



**Scottish
Water**

Trusted to serve Scotland

Annual Return 2014/15

Overview

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1. Executive Summary

This overview reports on Scottish Water's performance and activities in 2014/15, the final year of the 2010-15 regulatory period.

The year proved to be another successful year and as we conclude the 2010-15 period, Scottish Water performed strongly. Over the period drinking water quality and environmental performance has improved and customer satisfaction is at record levels. On customer satisfaction, as measured by the Institute of Customer Service during 2014/15, we are one of the top performing companies in the utilities sector. In 2014/15 our charges to household customers remained among the lowest in Great Britain – around £54 lower than the average household charge in England and Wales.

1.1 2014/15 Dashboard

Table 1 shows the 2014/15 year-end position for the key regulatory outputs set out in the Regulatory Contract.

Annual Dashboard – 2014/15			
Measure to be reported	Actual 2014/15	Delivery Plan Target 2014/15	Current RAG Status
Output Delivery			
Investment – completion of Q&SII/IIIa (Number of remaining projects requiring regulatory sign-off)	1	0	R
Investment – delivery of Q&SIIIb outputs (OMD Measure)	239.1	236.5 - 248.7	G
Levels of Service			
Customer Service OPA (rolling four quarters)	400	380	G
Leakage (MI/d) (rolling four quarters)	544	600	G
Water into supply (MI/d) (rolling four quarters)	1,807		
Expenditure			
Total capital expenditure (£m)	470	508	
Operating and PFI Costs (£m)	506 ¹	532	G
Financial Strength			
Cash interest cover	3.6	3.3	G
Funds from operations to net debt	13.5%	11.6%	G
Gearing	45%	46%	G
Net new borrowing (£m)	70 ²	110	G

Table 1 – Annual Regulatory Dashboard – 2014/15

Performance Status
Performance below target
Performance on or above target

¹ Includes the refund on property rates of £14.5 million.

² Net new borrowing in 2014/15 was £70 million, in line with our agreement with the Scottish Government.

1.2 Overall Performance Assessment (OPA)

We are pleased to report an increase in the levels of service to our customers as measured through OPA. In 2014/15 our OPA performance increased to 400, an increase from 397 in 2013/14, and exceeded our Delivery Plan target of 380.

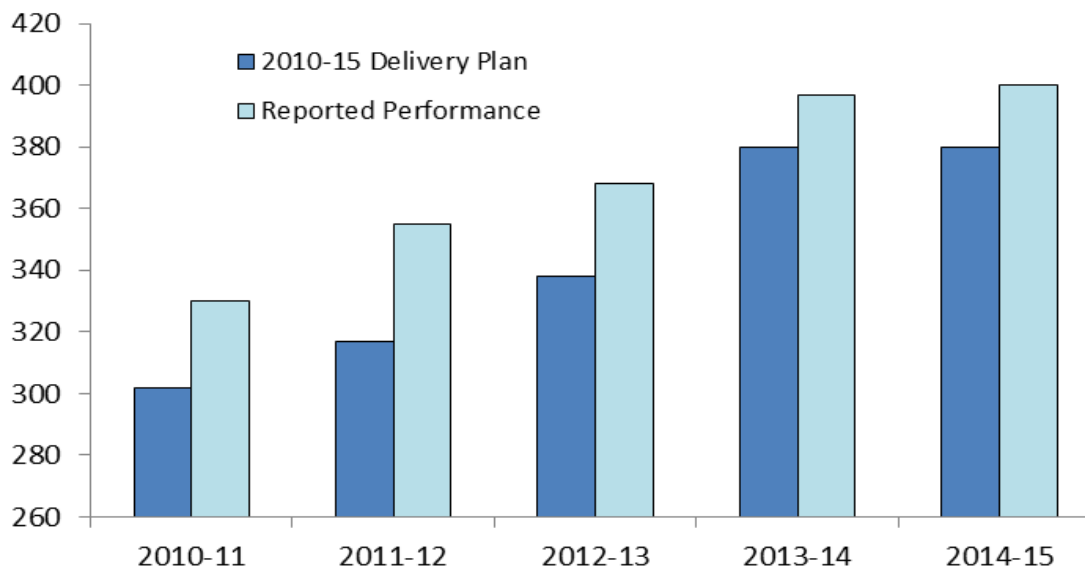


Figure 1 – OPA performance 2010-2015

1.3 Leakage

Our reported leakage for 2014/15 is 544 MI/d which is a 22 MI/d reduction on our reported level of 566 MI/d for 2013/14, successfully out-performing our 2014/15 Delivery Plan target of 600 MI/d.

1.4 Customer Satisfaction

Customer satisfaction has increased again in 2014/15 and reached a score of 92.1%; up from 90.1% in 2013/14. This has been achieved through a determined focus on listening to our customers. We continue to focus on customer satisfaction, with the introduction of a new survey methodology that will increase the ease of response, through channels that suit customers, and a new Customer Experience Measure to drive further improvement in the customer experience to all our customers in the 2015-21 period.

1.5 Compliance

Drinking water quality compliance

For the calendar year 2014, overall compliance with water quality standards continued to be of a very high standard with 99.90% of all water quality tests conducted in our sampling programme complying with quality standards. Water quality at customer taps in 2014 was maintained at 99.89%, the same as last year's best ever performance.

Waste water compliance

Waste water treatment works compliance under serviceability measures is reported as 3 failing works (Arrochar, Doune and Ellon) at 31 March 2015. This level of performance compares against our Delivery Plan 2010-15 forecast of 18 works, although in 2013/14 we achieved 1 failing waste water treatment works.

We continue to see improvement in the number of waste water environmental pollution incidents, although we have seen a slight increase in the more serious category 1 and 2 incidents. We continued to reduce the number of Unsatisfactory Intermittent Discharges (UIDs) on our sewerage network as a result of our investment programme during 2014/15. One bathing water where a Scottish Water asset could have had an influence (Lunan Bay) failed for the season, although this failure was attributed to wet weather and not our asset. All sludge was recycled in compliance with the regulations during 2014/15.

1.6 Capital programme delivery

Investment during 2014/15 totalled £470 million, comprising £436m on Q&S3b projects; £2 million on completion projects and £32 million on Q&S4 early start. Our total SR15 early start expenditure during the period was £46.8 million.

Overall Measure of Delivery (OMD) continued to provide 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 2015, the OMD score was 239.1 points, within the target range of 236.5 to 248.7.

We have delivered a total of 312 of the 313 completion projects since April 2010; Killylour water treatment works being the last remaining Q&S3a project and we are working to deliver water into supply by March 2016.

We have 37 outstanding projects that were due to be delivered by the end of the 2010-15 period and recognise that a significant proportion of these were in two important programme areas – water treatment works improved and improved waste water discharges. Where necessary, temporary mitigation measures have been put in place pending delivery of a permanent solution and we will maintain a strong focus delivering the remaining elements of the programme to ensure that benefits to customers are delivered as soon as possible.

