

M Tables – Regulatory Accounts Commentary

The sections in this document are:

1. General comments
 2. Results and reconciliations
 3. Assumptions
 - 4.1 Commentary – M tables 1-28
 - 4.2 Detailed Commentary – M tables 18 W & 18 WW
- Appendices

1. General Comments

Scottish Water prepares its statutory financial statements under International Financial Reporting Standards (IFRS). The M Tables have been prepared on a Regulatory basis, agreed with the WICS for the 2012/13 submission, which includes IFRS based information in addition to the 'original' Regulatory based information.

Details and explanations of the IFRS adjustments are provided in the commentary for the relevant tables in Appendix 1 to this document.

The consolidation tables – M27 and M28 – include the results of Scottish Water and all its subsidiaries, including Business Stream. Business Stream's results are included in the Licensed column. Due to the layout of these tables and the fact that the SW Core information has been referenced to Tables M1 and M2, the consolidated figures exclude all IFRS adjustments.

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 all subsidiaries, 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.

3. Assumptions

M Table completion

The M Tables are consistent with the basis agreed between Scottish Water and the WICS for the revised 2012/13 submission. Therefore, the M Tables have been completed using the historical cost information and IFRS based information. This approach aids transparency and the reconciliation processes between the historical cost based results in Tables M1 and M2, the IFRS based Regulatory Accounts themselves and the IFRS statutory accounts.

Non core tax charge

The tax charge for the non core element of Scottish Water is calculated on the actual profit attributable to the non regulatory businesses in 2013/14 at the standard Corporation Tax rate of 23% (2013: 24%) and added to the brought forward balance from the previous year (Tables M1, M2).

IFRS

Tables M4, M5, M6, M11 and M19 have been completed with IFRS based information to provide the Regulatory Accounts on the 'new' basis. There are no IFRS adjustments in respect of turnover, therefore Table M7 information remains unchanged, and the total appears in Table M1 and Table M4.

Additional tables have been provided, either within the commentary or as appendices, to aid the reconciliation between the historic costs tables (Tables M1 and M2), the IFRS Regulatory tables (Tables M4 and M5) and the statutory accounts.

Ratios

In agreement with the WICS in 2013, Table M6R – Regulatory Accounts, Ratio information – was added to the standard M Table file. This table provides all of the information for, and calculation of, the basic ratios in one place. The ratios calculated in Table M6R are the clean calculation using the actual financial information, with all figures referenced from the relevant M Tables. The information in Table M6R provides the platform from which any further regulatory funding type adjustments and calculations may be made by the WICS.

However, the 2010-15 Delivery Plan submission excludes IFRS adjustments. Therefore, for comparison purposes, the table below shows the ratios for 2013/14 consistent with the 2010-15 Delivery Plan and on an IFRS regulatory basis.

Ratios - 2013/14	Actual Historic basis	Actual IFRS/Reg basis
Cash interest cover	3.6	3.3
Funds from operations to net debt	13.2%	11.8%

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 – Historic Cost 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. The results in this table are consistent with the information presented in Table M1 in previous years and the basis for the internal management reporting to the Board. The main differences to the statutory income statement are due to the IFRS adjustments in respect of infrastructure assets, PFI costs and the pension charges. These are explained in more detail in the comments for Table M4.

Scottish Water's regulated operating costs (i.e. excluding depreciation, PFI charges and costs associated with non regulated activities), as shown in the table below, increased by £15.7m to £365.0m compared to £349.3m in 2012/13. The £15.7m increased cost was due primarily to:

- a £2.5m increase in costs associated with exceptionally dry weather earlier in the year;
- a £4.6m increase in power prices;
- a charge of £5.5m for landfill taxes; and
- the £7.8m impact of inflation; partly offset by
- a £2.9m reduction in restructure costs.

Adjusting for these movements, like-for-like controllable operating costs for 2013/14 were £273.5m reflecting a reduction in real terms of £3.5m (1.3%). The table below summarises this movement:

	2013/14 £m	2012/13 £m	Movement fav/(adv) £m
Core operating expenditure - line M1.2	365.6	349.9	-15.7
Less: Internal PFI costs	-0.6	-0.6	-
SW Regulated operating costs	365.0	349.3	-15.7
Restructure costs	-0.6	-3.5	-2.9
Dry weather related costs	-2.5		2.5
New Opex	-2.7		2.7
Average inflation (2.9%)	-	7.8	7.8
	359.2	353.6	-5.6
Power price	-4.6		4.6
Land fill tax	-5.5		5.5
LA rates	-61.0	-61.7	-0.7
SEPA and WIC costs	-14.6	-14.9	-0.3
Like-for-like real controllable costs	273.5	277.0	3.5

The cost of the PFI schemes in the year (line 1.3) was £149.6m (excluding PFI team costs), £0.2m higher than in 2012/13. The annual increase in service costs due to contract indexation of £3.0m was offset by weather related cost savings from reduced flow and load levels.

