Direct year-to-year comparisons are difficult owing to changes in scope, emissions factors associated with energy, and in activities, including the delivery of new assets to meet required quality standards, which may require additional power. We reduced our use of grid electricity, the main source of our greenhouse gas (GHG) emissions although our on-site use of fossil fuels increased. The report was again 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.

The detailed Carbon Plan we developed in 2009 (available on our website) has been further developed with the Carbon Trust in order to quantify some of the carbon savings available and thus be able to measure progress against actions. The updated Carbon Management Plan will be published in 2012.

5. Looking Forward

During 2011 we continued 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

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.

National Operations Centre

We are progressing with our plans for our new National Operations Centre in Stepps, Glasgow, which will be operational in early 2013/14. Having obtained detailed planning permission and awarded the construction contract, work started on site at the end of February. The new complex will accommodate all our current Glasgow based office staff.

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** - supporting Scottish Water's move from a reactive to a more planned environment by enabling access to the information our people need to make the right decision at the right time to improve the service we deliver to our customers.
- **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 is targeting change projects which will help to deliver our Vision. It is fully aligned with our aspiration of achieving PAS 55, to become leaders in customer focused asset management.

There are 15 projects currently running and we have already delivered 3 successfully into Business As Usual (BAU). Our Flagship projects currently include:

- **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 25 year 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, know we are efficiently investing each pound in the capital programme and creating a culture that continually improves value within future investment decisions and delivery.

- **LIMS Enhancements** – which will deliver an upgraded Laboratory System, to enable our Scientific Services team to drive efficiencies and grow its income through improved scheduling, field data capture, staff and customer management.

Water efficiency trials

We continued to work with the Scottish Government, SEPA, the Commission, and Consumer Focus Scotland (CFS) to advance the plan for water efficiency trials through household metering and other measures. We submitted our plan for a water efficiency trial for Ministers' approval in March 2011. Based on the Minister's response our plan aims to:

- understand how customer consumption behaviour in Scotland responds to a range of water efficiency measures, including metering, and to assess the relative cost/benefit of each of these measures; and
- gather robust Scottish evidence that can be used to inform future direction and policy in Scotland.

Due to the nature of this work these trials will continue beyond the end of this regulatory period.

During 2011/12 we continued to work on initiatives to incentivise developers to adopt water efficiency measures in new and refurbished housing including;

Building Research Establishment (BRE) - Work with the Buildings Research Establishment (BRE) has continued and a best practice guide has been produced. The guide will provide a market overview, technical overview and case studies on the benefits of implementing water efficiency measures in the housing market. As well as being made available to developers this guide will be issued to Building Standards Departments for inclusion as an appendix to Section 7 of the Building Standards Regulations.

Scottish Government Building Standards Division - We are working with Building Standards to ensure that water efficiency is incorporated into the next issue of building standards.

Housing Association Trials – We have reached agreement for a study into water use in social housing to begin involving Glasgow Housing Association, Property Log Book Company and 4 other housing associations. This work will map out tenant behaviour in the social housing sector in relation to water consumption and relate this to energy usage. This knowledge will be used to identify those behavioural interventions which have the greatest impact on saving water (and in turn reduce household energy bills).

Heriot-Watt University REALL project - We are in discussions with Heriot-Watt regarding their REALL (Riccarton Eco-village and Living Laboratory) project. The University is considering the construction of an 'eco-village' to study sustainable building design and construction as well as monitoring the effects of the internal fittings and fixtures. We hope to be able to include studies into water efficient fittings and fixtures as well as looking at rainwater harvesting and grey water recycling.

Governance

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. Black and Veatch have again audited the information

reported in the Annual Return 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 2011/12 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 7 June 2012