1.7 Wholesale service

2014/15 has seen the Scottish competitive market continue to develop rapidly with licences granted to a further 5 Licensed Providers; all but one of whom have now signed a Wholesale Services Agreement with Scottish Water. This takes the total number of Licensed Providers operating in the retail market in Scotland to 18. This has been accompanied by a sustained increase in the number of businesses switching licensed providers.

1.8 Research and Innovation

We recognise that innovation is key to sustaining high performance and delivering ever higher service to our customers. We continue to work with academia to develop new knowledge to improve services and with our supply chain to explore better ways to deliver increased value for customers. Our strategic research and innovation programme is progressing in the following areas:

- Enhancing water and environmental quality compliance
- Value recovery from waste water
- Sustainable rural communities

Alongside this, we are also pursuing single topic issues such as leakage, sewer flooding and carbon reduction through the UKWIR programme.

During 2014/15 we further developed our strategic approach to research and development, accelerating the adoption of new technologies and developing a corporate culture that supports innovation in all areas of Scottish Water.

1.9 Expenditure, Performance and Efficiency

Financials

The surplus before tax in the year for Scottish Water was £105.8 million, £19.5 million higher than in 2013/14 (£86.3 million). The regulated surplus before tax of £105.5 million was £19.4 million higher than in 2013/14 (£86.1 million).

Revenue

Regulated revenue for the year totalled £1,096.9 million (2014 - £1,078.2 million).

Revenue from services supplied to household customers increased by £21.9 million or 2.8% to £800.8 million reflecting the 1.6% tariff increase effective from 1 April 2014, the increase in connected properties and a reduction in council tax discounts applied.

Revenue from wholesale services supplied to Licensed Providers decreased by £4.4 million or 1.5% to £289.2 million reflecting the planned reduction in wholesale tariffs. Revenue from other sales increased by £1.2 million to £6.9 million.

Total costs

Total costs of £833.4 million were £2.8 million lower than in 2013/14.

Operating costs of £506.1 million were £9.2 million lower than 2013/14. Within these costs, regulated operating costs of £353.1 million were 3.3% of £11.9 million lower than in 2013/14 and PFI costs were £2.7 million higher at £153.0 million.

Headline regulated operating costs of £353.1 million were 3.3% or £11.9 million lower than in 2013/14. The decrease was primarily due to a £14.5 million reduction in local authority rates charges, reflecting a one-off refund associated with a successful revaluation appeal. After adjusting for this, the movement in landfill taxes and the increase in energy and carbon prices, like-for-like costs, as planned, increased in real terms by 1.6% or £4.4 million. The planned increase reflected the uplift in the household income collection charges from Scottish Councils, improvements to water quality processes and additional expenditure to improve data quality processes in the wholesale arena. Within the wholesale arena, we incurred additional operating costs of £2.3m in respect of the Gaps3 project.

Depreciation, including infrastructure depreciation, increased by £6.8 million to £338.0 million, due to the profile of the capital investment in the year. The gain on sale from asset disposals was £0.4 million higher than in 2013/14 at £10.7 million.

Finance costs

As at 31 March 2015, the weighted average interest cost of the outstanding long-term debt was 4.86%, (2014 – 4.93%). Net interest payable during the year was £156.6 million, £0.7 million higher than in 2013/14.

During the year, net debt decreased by £5.1 million to £3,078.9 million (being loans of £3,424.3 million less cash balances of £345.4 million). The decrease was driven by a £75.1 million increase in cash balances, partly offset by a £70.0 million increase in borrowing from the Scottish Government.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £70.0 million for 2014/15. Actual net new borrowings in 2014/15 were £70.0 million.

Assessment of financial out-performance

We have calculated our financial out-performance in accordance with the methodology set out by the Commission on 16 November 2007, applied to Scottish Water's regulated business. Our assessment in Appendix A shows that Scottish Water has generated financial out-performance against the 2009 Final Determination of £179.6 million, of which £122.4 million was generated in the period from April 2010 to March 2015. Out-performance has also been delivered through higher service levels. An overview of where Scottish Water has delivered substantially higher service levels than those required in the Final Determination is also provided in Appendix A.

1.10 Board Changes

Douglas Reid left the Scottish Water Board in December 2014. Mrs Jackie Moran was appointed on 1 January 2015 as a shadow Board member for a period of one year.

1.11 Strategic Review of Charges 2015

The Final Determination, with one addition in relation to a leakage incentive, reflected the agreement that we reached with the Customer Forum on our business plan for 2015 to 2021 and which we published in March 2014. We accepted the Water Industry Commission's Final Determination in December 2014 and prepared our Delivery Plan for the 2015 to 2021 period for Ministers approval, which we received in April 2015.

Our Delivery Plan is ambitious and sets out to build on our success to date and achieve further improvement and efficiency of our services and to provide our customers a leading service while at the same time reducing their charges in real terms. In light of customer research, and to reflect our increased ambition, we updated our corporate vision to being '**Trusted to care for the water on which Scotland depends**'.

We were pleased to work with the Water Industry Commission for Scotland on developments to the approach for setting prices for 2015 to 2021, and embraced their innovative approach to involve customers in agreeing our business plan through the formation of the Customer Forum. We welcomed working with the Customer Forum and the insights it provided in agreeing our Business Plan for 2015 to 2021. We look forward to working with the Water Industry Commission for Scotland and other stakeholders in determining the most effective way that customers remain at the heart of decision making in the water industry.

1.12 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. We also retained Black and Veatch to audit the information reported in the Annual Return as part of the normal assurance to the Scottish Water Board and consequently the Commission. Our process for preparing the Annual Return achieved ISO9001 accreditation in March 2015 and our approach continues to ensure that the Annual Return submission is based on sound processes and assumptions, and is subject to continuous improvement.

Please find our Board assurance statement at Appendix B.

2. Key Outputs and Service Delivery

2.1 Service Outputs and Performance

Overall Performance Assessment (OPA)

In 2014/15 our OPA performance increased to 400 and exceeded our Delivery Plan target of 380. Our 2014/15 OPA score represents a 3 point improvement compared with the 397 OPA points scored in 2013/14.

Table 2.1 below compares our 2013/14 and 2014/15 performance for each of the 17 indicators.