Depreciation, including the infrastructure renewals charge and amortisation charges/(credits) (lines 1.4 to 1.7) decreased by £2.3m to £331.2m, due to the profile of capital investment and lower levels of accelerated depreciation.

Other operating income of £10.3m (line 1.8) was the gain on disposal of fixed assets, £8.2m higher than in 2012/13 primarily due to the disposal of land at the Fairmilehead site in Edinburgh.

The net interest charge was £155.9m (2012/13: £154.4m) (line 1.11). The increase of £1.5m to £155.9m reflected the drawdown of the new borrowings.

SW's total tax credit, on a statutory basis, was £71.7m (2013: £3.5m credit) (line 1.14). 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 23% to 20% that will be effective from April 2015. To date, there has been no cash impact on SW's tax payments as a result of accounting on an IFRS basis.

Table M2 – Historic Cost 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 results in this table are consistent with the information presented in Table M2 in previous years and the basis for the internal management reporting to the Board. The main differences to the statutory balance sheet are due to the IFRS adjustments in respect of infrastructure assets, PFI assets and the pension liability. These are explained in more detail in the comments for Table M5. In addition, the Infrastructure Renewals accrual is recognised separately in Table M2 (£134.6m, line 2.14).

Investment – other (line 2.3) of £37.6m is the investment in SWHH (£37.6m).

Total cash at bank (lines 2.7 & 2.8) increased by £24.8m to £270.3m, of which £144.0m was on short term deposit (2012/13: £193.9m).

The infrastructure renewals accrual (line 2.14) has increased to £134.6m at 31 March 2014. However, approximately £111m of infrastructure maintenance expenditure has been identified within assets under construction, awaiting project completion and reclassification. This would leave a balance of around £24m as the accrual.

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 because the IAS 19 pension liability is not included in Table M2, being an IFRS adjustment. This approach is consistent with the presentation of Table M2 in previous years.

Other provisions (line 2.28) have decreased by £8.3m to £37.2m due mainly to a reduction in the reorganisation provision (£6.0m) and a net decrease in the wholesale income uncertainty provisions (£2.1m).

Table M3 – HCA Balance Sheet – Reconciliation to Statutory Accounts

This provides a summary of the main reconciling items from Tables M1 and M2 to the main financial results in the statutory accounts.

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 – Regulatory Accounts Income & Expenditure

Table M4 provides the results of Scottish Water Core on the IFRS Regulatory Accounting basis i.e. aligning with the statutory IFRS basis. The additional lines provide greater visibility of the relevant cost elements.

The reconciliation of the results shown in Table M1 to the results in Table M4 is provided in Appendix 1.1. The reconciling items are purely the IFRS entries in respect of the pension and holiday pay adjustments, infrastructure assets and PFI costs. The net impact on the profit before tax is summarised below.

<i>Favourable / (unfavourable) impact on surplus before tax</i>		<i>£m</i>	<i>Note ref.</i>
IAS 19	Pension & holiday pay adjustments - Opex	(0.1)	1.
IAS 19	Pension adjustments - Finance costs	(10.9)	1.
IAS 16	Infrastructure assets - depreciation & maintenance	(16.1)	2.
IFRIC 12	PFI costs - depreciation & lease liability	1.0	3.
Scottish Water - IFRS adjustments		(26.1)	

1. IAS 19 'Employee benefits'

Pension charges are calculated under IAS 19. In the statutory income statement, the adjustments impact on cost of sales, administration costs and finance costs. In Table M4, line 4.5 'Pension contributions (ongoing contribution)' captures the current service cost as determined by IAS 19; and line 4.18 'Net pension financing income/expense' captures the net financing elements as calculated under IAS 19. In 2013/14 the total service cost was £21.6m and the net financing expense was £10.9m.

In addition, the holiday pay accrual was decreased by £0.1m in 2013/14.

These charges replace the costs charged in Table M1, with a net increase to costs of £11.0m.

On 1 April 2013, Scottish Water adopted IAS 19 'Employee Benefits (revised 2011)' which meant the results for 2012/13 have been restated retrospectively. The impact of the restatement is detailed on page 66 of the Annual Report and Accounts, in Note 1.22. The restatement had no impact on cash, the pension liability or net assets of Scottish Water.

2. IAS 16 'Property, plant & equipment'

Under IAS 16 infrastructure renewals accounting is not permitted and infrastructure assets are depreciated over the estimated 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 and is entered in line 4.10 'Infrastructure capital maintenance charge'. However, these costs, along with the calculated depreciation, replace the original 'Infrastructure renewals charge' (IRC). In 2013/14 the infrastructure expenditure charged to the income statement was £111.8m (line 4.10) and the depreciation charge was £14.3m (line 4.8).

These charges replace the IRC charged in Table M1, with a net increase to costs of £16.1m.

3. IAS 17 'Leases' & IFRIC 12 'Service concession arrangements'

Under IFRIC 12, the PFI service concession arrangements were reclassified as finance leases resulting in the PFI assets being brought on to Scottish Water's balance sheet. The annual PFI costs incurred are broken down into three categories: operating costs, finance

costs and a reduction of the finance lease obligation. In addition, there is a depreciation charge calculated in respect of the leased assets held on the balance sheet.

In Table M4, line 4.3 'PPP costs' consists of the operating costs totalling £108.7m in 2013/14. The total depreciation charges of £17.8m are in line 4.9 and the finance costs of £24.6m are in line 4.17.

The net reduction to costs compared to Table M1 is £1.0m, due to the offsetting effect of the costs transferred against the finance lease obligation in the balance sheet (Table M5, line 5.25).

Table M5 – Regulatory Accounts Balance Sheet

Tangible assets balance (line 5.1) equals the Property, plant & equipment balance per the IFRS statutory accounts, excluding the PFI assets which are shown separately in line 5.2.

The PFI assets total of £386.6m consists of the SW owned assets and the assets treated as leased under the IFRS basis. The related finance lease liability is shown in line 5.25. The following tables provide additional analysis and reconciliation to the presentation in the statutory accounts.

Balance sheet (see Appendix 2.3)

Property, plant & equipment			
	Leased assets		345.0
	Owned assets	<i>(reclassification)</i>	41.6
		M5, line 5.2	<u>386.6</u>
Other loans & borrowings			
	Finance lease liability	< 1 year	(17.3)
		> 1 year	(381.9)
		total	M5, line 5.25 <u>(399.2)</u>

Third party contributions (line 5.3) consist of grants and contributions.

Other creditors due after one year (line 5.17) consists of payments received in advance (£75.3m).

Post employment asset / (liability) (line 5.20) shows the retirement benefit obligation under IAS 19, net of the related deferred tax balance, as detailed below.

Balance sheet (see Appendix 2.3)

	Retirement benefit obligations (/Post employment liabilities)	(139.3)
	Deferred taxation on retirement benefit obligations	27.8
	Retirement benefit obligations - net	M5, line 5.20 <u>(111.5)</u>

The other provisions total of £16.5m (line 5.21), a decrease of £2.4m compared to 2012/13, is made up of restructure (£2.4m), income uncertainty (£13.4m) and other (£0.7m).

Restructure: This provision relates to the redundancy costs associated with employees who will leave SW under VR and early retirement. Pension related liabilities associated with employees who have left SW under the VR schemes are recognised in the post employment liability (line 5.20).

Income uncertainty: This provision relates to uncertainty around the wholesale/non-domestic income. The balance of £13.4m represents the balance associated with Business Stream. Progress has continued to be made in stabilising the data and settlement process, with the final settlements in respect of 2008/09 and 2009/10 being

processed during the financial year. However, at 31 March 2014, the financial years from 2010/11 onwards were technically still 'open'.

For the purposes of the year end close and the Scottish Water group reconciliation, the forecast out-turns for 2010/11, 2011/12, 2012/13 and 2013/14 as calculated by SW's wholesale team were compared to the forecasts calculated by Business Stream. Overall, there were no material differences. Out-turn positions were therefore agreed with the relevant adjustments being posted by both companies.

Retained earnings (line 5.26) consists of the total of the reserve brought forward from 31 March 2013 and the retained profit for 2013/14 (Table M4, line 4.26).

The movement in the pension surplus/(deficit) (line 5.27) of £86.1m is the actuarial gain on the post employment plans, net of deferred tax as per Table M19.

Table M6 – Regulatory Income and Expenditure and Cash Flow

Table M6 includes the calculation of the '*Operating profit for regulatory purposes*' (line 6.10) and the reconciliation to the '*Net cash flow from operating activities*' (line 6.17).

The capital maintenance charge (line 6.7), used in calculating the '*Operating profit for regulatory purposes*', is the three year rolling average of capital maintenance expenditure, in real terms. This calculated average charge replaces the actual annual charges shown in Table M4 for depreciation (lines 4.7, 4.8 & 4.9) and infrastructure capital maintenance (line 4.10).

The average capital maintenance charge is added back, along with other 'non cash' adjustments and the working capital movement, to give the net cash flow from operating activities (line 6.17).

Interest paid (line 6.20) of £156.0m includes intercompany interest paid to Business Stream of £0.2m in relation to the settlement of wholesale billing and reconciliation process. Loan interest payments in respect of Government and other borrowings totalled £155.8m.

On the IFRS basis, £24.6m of PFI costs were reclassified as finance lease interest payments and appear in line 6.21.

The total capital expenditure is adjusted for the movement in short term capital creditors year on year. The tables below provide the detail and the reconciliation of the total capital investment to the capital enhancement expenditure (line 6.25) and capital maintenance expenditure (line 6.26).