Indicator	AR14 OPA Performance	AR15 OPA Performance	AR14 OPA score	AR15 OPA score	Change
% of properties subject to inadequate water pressure	0.00%	0.00%	37.36	37.38	0.03
Connected properties experiencing unplanned interruptions	0.41%	0.34%	34.26	35.02	0.76
Hosepipe restrictions	0	0	12.50	12.50	0.00
Security of Supply absolute performance	89	93	7.50	11.25	3.75
Security of Supply performance against target	-3.49%	-2.20%	12.50	12.50	0.00
% of water samples that comply with parameters	99.79%	99.74%	44.12	42.64	-1.49
Leakage	-6.04%	-10.30%	12.50	12.50	0.00
Water Service (sub-total)			160.74	163.79	3.05
% properties suffering sewer flooding incidents caused by overloading	0.0017%	0.0014%	24.90	25.00	0.10
% properties suffering sewer flooding incidents caused by other causes	0.0037%	0.0029%	37.50	37.50	0.00
Sewer flooding (at risk)	0.01244%	0.00976%	12.44	12.50	0.06
Sewerage Service (sub-total)			74.84	75.00	0.16
Customer Contact (total of complaints and telephone performance)	18.54	18.51	18.54	18.51	-0.04
Assessed customer service	8	8	37.50	37.50	0.00
Customer Service (sub-total)			56.04	56.01	-0.04
Category 1 & 2 sewage EPIs	5	8	25.00	24.40	-0.60
Category 3 sewage EPIs	259	241	10.11	10.29	0.18
Category 1 & 2 water EPIs	1	1	11.21	11.22	0.01
Sewage sludge disposal	0%	0%	12.50	12.50	0.00
% pe served by non-compliant sewerage treatment works	0.29%	0.25%	47.39	47.75	0.37
Environmental Performance Service (sub-total)			106.20	106.16	-0.05
Total			397.83	400.95	3.12

Table 2.1: OPA Performance 2014/15

Significant movements against the OPA indicators are explained below.

Connected Properties Experiencing Unplanned Interruptions

Table 2.2 shows the change in the number of properties that experienced unplanned interruptions compared to last year. A total of 8,914 weighted properties, or 0.34% of total population, received a supply interruption greater than 6 hours.

	2013/14	2014/15
Properties interrupted for 6 to 12 hours	8,849	7,626
Properties interrupted for 12 to 24 hours	820	482
Properties interrupted for more than 24 hours	20	81
Total number of properties interrupted for more than 6 hours	9,689	8,189
Total number of properties interrupted for more than 12 hours	840	563
Total 'weighted' properties interrupted for more than 6 hours	10,569	8,914

Table 2.2: Unplanned Interruptions to Supply 2013/14 and 2014/15

In this reporting year 5 large incidents caused 3,402 properties to lose supply for greater than six hours. These were:

- In August 2014, 403 properties were affected by an incident in Dunblane with supply being restored within 7 hours.
- In September 2014, 593 properties were affected by an incident in Denny with supply being restored within 11½ hours.
- In November 2014, 1,659 properties were affected by an incident in Main Street, Wishaw with supply being restored in 11¾ hours.
- In January 2015, severe storms and resulting power loss on the Isle of Skye and surrounding area led to a number of interruptions to the water supply. Two of the larger events that were a direct result of this led to a total of 434 properties losing their supply for around 11 hours and 50 minutes³.
- In March 2015, 313 properties were affected by an incident on Edinburgh Road, Bathgate with supply being restored within 8½ hours.

Security of Supply Index (SOSI)

Our SOSI absolute performance score improved in 2014/15, rising from 89 to 93, achieving a banding of 90-99 (SOSI band B) and 11.25 OPA points. Absolute performance is measured on total SOSI score. We are also measured in terms of our SOSI performance against our annual target. We scored 93 SOSI points in 2014/15 and exceeded our target of 91. Our SOSI target score remained at the maximum 12.5 points.

Percentage of water samples at customer taps that comply with parameters

In 2014/15 our OPA performance in the six parameters measured in this component decreased from 99.79% to 99.74%, achieving a score of 42.64 points. The percentage of water samples that comply with each parameter is shown in Table 2.3.

³ At Dunvegan, 236 properties lost supply for 11 hours and 43 minutes; At Kyleakin, 198 properties lost supply for 11 hour and 55 minutes

Parameter	Compliance
Aluminium	99.99%
E.coli	99.98%
Iron	99.85%
Manganese	99.82%
THM	98.79%
Turbidity	99.99%
Average Compliance = average of all 6 components	99.74%

Table 2.3: Drinking water quality 2014 – OPA parameters

Our water quality performance is discussed in Section 2.4 below.

Waste Water Category 1&2 EPIs

We reported an increase in Category 1 & 2 incidents in 2014/15 from 5 to 8. This decreased our OPA performance by 0.6 points to 24.4 points for this indicator.

Percentage of Population Equivalent Served by Non-compliant Sewage Treatment Works

The compliance of Scottish Water's waste water treatment works increased in 2014/15. In 2014/15, 0.25% of the connected population equivalent was served by a non-compliant works compared to 0.29% in 2013/14; this improved our score by 0.37 points to 47.75.

2.2 Leakage

Our reported leakage for 2014/15 is 544 MI/d which is a 22 MI/d reduction on our reported level of 566 MI/d for 2013/14, successfully out-performing our 2014/15 Delivery Plan target of 600 MI/d. Table 2.4 details the leakage reduction we have achieved across the 2010-15 period.

Description (ML/d)	2010/11	2011/12	2012/13	2013/14	2014/15
Regulatory reported leakage (OPA)	699	629	575	566	544
Leakage target (OPA) (ELL)	720	670	670	600	600
Mean Leakage Estimate adjusted leakage	699	629	575	566	544

Table 2.4 – Leakage levels for the 2010 to 2015 period

2.3 Customer Satisfaction

We have been monitoring customer satisfaction during the 2010-15 period. Customer satisfaction has increased again this year and reached a score of 92.1% from 90.1% in 2013/14. This has been achieved through a determined focus on listening to our customers. We continue to focus on customer satisfaction, with the introduction of a new survey methodology that will increase the ease of response, through channels that suit customers, and a new Customer Experience Measure (CEM) to drive further improvement in the customer experience to all our customers in the 2015-21 period.

2.4 Drinking Water Service

Overall Water Quality Compliance

Overall compliance with water quality standards continues to be of a very high standard for the 2014 calendar year, with 99.90% of all water quality tests conducted in our sampling programme complying with quality standards (2013: 99.91%; 2012: 99.88%; 2011: 99.86%).

Microbiological Quality

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

a) water leaving treatment works

In 2014, 26,817 samples were taken for *E.coli* and coliform analysis. Compliance with the *E.coli* standard was 99.99% and with the total coliform standard was 99.85%.

b) water in service reservoirs

In 2014, 51,543 samples were taken for *E.coli* and coliform analysis. Compliance with the *E.coli* standard was 99.99% and the total coliform standard was 99.80%.

c) water at customer taps

In 2014, 14,055 samples were taken for *E.coli* and coliform analysis. Compliance with the *E.coli* standard was 99.99% and the total coliform standard was 99.55%.

Table 2.5 highlights performance in microbiological water quality from 2011 to 2014 based on regulation samples:

		2011 fails	2011 compliance	2012 fails	2012 compliance	2013 fails	2013 compliance	2014 fails	2014 compliance
Treatment Works	Coliforms	49	99.83%	33	99.88%	17	99.94%	40	99.85%
	<i>E.coli</i>	5	99.98%	3	99.99%	1	99.99%	2	99.99%
Service Reservoirs	Coliforms	122	99.77%	109	99.79%	73	99.86%	104	99.80%
	<i>E.coli</i>	13	99.97%	7	99.99%	5	99.99%	2	99.99%
Customer Taps	Coliforms	60	99.58%	61	99.57%	50	99.65%	63	99.55%
	<i>E.coli</i>	2	99.99%	2	99.99%	3	99.98%	2	99.99%

Table 2.5 - Microbiological quality of water

Chemical Sampling

Physical and chemical quality standards apply to water supplied at customer taps. 117,044 samples were taken from customer taps to test for all parameters during 2014.