	M Table / line ref	2013/14 £m
Opening short term capital creditor	M11.10 (12/13)	99.3
Add: Capital investment (gross)		473.3
Less: Closing short term capital creditor	M11.10 (13/14)	-85.2
=> Capital enhancement expenditure		487.4
Analysed:		
Capital enhancement expenditure	M6.25	202.4
Capital maintenance expenditure	M6.26	285.0
		487.4

	2013/14 £m
Capital investment (net cost) on a regulatory basis	462.0
Add: PFI investment	4.7
Capital investment including PFI (net cost)	466.7
Add: Infrastructure income release	6.6
Capital investment (gross)	473.3

In 2013/14 £4.7m was invested at Dalmuir PFI thereby increasing PFI assets. This expenditure has been included in the capital enhancement total within the cash flow (line 6.25) as shown in the table above.

Table M6R – Regulatory Accounts – Ratio information

Table M6R provides all of the information for, and calculation of, the 'basic' ratios in one place. The ratios provided are:

- funds from operations to net debt;
- cash interest cover [1]; and
- cash interest cover [2], i.e. after deduction of capital maintenance expenditure.

The ratios presented here are the clean calculations using the actual financial information, with all of the figures referenced from the relevant M Tables.

Table M7 – Analysis of Turnover and Operating Income

Turnover from services supplied to household customers increased by £28.0m to £778.9m (line 7.1) reflecting the 2.8% tariff increase effective from 1 April 2013 and the increase in connected properties.

Turnover from wholesale services provided to Licensed Providers decreased by £3.1m, or 1.0%, to £293.6m (line 7.3) primarily due to the planned reduction in tariffs.

Turnover from other sales increased by £0.3m to £5.7m (line 7.7).

Table M11 – Regulatory Accounts Working capital (Core)

All of the balances presented in Table M11 are on an IFRS basis. A separate reconciliation (Appendix 1.3) has been prepared showing the reclassifications of the balances in Table M2 at 31 March 2014 into the regulatory IFRS working capital (Table M11).

Trade debtors decreased by £3.4m to £33.5m (line 11.2). The table below provides a breakdown of the household gross balances and bad debt provisions by age:

	96/09 £m	09/10 £m	10/11 £m	11/12 £m	12/13 £m	13/14 £m	Total £m
Gross Debt	234.4	30.1	31.0	32.1	42.6	62.1	432.3
Bad Debt Provision	(232.3)	(29.3)	(30.0)	(30.3)	(37.6)	(39.3)	(398.8)
Net Debt	2.1	0.8	1.0	1.8	5.0	22.8	33.5

Other trade debtors (line 11.4) relate to sundry and non primary wholesale billing.

The increase in prepayments and other short term debtors (line 11.6) was due to higher insurance premium prepayments, intercompany receivables and vehicle lease prepayments.

The wholesale charge prepayment of £24.3m at March 2014 is the total of the provisional invoices for April 2014.

Capital creditors consist of the balances due to SW Solutions 2 (£0.8m) and capital creditors and accruals relating to third parties (£84.4m).

The increase in accruals and other creditors (line 11.12) was due to primarily to the accrual for landfill tax.

Table M19 – Regulatory Accounts - Statement of total recognised gains and losses

This table has been completed on the IFRS basis. The profit for the year is the Core retained profit from Table M4 (line 4.26). The actuarial gains/losses on post employment plans are the actuarial gains/losses, net of related deferred taxation, as reported in the statutory results for Scottish Water. There were no other gains or losses.

Table M21 – Taxation analysis

The 2012/13 data has been updated to reflect the actual 2012/13 tax computation submitted. We have further updated the data in relation to an ongoing issue between the water industry and HMRC. This was in relation to the capital allowances on spend on Water Treatment Works and Wastewater Treatment Works and has resulted in a reduction to our capital allowance claim for all years since 2008/09 which has also resulted in a reduction to our tax losses carried forward.

Table M22 – Fixed asset additions

The non infrastructure additions (line 22.8) are the amounts reclassified from the fixed assets under construction (AUC) during the financial year. The total of £194.5m (line 22.8) agrees to the total of the reclassifications in the statutory accounts (Note 9, SW company) from AUC into Specialised operational properties and structures; Non-specialised operational properties and structures; and Plant, machinery and vehicles.

The figures in the section “Infrastructure renewals charges, expenditure and provision”, (lines 22.20 – 22.22), are the movements during each financial year. The closing balance at March is shown in Table M2, line 2.14.

As previously mentioned, the infrastructure renewals prepayment/(accrual) balance is only relevant in the historic cost accounts (Table M2). Due to the different treatment of the non-enhancement infrastructure expenditure under IFRS, there is no prepayment/(accrual) balance in the new Regulatory/IFRS balance sheet (Table M5).