Table 2.6 highlights the performance of the key chemical parameters for 2011 to 2014.

	2011 fails	2011 compliance	2012 fails	2012 compliance	2013 fails	2013 compliance	2014 fails	2014 compliance
THM Total	42	97.33%	42	97.30%	13	99.14%	16	98.95%
Iron	46	99.09%	34	99.34%	35	99.32%	19	99.63%
Colour	3	99.94%	0	100%	0	100%	1	99.98%
Manganese	28	99.45%	32	99.38%	25	99.51%	15	99.70%
Aluminium	11	99.78%	2	99.96%	5	99.90%	1	99.98%

Table 2.6 – Key Chemical Parameters

THM

Trihalomethanes (THM) are formed by the reaction of chlorine with naturally occurring organic compounds in the water. Formation can be minimised by removing as much of the organic material as possible prior to chlorination. Introduction of chloramination as a means of disinfection also reduces THM formation. A high percentage of our supplies are derived from upland sources containing significant levels of organic compounds and historically THM is a parameter subject to a high number of exceedances. In 2014, 16 THM failures were reported from 10 failing zones, resulting in a slight drop in THM compliance to 98.95% from 99.14% in 2013 (13 failures from 9 zones). THM and other disinfection by-products remains an area of focus with further operational and capital investment planned in the 2015-21 period.

Manganese

Manganese occurs naturally in many raw waters, and concentrations can vary seasonally. The standard (50µg/l) is set for aesthetic reasons. The presence of manganese in water at customers' taps can be attributed to the accumulation of residual amounts in the distribution network not removed by the water treatment process. These deposits are dealt with by cleaning or relining the distribution system and the introduction of manganese removal stages in water treatment processes aimed at preventing this accumulation of deposits. In 2014, 15 manganese failures of the standard were reported, this is an improvement on the 25 failures in 2013 and compliance has increased to 99.70% from 99.51%.

Water Resources Licensing

We submitted our annual Water Resource data return to SEPA for the 2014 calendar year, which covers abstraction and impoundment activities authorised under the Controlled Activities Regulations (CAR) and includes data for 276 abstraction and 101 compensation activities. It is a legal requirement of our Water Use (CAR) Licences to provide SEPA with data on our abstraction and compensation activities to enable them to monitor our compliance against the conditions of the licences we hold – typically maximum abstraction limits from our sources and minimum compensation flow requirements from our reservoirs.

There were 6 sites reported as non-compliant against abstraction limits most or all of the time during 2014. All of these have investment drivers which either have already resolved the issue during 2010-15 or will resolve it during 2015-21. For compensation flows, equipment operability is the most significant issue with 25% of sites having no data for 2014; investment is in place to address this. Performance against both numeric licence conditions and also how we manage our sites is now assessed by SEPA as part of its Compliance Assessment Scheme and we continue to work with SEPA to analyse our performance and develop action plans where improvements in compliance and equipment operability are required.

Sustainable Land Management

The work of the Sustainable Land Management (SLM) team helps to protect and improve source water quality in our drinking water catchments.

Land use such as farming practices, forestry activities, aerial pesticide applications, large and small scale construction can all affect the quality of our source water. The SLM team helps to assess these risks to minimise any impact to source water quality. This work is undertaken using various different approaches: catchment visits, the SLM Incentive Scheme; consultation on activities.

The SLM team have undertaken visits for catchments that supply 51 of our water treatment works. The visits have taken place due to concerns which include *Cryptosporidium*, algal blooms, nitrates, high colour and turbidity. Each visit assesses the condition of the land around the watercourse and identifies any poor land management practices. It also makes suggestions to improve source water quality.

The SLM Incentive Scheme provides financial assistance for selected items to improve and protect source water quality within a catchment, going beyond expected land management practice. The scheme was launched in April 2012 and more detailed information can be found at www.scottishwater.co.uk/protectdwsources. There are currently nine catchments across Scotland where land managers are eligible to apply to the SLM Incentive Scheme. In each of these catchments we monitor the water quality at a number of locations. This helps us understand the scale of the problem and identify any seasonal patterns. It also enables us to target our activities and provides baseline information to help evaluate the success of any land based measures.

Since the SLM Incentive Scheme was launched we have received a total of 168 applications and have approved 98 of these. Each application is carefully reviewed before being approved and some may be modified to ensure that the work will provide a benefit to source water quality. When the proposed activity shows no benefit then it is rejected.

The SLM team respond to a wide variety of consultations on activities that take place in or near our drinking water catchments. In 2014/15 this totalled 423 consultations and notifications, which included wind farm and hydro scheme developments, power line installations, forest management and felling activities and the aerial application of pesticide. There has been a significant increase in the number of wind farm developments over the past few years and during 2014/15 we responded to 47 different wind farm applications within our drinking water catchments.

We continue to work in close partnership with a number of agencies to deliver sustainable land management and ensure that source water quality is protected and the status of the environment is enhanced.

2.5 Waste Water Service

Compliance – Waste water serviceability

Waste water treatment

Waste water treatment works compliance under serviceability measures is reported as 3 failing works (Arrochar, Doune, and Ellon) at 31 March 2015. This level of performance compares against our Delivery Plan 2010-15 forecast of 18 works, although in 2013/14 we achieved 1 failing waste water treatment works.

We continue to focus on improving processes and alignment of operational and investment activities. This is supported and driven by a functional structure that supports continuous improvement in compliance.

Bathing Waters

Scotland had 84 bathing waters officially designated for 2014, of which 72 can potentially be affected by Scottish Water assets. Scottish Water undertakes extensive pre-season inspections of assets that may impact bathing waters to identify any issues and ensure they are managed to minimise the risk to the bathing water.

71 of the 72 Scottish Water influenced bathing waters passed for the 2014 Bathing Season, which was characterised by generally dry and warm weather, with short period of excessive rainfall. The only bathing water that failed where our assets have the potential to impact was Lunan Bay. The cause of failure was attributed by SEPA to widespread wet weather which impacted a number of sites around the time of this sample. Scottish Water's overall performance was good and operational issues were managed by the agreed protocols with SEPA to ensure compliance.

Pollution Incidents

There has been continued improvement in our performance with regards to waste water Environmental Pollution Incidents (EPIs), as shown below. Substantial improvements took place following 2009/10 when a new focus and dedicated team was established to better understand and improve our performance on environmental pollution incidents. A key focus is to improve data and understand the root causes of EPIs in order to better deploy resources to prevent incidents occurring. The trend in overall waste water EPI performance (Categories 1-3) is shown below:

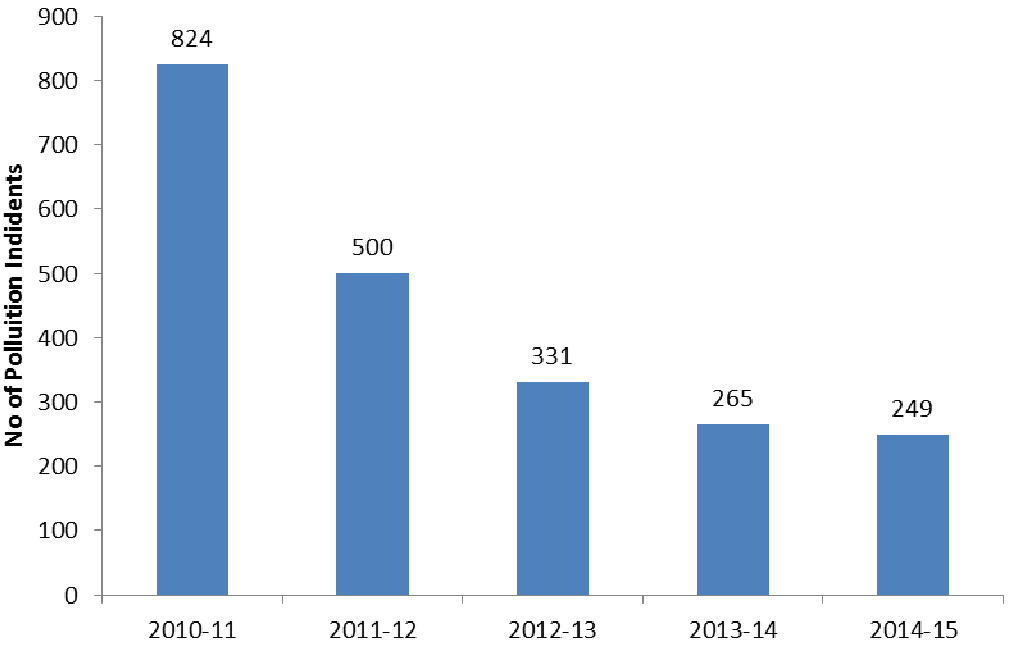


Figure 2 – Number of Environmental Pollution Incidents (Category 1-3)

Performance has continued to improve during 2014/15 with a total of 249 waste water EPIs reported. These include 8 Category 1&2 incidents and 241 Category 3 incidents, as agreed with SEPA. Better data and intelligence of our operations has allowed us to allocate resources and avoid environmental pollution incidents and has been key to the improvements made; we will continue to apply these approaches.

With respect to water assets there was a single Category 1 environmental pollution incident reported in 2014/15.

Waste water sludge

Each year, we are required to submit a register detailing our activities in relation to sludge recycling to agricultural land. The register is based on a calendar year and reports each recycling event, the sludge volumes, quality and soil conditions of the receiving farmland to demonstrate that it contributes to the soil nutrient and organic condition. The 2014 register identifies that all recycling activities complied with the Sludge (Use in Agriculture) Regulations, which specify the safe levels of potential contaminants such as metals.

Unsatisfactory Intermittent Discharges (UIDs)

We continued to reduce the number of Unsatisfactory Intermittent Discharges (UIDs) on our sewerage network as a result of our investment programme during 2014/15, with the completion of a further 58 Q&S3b and 3 Q&S3b+ outputs. The total number of outputs improved or removed during the Q&S3b and Q&S3b+ programmes has increased to bring the total improved to 153 out of a total programme of 254.

We supported a successful Glasgow Commonwealth Games in 2014. We worked closely with Glasgow City Council to ensure that our projects did not impact on the Games.

2.6 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 2014/15 investment totalled £470 million, comprising £436 million on Q&S3b projects, £2 million on completion (Q&S2 and Q&S3a) projects and £32 million on Q&S4 early start. Our total SR15 early start expenditure during the period was £46.8 million.

Completion Programme (Q&S2 and Q&S3a)

We have delivered a total of 312 of the 313 completion projects since April 2010. The last remaining project is at Killylour water treatment works and although plant performance on water quality is good, issues around membrane throughput identified during commissioning are preventing the works being placed into supply and have led to a delay in acceptance. We have agreed a design with the contractor for an additional upstream dissolved air flotation system (DAF) treatment process. The planning application for the DAF treatment process was approved by Dumfries and Galloway Council on 27 May 2015 and we are working to deliver water into supply by March 2016.

Q&S3b

The Overall Measure of Delivery (OMD) 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 2015, the OMD score was 239.1 points, within the target range of 236.5 to 248.7.

Of the 23 programme areas that are reviewed quarterly by the Output Monitoring Group, 12 areas were completed on or ahead of target; 4 areas are on target at 31 March 2015 and 7 areas are assessed as 'behind target' and therefore completing later than planned.

	Quarterly monitored programme areas	Q4 Target	Q4 Actual	Year end position
Drinking Water Quality	Raw water sampling and treatment	235	235	Complete
	Measures to protect Water Quality	268	268	Complete
	Number of lead communication pipes removed	0	394	Complete
	Number of DMAs subject to investigations	143	143	Complete
	Number of sites covered by drinking water safety plans	174	196	Complete
	Security of Supply Improvements	13	13	On target
	Mains rehabilitation	2,827	2,922	On target
	Number of water treatment works improved	76	58	Behind target
	Number of zones with reduced lead levels	64	62	Behind target
	Security and Emergency Measures Direction (SEMD)	735	689	Behind target
Environmental Protection	Non-strategic UIDs and dual manholes addressed	35	35	Complete
	Improvements to the wastewater network (properties)	15	15	Complete
	Works associated with the Commonwealth Games	68	68	Complete
	Surface Water outfalls improved	6	6	Complete
	Number of UIDs improved (under 7-stage)	114	126	On target
	Number of environmental studies undertaken	113	113	On target
	Number of improved wastewater discharges	92	81	Behind target
	Compliance with wastewater licences	327	325	Behind target
Malodour	Number of sites where malodour is reduced	4	4	Complete
Flood Management	Duties under the Flood Risk Management Act	392	389	Behind target
Customer Service	Number of properties removed from low pressure register	2,437	3,086	Complete
Completion of past investment	Projects completed in the Q&S2 (2002-06) programme	62	62	Complete
	Projects completed in the Q&S3a (2006-10) programme	251	250	Behind target
Summary	Programme areas completed	12 of 23		
	Of the remaining programme areas:			
	On or ahead of target	4 of 11		
	Behind target	7 of 11		

Table 2.6: Q&S3b Output sign-off

We have 37 projects that were not delivered by the end of the period and recognise that a significant proportion of these were in two important programme areas – water treatment works improved and improved waste water discharges. While overall performance was on target during the period, Scottish Water takes seriously the concerns raised by the Commission and the disappointment expressed by the quality regulators with the delays that have occurred with the outstanding elements of our investment programme. Where necessary, we have put in place temporary mitigation measures pending the delivery of a permanent solution and will maintain a strong focus on delivering the remaining elements of the programme to ensure that benefits to customers are delivered as soon as possible.

Our forecast delivery of projects due to have completed by March 2015 is shown in Table 2.7.