Table M27 – Consolidated Historic Cost 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 2013/14 Business Stream declared a dividend of £12.0m, 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 Historic Cost 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 Horizons 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	742.6	
Administration expenses	145.4	

SW Group Consolidated Expenditure **888.0**

<i>Less</i>	Business Stream	(43.7)
<i>Add</i>	IFRS adjustments	9.5

Total expenditure (excluding Business Stream & IFRS) **853.8**

Represented by

SW Regulated	836.3
SW Non Regulated	2.4
Horizons	13.8
International	1.4

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	154.4		378.7	222.6	156.1		362.4
Other	227.8						
Opex	382.2	3.5	378.7	222.6	156.1	16.3	362.4
PFI	150.3	(3.8)	154.1	0.0	154.1	0.0	154.1
IMC	110.0	0.2	109.8	75.8	34.0	0.1	109.7
Depreciation	220.2		212.5	110.0	102.5		211.2
Grant Amortisation	(1.0)	(0.2)	(1.0)	(0.7)	(0.3)	1.2	(0.9)
Amort PFI	2.5		0.0				0.0
Gain on assets	(10.4)		0.0				0.0
Expenditure	853.8	(0.3)	854.1	407.6	446.5	17.6	836.5
Explained by							
Charges to SWBS for support		0.3					

* Excludes Business Stream, IFRS & IAS19

The line differences are table presentation differences explained as follows:

- £3.8m difference between Scottish Water's 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 (£2.3m), terminal pumping station costs pumping to PFI works (£1.0m) and support costs for the PFI team (£0.5m).
- £0.3m 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.
- £17.6m Non Regulated expenditure is included in M18 Tables but is excluded from E Tables.

Commentary

Total operating costs excluding PFI costs and exceptional items decreased by £3.1m (0.4%) to £700.0m.

	2013/14 £m	2012/13 £m	Variance £m
Operating expenditure - Water M18w.43	222.621	211.937	(10.684)
Capital maintenance - Water M18w.54	185.032	194.319	+9.287
Operating expenditure - Waste M18ww.44	310.180	308.597	(1.583)
Capital maintenance - Waste M18ww.55	136.280	141.953	+5.673
	854.113	856.806	+2.693
exclude PFI included in M18ww.35	(154.078)	(153.661)	+0.417
	700.035	703.145	+3.110

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.

Summary Activity Analysis from Tables M18W & M18WW

	2013/14 £m	2012/13 £m	Variance £m
Non Regulated	17.631	25.784	+8.153
Wholesale (excluding PFI)	624.523	625.688	+1.165
Retail	57.881	51.673	(6.208)
	700.035	703.145	+3.110

Non Regulated costs decreased by £8.2m (31.5%) to £17.6m (£2.4m Scottish Water; £13.8m Horizons; £1.4m International). The £8.2m reduction in costs reflected a £2.5m (16.2%) decrease in direct costs, a £1.4m (41.4%) decrease in general and support costs and a £4.1m (75.6%) decrease in capital maintenance.

The key movements in Non Regulated Operating Costs from 2012/13 were:

- Market conditions experienced by the Environmental Business led to the withdrawal from the green waste and composting business in 2012/13, with a reduction of £2.1m (employment £0.5m, materials and consumables £0.2m, other direct costs £0.2m and general and support £1.1m), and the write down of associated assets by £4.4m (depreciation) in 2012/13; and
- External developer consultancy decreased by £1.7m mainly due to lower volumes caused primarily by economic conditions.

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 £6.2m (12.0%) to £57.9m.

The split of Retail operating costs between water and wastewater level has remained consistent with 2012/13 (51.8% water, 2012/13 versus 49.9%, 2012/13).

Retail	2013/14	2013/14	2012/13	2012/13
	£m	%	£m	%
Water - Domestic M18w.55	25.499	44.1%	22.696	43.9%
Water - Non Domestic M18w.55	4.437	7.7%	3.109	6.0%
Wastewater - Domestic M18ww.56	24.286	42.0%	23.224	44.9%
Wastewater - Non Domestic M18ww.56	3.659	6.3%	2.644	5.1%
	57.881		51.673	
	2013/14	2012/13	Variance	
	£m	£m	£m	
Domestic	49.785	45.920	(3.865)	
Non Domestic - Measured	6.260	4.486	(1.774)	
Non Domestic - Non Measured	1.836	1.267	(0.569)	
	57.881	51.673	(6.208)	

Domestic customer retail total operating costs increased by £3.9m (8.4%).

The key movements from 2012/13 were:

- Increase due to the reclassification of customer contact costs from wholesale to retail of £4.4m in order to comply with WICS review of retail costs, as per email of 21 March, (direct (£2.1m, general and support £1.8m and depreciation £0.5m);
- Increase in advertising and marketing of £1.6m driven by the major television and radio customer awareness campaigns at £1.5m and increases in customer market research costs of £0.1m; and
- A £1.9m decrease in bad debt charge. Although cash collection levels held up well in 2013/14, we continue to be concerned about the sustainability of this performance on future collection rates, primarily due to the impact of Welfare Reform.

Non domestic customer retail total operating costs have increased by £2.3m (40.7%) to £8.1m (£6.3m measured and £1.8m unmeasured).

The key movements from 2012/13 were:

- Increase due to the reclassification of customer contact costs from wholesale to retail (as above) of £1.5m (direct £0.7m, general and support £0.6m and depreciation £0.2m);
- Increase in the cost of managing billing data of £0.5m, mainly due to the meter information cleansing project; and
- Increase in the cost of services provided to Business Stream under service agreements. 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 (£0.3m).

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);
- Costs of handling customer contacts from Licensed Providers and non-domestic customers. This was reclassified, from wholesale core, in 2013/14 to be in line with regulatory guidance;
- The CMA costs charged to Scottish Water for set up and operation of the CMA systems and processes; and to a lesser extent; and
- 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 England and Wales there are a number of activities defined by OFWAT as Retail which are not allocated as such in Scotland. The total of those activities, as far as Scottish Water has been able to determine them, in 2013/14 is £2.4m. These are analysed as £1.6m water (£1.5m household; £0.1m non household) and £0.8m waste water (£0.7m household; £0.1m non household).

Scottish Water

Year ended 31 March 2014

Reconciliation of Historic Accounts Income Statement (Table M1) to IFRS Regulatory Income Statement (Table M4)

TABLE M1			IFRS adjustments					Table M4		
Line	Description	Core	IAS 19 - Pension adj	IAS 19 Holiday pay	IAS 16 Infra costs	IFRIC 12 PFI	Category reallocation	Core	Line	Description
		£m	£m	£m	£m	£m	£m	£m		
1.1	Turnover	1,078.203						1,078.203	4.1	Turnover
1.2	Operating expenditure	(365.622)	21.406	0.065			0.633	(343.518)	4.2	Operating expenditure
1.3	PPP costs	(149.639)					40.910	(108.729)	4.3	PPP costs (excluding PPP interest costs)
								(0.633)	4.4	SW internal costs re PPP contracts
				(21.610)				(21.610)	4.5	Pension contributions (ongoing contribution)
1.4	Historical Cost Depreciation	(219.657)						(219.657)	4.7	Depreciation charges - non infra assets
					(14.350)			(14.350)	4.8	Depreciation charges - infra assets
1.5	Infrastructure Renewals charge	(110.000)			(1.800)			(111.800)	4.10	Capital maintenance charge (infra t/f from AUC)
1.6	Amortisation of PFI assets	(2.494)					(15.300)	(17.794)	4.9	Depreciation charges - PPP assets
1.7	Amortisation of deferred income	0.934						0.934	4.11	Amortisation of deferred income
1.8	Operating income	10.338						10.338	4.14	Profit on disposal of fixed assets
1.11	Net interest receivable less payable	(155.895)						(155.895)	4.16	Net interest receivable less payable
								(24.580)	4.17	PPP interest payable
				(10.947)				(10.947)	4.18	Net pension financing income/expense
1.12	Profit on ordinary activities before taxation	86.168	(11.151)	0.065	(16.150)	1.030	-	59.962	4.19	Profit before taxation
1.14	Taxation - deferred	71.684	0.500					72.184	4.21	Taxation - deferred
1.19	Retained profit for year	157.852	(10.651)	0.065	(16.150)	1.030	-	132.146	4.26	Profit retained

Scottish Water

Year ended 31 March 2014

Reconciliation of Historic Accounts Balance Sheet (Table M2) to IFRS Regulatory Balance Sheet (Table M5)

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:			TABLE M5	
Line	Description	Core	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/deprn	IFRIC12 PFI assets/ finance lease	Infra renewals accrual	Various - other	Operating working capital	Line	Description
£m (3dp)									£m (1dp)	
	<i>Fixed Assets</i>									<i>Fixed Assets</i>
2.1	Tangible Assets	5,202.393		(46.4)		(134.6)			5.1	Tangible Assets
					386.6				5.2	PPP assets (IFRS)
							(15.9)	(i)	5.3	Third party contributions
							(34.6)	(ii)		
2.3	Investment - Other	34.640								
2.4	<i>Total fixed assets</i>	<u>5,237.033</u>								
2.5	Stocks	2.123						(2.1)	(iii)	
2.6	Debtors	87.604	(17.7)					(69.9)	(iii)	
								(210.2)	(iii)	5.4 Working capital
2.7	Cash at bank and in hand	126.292								5.5 Cash
2.8	Short term deposits	114.000								5.6 Short term deposits
2.10	Assets transferred to PPP contractors	41.541			(41.5)					
2.12	<i>Total current assets</i>	<u>371.560</u>								5.9 <i>Net operating assets</i>
2.14	Infrastructure Renewals accrual	(134.592)				134.6				
2.15	Creditors	(286.723)	4.5					282.2	(iii)	
2.16	Borrowings (excl. Govt. loans)	(0.514)								5.10 Borrowings
							34.6	(ii)		
2.17	Corporation tax payable	0.850								5.12 Investment - other
2.19	<i>Total creditors</i>	<u>(420.979)</u>								5.13 Corporation tax payable
2.20	Net current assets	(49.419)								5.15 <i>Non-operating assets & liabilities</i>
2.21	<i>Total assets less current liabilities</i>	<u>5,187.614</u>								
2.22	Borrowings (excl. Govt. loans)	(1.000)								5.16 Borrowings
2.23	Other creditors	(75.300)								5.17 Other creditors
2.24	<i>Total creditors</i>	<u>(76.300)</u>								5.18 <i>Creditors > 1 year</i>
	<i>Provision for liabilities & charges</i>									
2.25	Deferred tax provision	(377.852)								5.19 Deferred tax provision
2.26	Deferred income - grants and contributions	(15.857)					15.9	(i)		
2.27	Post employment assets / (liabilities)	-	(111.5)							5.20 Post employment assets / (liabilities)
2.28	Other provisions	(37.244)	20.8							5.21 Other provisions
2.29	<i>Net Assets employed</i>	<u>4,680.361</u>	(103.9)	(46.4)	345.1	-	-	-		5.23 <i>Net assets</i>
	<i>Capital and reserves</i>									<i>Capital & reserves</i>
2.30	Govt. loans	3,352.761								5.24 Government loans
						399.2				5.25 PPP debt/lease (IFRS)
2.31	Income and Expenditure account	1,224.170	6.9	(46.4)	(54.1)					5.26 Income and Expenditure account
			(110.8)							5.27 Pension surplus/(deficit) (IFRS)
2.32	Other reserves	133.430								5.28 Other reserves
2.33	<i>Capital & reserves</i>	<u>4,710.361</u>	(103.9)	(46.4)	345.1	-	-	-		5.29 <i>Capital & reserves</i>