Programme area	March 2015	March 2016	March 2017	March 2018	March 2019
Actual number of projects to complete by March 2015	37	9	6	2	0

Table 2.7: Q&S3b – forecast delivery of projects to have been completed pre 31 March 2015

2.7 Wholesale Service

2014/15 has seen the Scottish competitive market continue to develop rapidly with licences granted to a further 5 Licensed Providers; all but one of whom have now signed a Wholesale Services Agreement with Scottish Water. This takes the total number of Licensed Providers operating in the retail market in Scotland to 18. This has been accompanied by a sustained increase in the number of businesses switching licensed providers.

Scottish Water has participated in a number of cross-market initiatives:

Scottish Assessor's Association (SAA) Project: The Central Market Authority has run a project to match Supply Points to business premises recorded by the Scottish Assessors in order to improve market data; this has identified a significant number of candidate gap sites. We have worked together with participating Licensed Providers to qualify these sites and, where appropriate, register them in the Central Systems.

Scottish Government Exemption Scheme: In August 2014 the Scottish Government announced a new Charitable Exemption Scheme to support Charities and Community Amateur Sports Clubs with the costs of water and sewerage charges from April 2015. The new scheme is simpler and fairer than the previous arrangements and opened for applications from January 2015. As at May 2015, 580 applications have been processed with 309 charities and sports clubs gaining exemption.

Public Sector tender: Licensed Providers were invited to tender for the supply of water and sewerage services to Scottish public sector premises. Whilst the outcome of the tender exercise has yet to be confirmed, we have planned to ensure we are able to provide any necessary support to Licensed Providers should it result in a large scale switch of supply points.

Service Levels: We completed 92% of Licensed Provider requested tasks within the required Operational Code or Disconnection Document KPIs in 2014/15, excluding tasks which had been delayed at customer or Licensed Providers' request. Performance varied across process areas, falling below target in connections due to focus on resolving process and system issues combined with the clearance of backlog activity. Challenges with field resource capacity and quality caused a drop in reported KPI performance for metering processes early in the year although corrective actions improved the position in later months. Recognising that the current KPIs focus solely on timeliness, a non-household Customer Experience Measure has also been developed and will be launched in April 2016.

Developments to the Wholesale Service

A new escalation process was launched in 2014, providing Licensed Providers with more defined arrangements for escalating service problems along with reporting to improve visibility.

During the year we tested Scottish Water's legal powers to obtain warrants to gain access to premises to temporarily disconnect for non-payment in the event that the customer has repeatedly refused to grant entry. Following two successful test cases the process will now be implemented more widely.

We reviewed the resource levels of our Wholesale Services team in light of the recent increase in Licensed Providers and switching activity. This has resulted in the expansion of the account management and wholesale billing teams to better support Licensed Providers' needs, provide a more resilient billing function and to support the new Exemption Scheme.

We have initiated a review of our wholesale service to assess how well it supports our customers' requirements and to identify areas for improvement. The initial focus has been on the gap site process, given the scale of the current Scottish Assessor's Association (SAA) project and the impact that this has on participating Licensed Providers.

Along with other market participants, we continued to engage in the Open Water programme which is implementing the competitive market framework in England in 2017. We have participated in a series of Open Water and OFWAT workshops and met with a number of English wholesalers over the last year to share our experience of water retail competition.

3. Expenditure, Performance and Efficiency

HCA financial results

Table 3.1 compares the Historical Cost Accounting results for Scottish Water's activities to 31 March 2015 excluding subsidiaries. The financial results below exclude all of the statutory adjustments required under the International Accounting Standards (IAS), including IAS 19 'Employee Benefits'.

£million	2014/15	2013/14	Change
Turnover	1,096.9	1,078.2	18.7
Operating costs	506.1	515.3	9.2
Depreciation / amortisation	338.0	331.2	-6.8
Gain on sale of assets	-10.7	-10.3	0.4
Total costs	833.4	836.2	2.8
Operating surplus before interest	263.5	242.0	21.5
Finance costs - net	158.0	155.9	-2.1
Profit before tax – Regulated	105.5	86.1	19.4
Profit before tax – Non Regulated	0.3	0.2	0.1
Profit before tax – Scottish Water	105.8	86.3	19.5
Taxation (charge)/credit	-10.1	71.6	-81.7
Profit after tax	95.7	157.9	-62.2

Table 3.1: Historic cost financial results

For the year ending 31 March 2015 Scottish Water's costs (excluding subsidiaries and statutory adjustments under IAS) totalled £833.4 million.

The surplus before tax in the year for Scottish Water was £105.8 million, £19.5 million higher than in 2013/14 (£86.3 million). The regulated surplus before tax was £19.4 million higher at £105.5 million.

Revenue

Regulated revenue for the year totalled £1,096.9 million (2014 - £1,078.2 million) and is analysed by category in table 3.2 below:

£million	2014/15	2013/14	Change
Household	800.8	778.9	21.9
Wholesale	289.2	293.6	-4.4
Other	6.9	5.7	1.2
Total regulated revenue	1,096.9	1,078.2	18.7

Table 3.2: Regulated revenue for 2014/15

Household revenue increased by £21.9 million, or 2.8%, to £800.8 million reflecting the increase in household charges of 1.6%, effective from 1 April 2014, the growth in new connected properties and a net £2.3 million reduction in council tax discounts applied. Revenue from wholesale services supplied to Licensed Providers decreased by £4.4 million or 1.5% to £289.2 million reflecting the planned reduction in wholesale tariffs. Vacancy and gap site incentive payments reduced turnover in the year by £2.8m (2014: £2.5m). Revenue from other sales increased by £1.2 million to £6.9 million.

Total costs

Total costs of £833.4 million were £2.8 million lower than in 2013/14.

Operating costs of £506.1 million were £9.2 million lower than in 2013/14. Within these costs, headline regulated operating costs of £353.1 million were 3.3% or £11.9 million lower than in 2013/14. The decrease was primarily due to a £14.5 million reduction in local authority rates charges, reflecting a one-off refund associated with a successful revaluation appeal. After adjusting for this, the movement in landfill taxes and the increase in energy and carbon prices, like-for-like costs, as planned, increased in real terms by 1.6% or £4.4 million. The planned increase reflected the uplift in the household income collection charges from Scottish Councils, improvements to water quality processes and additional expenditure to improve data quality processes in the wholesale arena. Table 3.3 below summarises this movement:

£million	2014/15	2013/14	(inc)/dec	%
Regulated operating costs	353.1	365.0	11.9	3.3%
Local Authority rates charges	-46.5	-61.0	-14.5	
Landfill tax	5.5	-5.5	-11.0	
Carbon Reduction Charge & energy price	-5.1	-2.9	2.2	
Dry weather related costs	-	-2.5	-2.5	
New operating costs	-3.3	-	3.3	
Like-for-like costs	303.7	293.1	-10.6	-3.6%
Average RPI inflation at 1.96%		5.7	5.7	
Like-for-like real controllable costs	303.7	298.8	-4.9	-1.6%

Table 3.3: Movement in regulated operating costs 2014/15

Within the wholesale arena, we incurred additional operating costs of £2.3m in respect of the Gaps3 project.

The increase in PFI costs of £2.7 million to £153.0 million was attributable to the annual indexation of service costs and the higher volume of waste being treated by the PFI schemes.

Depreciation, including infrastructure depreciation, increased by £6.8 million to £338.0 million, due to the profile of the capital investment in the year. The gain on sale from asset disposals was £0.4 million higher than in 2013/14 at £10.7 million.

The average number of employees increased throughout the year by 62, or 1.9% to 3,389 (including SWS2 secondees).

Finance costs

As at 31 March 2015, the weighted average interest cost of the outstanding long-term debt was 4.86%, (2014 – 4.93%). Net interest payable during the year was £156.6 million, £0.7 million higher than in 2013/14.

During the year, net debt decreased by £5.1 million to £3,078.9 million (being loans of £3,424.3 million less cash balances of £345.4 million). The decrease was driven by a £75.1 million increase in cash balances, partly offset by a £70.0 million increase in borrowing from the Scottish Government.

Taxation

Scottish Water's tax charge was £10.1 million (2014 – £71.6 million credit). The credit in 2013/14 was due primarily to the favourable impact of the change in UK corporation tax rate from 23% to 20%, effective from 1 April 2015, which meant the re-measurement of deferred tax balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £70.0 million for 2014/15. Actual net new borrowings in 2014/15 were £70.0 million.

Out-performance assessment

We have calculated our financial out-performance in accordance with the methodology set out by the Commission on 16 November 2007, applied to Scottish Water's regulated business.

In comparing Scottish Water's closing net debt position with that allowed in the 2009 Final Determination, several regulatory adjustments are necessary to reflect unforeseen events outside of Scottish Water's control, such as the outturn on indexation and changes to taxation. On this basis Scottish Water has generated financial out-performance against the 2009 Final Determination of £179.6 million, of which £122.4 million was generated in the period from April 2010 to March 2015.

Our assessment of financial out-performance is shown in Appendix A and sets out the regulatory adjustments with explanations for each.

Out-performance has also been delivered through higher service levels. An overview of where Scottish Water has delivered substantially higher service levels than those required in the Final Determination is also provided in Appendix A.

4. Supporting Information

4.1 Climate change

The Climate Change (Scotland) Act sets a duty on public bodies to contribute to 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 included a number of projects focussed on climate change adaptation and carbon mitigation. Notably we installed over 25GWh of renewable energy (hydropower and other renewables), and undertook pilots of sustainable treatment options.

The climate adaptation projects were completed in 2012/13 and have helped us to determine adaptation measures for the next investment period. The studies identified a need for improved long term monitoring of the environment and our assets, which we are progressing in Q&S4. This will help us to understand better the way in which the climate is changing, its effects on our service, and reduce the uncertainty presented by climate change models in order to make appropriate adaptation choices.

We have completed all but one of our carbon mitigation studies and are working closely with SEPA on the remaining one, which involves field trials into more sustainable treatment options. A key project delivered was the carbon assessment tool which provides the capability for investment planners and capital delivery teams to quantify the operational and embodied carbon associated with capital projects. We are now making the necessary changes to automate this capability into our systems.

We have been reporting our annual operational carbon footprint (CFP) for eight years. Over that time there have been improvements in data but also changes in method and in carbon factors. The CFP can be reassessed to incorporate these changes. In 2013 Defra made major changes to the way in which it calculates grid emissions factors and, on its recommendation, in 2014 we recalculated our CFP for all years. We found it had reduced year on year, leading to an overall reduction of around 18%. This is in spite of continued quality enhancement, which has in the past driven up electricity consumption.

Our operational carbon footprint for 2013/14, the most recently reported year, was 379,000 tonnes of carbon dioxide equivalent (tCO₂e)⁴. This is 3% lower than 2012/13, when compared on a like-for-like basis. The main factors in this decrease were a reduction in the amount of natural gas used and a reduction in the amount of grid electricity used. The report was produced in-house and verified, in accordance with ISO14064-3, by a consultancy experienced in greenhouse gas inventories.

4.2 Research and Innovation

We continue to develop our strategic approach to research and development, accelerating the adoption of new technologies and developing a corporate culture that supports innovation in all areas of the business.

Innovation is key to sustaining high performance and delivering ever higher service standards. We continue to work with academia to develop new knowledge to improve services and with our supply chain to explore better ways to deliver increased value for customers. Our strategic Research and Innovation programme is progressing, focussing on the following:

- Enhancing water and environmental quality compliance
- Value recovery from waste water
- Sustainable rural communities

Alongside this, we are also pursuing single topic issues such as leakage, sewer flooding and carbon reduction through the UKWIR programme.

Research engagement

We are gearing up to progress site pilots and trials in support of academic research and findings, especially in the following areas:-

- Alternative polymeric and ceramic membranes
- Ion exchange processes
- Alternative filter media
- Clarifier improvements to increase treatment capacity
- Sustainable waste water treatment in small works
- Algal treatment for nutrient recovery from waste water
- Anaerobic treatment of waste water

We are seeking to identify whether there could be significant performance and efficiency opportunities identified through these trials.

⁴ This is not comparable to the figures reported in the previous Annual Return Overview due to the 2014 rebaselining exercise which was undertaken in response to Defra's recommendations that companies accommodate their revised back-casted carbon emission factors and associated methodology changes. Scottish Water took this opportunity to apply other improvements to emission factors, data and agreed methodologies within the rebaselining exercise to enable more direct year on year comparisons. For a full set of comparable CFPs, please refer to our Sustainability Report 2014 or our paper 'Scottish Water's Rebaselined Carbon Footprint', both available on our website.

We continue to support partnerships with universities and supply chain to access funding from research and innovation bodies (e.g. research councils and Innovate UK) where we see potential medium and long term benefit.

During 2014/15 we continued to develop our research portfolio to support the strategic focus of the business and work with Scottish and UK universities.

European research programme

We are taking part in collaborative bids for EU funding through Horizon 2020 and INTERREG calls, whilst we continue to seek European partnerships through the EU Framework Programme that support our strategic aspirations. We are currently engaged (to varying degrees) in 5 EU funded projects covering:

- Transition to future sustainable urban treatment systems;
- Developing an autonomous ultrasonic unit to manage algal blooms in water sources;
- Understanding the source and fate of pharmaceuticals from domestic use in our waste water systems;
- Understanding the effectiveness of vertical wetlands as a low carbon waste water treatment solution for small scale systems.

We are active in a number of EU Action Groups and Platforms that share knowledge and insights on current issues, best practise and future challenges

Innovation in action

We are already starting to see benefits from some key innovations we introduced during 2013/14.

We introduced the Nereda® technology to the business, which is currently undergoing trials as a potential solution for nutrient removal and Water Framework Directive compliance in the Lower Clyde Estuary.

We tested a primary waste water treatment technology at plants in East Lothian and the Highlands, which recovered all cellulose based material from the wastewater influent, reducing the downstream load on the treatment plant and its energy demand. It was the first time this technology was tested in the UK and the trials provided valuable data that may influence future investment, as well as insight that allowed us to improve our own processes and project delivery capabilities.