Scottish Water
Year ended 31 March 2014
Reconciliation of Working Capital between M Tables

TABLEM2				IFRS	Expand	Table	Table	Line	Description
Line Description	Total	Non Core	Core	Adjs	categories	M11	M5		
	£m	£m	£m	£m	£m	£m	£m		
2.5 Stocks	2.1	-	2.1			2.1		11.1	Stocks
2.6 Debtors	88.0	0.4	87.6	(17.7)	(69.9)				
					33.5	33.5		11.2	Trade debtors - household
					2.6	2.6		11.4	Other trade debtors
					33.8	33.8		11.6	Prepayments & other short term debtors
2.15 Creditors	(284.2)	2.5	(286.7)	4.5	282.2				
					(15.1)	(15.1)		11.7	Trade creditors
					(24.3)	(24.3)		11.8	Wholesale income prepayment
					(85.2)	(85.2)		11.10	Short-term capital creditors
					(30.5)	(30.5)		11.11	Credit note provisions
					(127.1)	(127.1)		11.12	Accruals & other creditors
2.23 Other creditors	(75.3)	-	(75.3)				(75.3)	5.17	Other creditors
	(269.4)	2.9	(272.3)	(13.2)	-	(210.2)	(75.3)		

Scottish Water
Year ended 31 March 2014
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M27			IFRS	Statutory Accounts (IFRS)	
Line	Description	Consolidated	adjustments	Consolidated	
		£m (3dp)	£m (1dp)	£m (1dp)	
27.1	Turnover	1,179.694	-	1,179.7	Revenue
27.2	Operating costs	(424.719)			
27.3	PPP costs	(149.639)			
27.4	Historical Cost Depreciation	(221.977)		(742.6)	Cost of sales
27.5	Infrastructure Renewals charge	(110.000)			
27.6	Amortisation of PFI assets	(2.494)		(145.4)	Administrative expenses
27.7	Amortisation of deferred income	1.021			
27.8	Operating income	10.328			
		(897.480)	9.5	(888.0)	
27.9	Operating profit	282.214	9.5	291.7	Operating surplus
				1.1	Finance income
				(191.8)	Finance costs
27.11	Net interest receivable less payable	(155.300)	(35.4)	(190.7)	
27.12	Profit on ordinary activities before taxation	126.914	(25.9)	101.0	Surplus before taxation
27.13	Taxation - current	(7.073)			
27.14	Taxation - deferred	71.093			
		64.020	0.5	64.5	Taxation
27.19	Retained profit for year	190.934	(25.4)	165.5	Surplus for the year

Scottish Water

Year ended 31 March 2014

Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M28			IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Consolidated	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/deprn	IFRIC12 PFI assets/ finance lease	Infra Renewals Prepayment	Deferred / Current tax presentation	Split <> 1yr	Consolidated	
		£m (3dp)							£m (1dp)	
	<i>Fixed Assets</i>									<i>Non-current assets</i>
2.1	Tangible Assets	5,225.104		(46.4)	386.6	(134.6)			5,430.6	Property, plant & equipment
2.3	Investment - Other	0.040								
2.4	Total fixed assets	5,225.144						0.1	5,430.7	Deferred tax asset
	<i>Current Assets</i>									<i>Current assets</i>
2.5	Stocks	2.372							2.4	Inventories
2.6	Debtors	180.998	(17.7)						163.2	Trade & other receivables
2.7	Cash at bank and in hand	192.602						5.6	5.6	Current tax asset
2.8	Short term deposits	224.010							416.6	Cash & cash equivalents
2.10	Assets transferred to PPP contractors	41.541			(41.6)					
2.12	Total current assets	641.523							587.8	
	<i>Creditors: amounts falling due within one year</i>									<i>Current liabilities</i>
2.14	Infrastructure Renewals accrual	(134.592)				134.6				
2.15	Creditors	(391.605)	4.6					(2.9)	(389.8)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	(0.514)			(17.3)				(17.8)	Other loans & borrowings
2.17	Corporation tax payable	5.555					(5.6)		-	Current tax liabilities
2.19	Total creditors	(521.156)						(2.9)	(2.9)	Provisions for liabilities
2.20	Net current assets	120.367							(410.5)	
2.21	Total assets less current liabilities	5,345.511							177.3	
	<i>Creditors: amounts falling due after one year</i>									<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(1.000)			(381.9)				(382.9)	Other loans & borrowings
2.23	Other creditors	(75.300)						(20.0)	(95.3)	Trade & other payables
2.24	Total creditors	(76.300)							(478.2)	
	<i>Provision for liabilities & charges</i>									
2.25	Deferred tax provision	(378.500)	27.4				(0.1)		(351.3)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(22.912)						22.9	(137.2)	Retirement benefit obligations
2.27	Post employment assets / (liabilities)	-	(137.2)						(137.2)	Provisions for liabilities
2.28	Other provisions	(23.728)	20.6					2.9	(0.2)	Provisions for liabilities
2.29	Net Assets employed	4,844.071	(102.3)	(46.4)	(54.2)	-	(0.0)	-	4,641.1	<i>Net assets</i>
	<i>Capital and reserves</i>									<i>Equity</i>
2.30	Govt. loans	3,352.761							3,352.8	Government loans
2.31	Income and Expenditure account	1,357.880	(102.3)	(46.4)	(54.2)			-	1,154.9	Retained earnings
2.32	Other reserves	133.430							133.4	Other reserves
2.33	Capital & reserves	4,844.071	(102.3)	(46.4)	(54.2)	-	-	-	4,641.1	

Scottish Water

Year ended 31 March 2014

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

TABLEM2		IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Total	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/deprn	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	5,202.393		(46.4)	386.6	(134.6)			5,407.9 Property, plant & equipment
2.3	Investment - Other	37.640							37.6 Investments
2.4	Total fixed assets	<u>5,240.033</u>							<u>5,445.5</u>
	Current Assets								<i>Current assets</i>
2.5	Stocks	2.123							2.1 Inventories
2.6	Debtors	87.971	(17.7)						70.3 Trade & other receivables
2.7	Cash at bank and in hand	126.293					0.9		0.9 Current tax asset
2.8	Short term deposits	144.000							270.3 Cash & cash equivalents
2.10	Assets transferred to PPP contractors	41.541			(41.6)				
2.12	Total current assets	<u>401.928</u>							<u>343.6</u>
	Creditors: amounts falling due within one year								<i>Current liabilities</i>
2.14	Infrastructure Renewals accrual	(134.592)				134.6			
2.15	Creditors	(284.222)	4.5					(1.4) (i)	(281.1) Trade & other payables
2.16	Borrowings (excl. Govt. loans)	(0.514)			(17.3)				(17.8) Other loans & borrowings
2.17	Corporation tax payable	0.850					(0.9)		
2.19	Total creditors	<u>(418.478)</u>						(13.8) (ii)	<u>(13.8)</u> Provisions for liabilities
2.20	Net current assets	(16.550)							<u>(312.7)</u>
2.21	Total assets less current liabilities	<u>5,223.483</u>							<u>30.9</u>
	Creditors: amounts falling due after one year								<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(1.000)			(381.9)				(382.9) Other loans & borrowings
2.23	Other creditors	(75.300)						(14.5) (i)	(89.8) Trade & other payables
2.24	Total creditors	<u>(76.300)</u>							<u>(472.7)</u>
	Provision for liabilities & charges								
2.25	Deferred tax provision	(378.645)	27.8						(350.8) Deferred tax liabilities
2.26	Deferred income - grants and contributions	(15.857)						15.9 (i)	(139.3) Retirement benefit obligations
2.27	Post employment assets / (liabilities)	-	(139.3)						(2.7) Provisions for liabilities
2.28	Other provisions	(37.244)	20.8				13.8 (ii)		(2.7) Provisions for liabilities
2.29	Net Assets employed	<u>4,715.437</u>	<u>(103.9)</u>	<u>(46.4)</u>	<u>(54.2)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,510.9</u> <i>Net assets</i>
	Capital and reserves								<i>Equity</i>
2.30	Govt. loans	3,352.761							3,352.8 Government loans
2.31	Income and Expenditure account	1,229.246	(103.9)	(46.4)	(54.2)				1,024.7 Retained earnings
2.32	Other reserves	133.430							133.4 Other reserves
2.33	Capital & reserves	<u>4,715.437</u>	<u>(103.9)</u>	<u>(46.4)</u>	<u>(54.2)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,510.9</u>