We are working with a Scottish based biomimicry treatment company to evaluate their technology for waste water treatment and reuse. We are testing the mobile unit we built in partnership through a Technology Strategy Board innovation grant, and will be deploying it across trial sites in the north of Scotland.

We are actively engaging with Scottish Water Horizons and Scottish Enterprise to contribute to the delivery and governance of the water and waste water Innovation Testing Services, promoted by the Scottish Government as outlined in the Hydro Nation agenda. This includes the development of a water treatment test site and a wastewater treatment test site.

4.3 Board Changes

As at March 2015, the Scottish Water Board consisted of:

Chair

Ronnie Mercer CBE (until 31 May 2015; Lady Susan Rice CBE from 1 June 2015)

Executive Directors

Douglas Millican - CEO
Alan P Scott – Finance Director
Peter Farrer – Chief Operating Officer
Geoff Aitkenhead – Asset Management Director

Non-executive Directors

Alan Bryce	Donald Emslie
Lynne Peacock	Matt Smith OBE
James Spowart	Andrew Wyllie CBE

5. Looking forward

Our Delivery Plan for 2015-21 is ambitious and sets out to build on our success to date and achieve further improvement and efficiency of our services and to provide our customers a leading service while at the same time reducing their charges in real terms. In light of customer research, and to reflect our increased ambition, we updated our corporate vision to being '**Trusted to care for the water on which Scotland depends**'.

We look forward to working constructively with stakeholders in the following areas:

- Building on the success of the Customer Forum in putting customers at the heart of our plans;
- Developing our performance measures such as the non-household Customer Experience Measure and the High Esteem Test; and
- Agreeing the process and governance arrangements for the rolling investment review in 2018.

APPENDIX A: 2010-15 OUT-PERFORMANCE ASSESSMENT

Overview

We have calculated our financial out-performance in accordance with the methodology set out by the Commission on 16 November 2007, applied to Scottish Water's regulated business.

In comparing Scottish Water's closing net debt position with that allowed in the 2009 Final Determination several regulatory adjustments are necessary to reflect unforeseen events outside of Scottish Water's control, such as the outturn on indexation and changes to taxation. On this basis Scottish Water has generated financial out-performance against the 2009 Final Determination of £179.6 million, of which £122.4 million was generated in the period from April 2010 to March 2015.

Our assessment of financial outperformance sets out the regulatory adjustments with explanations provided for each.

Out-performance has also been delivered through higher service levels. An overview of where Scottish Water has delivered substantially higher service levels than those required in the Final Determination is also set out below.

Financial Assessment

	£'m	Notes
<u>Final Determination expectation</u>		
Gross debt at 31 March 2015 from 2009 Final Determination	3,676.3	2
Forecast cash at 31 March 2015 from 2009 Final Determination	-80.6	2
Deduction of double financing of Q&S 3b early start	-48.3	3
Allowed net debt at 31 March 2015	3,547.4	3
 <i>Regulatory Adjustments</i>		
Deduction of beneficial impact of actual inflation relative to that assumed in the 2009 Final Determination	-156.5	4a
Add K factor not taken	130.4	4b
Addition of adverse taxation change	123.9	4c
Deduction of beneficial taxation impact	-36.2	4d
Allowed net debt at 31 March 2015 after Regulatory Adjustments	3,609.0	5
 <u>Actual performance</u>		
Actual debt at 31 March 2015	3,424.3	6
Less: actual cash balance at 31 March 2015	-345.4	7
Actual net debt at 31 March 2015	3,078.9	7
Add: debt required to complete the outstanding investment programme	355.5	8a
Less: Early delivery of SR15 outputs	-5.0	8b
Adjusted forecast net debt on completion of the outstanding investment programme	3,429.4	9
 Out-performance against the determination as a whole	 179.6	 10
Deduction of out-performance generated in the period to 31 March 2010	-57.2	11
Out-performance from April 2010 to March 2015	122.4	12

Explanation of approach

1. The assessment has been undertaken for Scottish Water's regulated business. All references in this section to Scottish Water therefore apply only to that business.
2. In the 2009 Final Determination, the Commission expected that, on completion of the delivery of the 2010-15 ministerial objectives (Q&S3b), Scottish Water would have gross debt of £3,676.3 million and cash of £80.6 million (including the financial reserve).
3. From this the double financing of Q&S3b early start (£48.3 million) should be deducted to give allowed net debt of £3,547.4 million.
4. Several regulatory adjustments are then required to incorporate unforeseen events. These adjustments are the outturn on inflation compared to that assumed in the Final Determination, the K factor not taken and taxation changes. Details of each of these adjustments are set out below.

a. Inflation:

The first table below shows the inflation assumed in the Final Determination relative to the outturn for the 2010-15 period. The second table shows the impact of outturn values when applied through the 2009 Final Determination financial model to revenue, opex & PFI, and capex; and that the combined impact was to increase our net cash generated by £156.5 million.

	2010/11	2011/12	2012/13	2013/14	2014/15
Final Determination					
RPI - prices	-0.80%	2.50%	2.50%	2.50%	2.50%
RPI - opex	2.50%	2.50%	2.50%	2.50%	2.50%
COPI	2.50%	2.50%	2.50%	2.50%	2.50%
Actual					
RPI - prices	-0.80%	4.54%	5.40%	3.20%	2.57%
RPI - opex	4.96%	4.80%	3.09%	2.88%	1.96%
COPI	-2.81%	2.40%	3.18%	3.75%	4.12%

Increase in cash generated from inflation outturn	£'m
Revenue increase from higher RPI	192.8
Opex & PFI increase from higher RPI	-136.3
Capex decrease from lower COPI	100.0
Overall impact from inflation outturn	156.5

b. K factor not taken:

In 2012/13 we froze our household tariffs for a further year following discussions with the Scottish Government, and so did not take up the increase allowed in the Final Determination, as highlighted in our June 2013 logging assessment. In 2014/15 we restricted our charge increases to less than allowed in the Final Determination in agreement with the Customer Forum. The combined impact, calculated by applying the outturn K factors into the 2009 Final Determination financial model adjusted for outturn inflation, was to reduce household revenue by £130.4 million.

c. Adverse taxation changes:

The 2010 revaluation of non-domestic rates and the introduction of the carbon reduction commitment (CRC) occurred after the Final Determination. These cost increases are outside of management control and, as agreed in the Commission's letter of 15 December 2009, we have used 2007/8 as the baseline from which to calculate the regulatory adjustment. As shown in the table below, the required uplift in cost over the 2010-15 period is £123.9 million.

£million	2010/11	2011/12	2012/13	2013/14	2014/15	Total
LA Rates and CRC: Final Determination	35.4	37.1	38.2	39.3	40.1	190.2
LA Rates and CRC: Actual	59.1	64.8	68.2	67.5	54.5	314.1
Difference	23.7	27.7	30.0	28.2	14.4	123.9

d. Beneficial taxation impact:

Our lower profitability arising from the K factor not taken and the adverse taxation changes, partially offset by increased cash generated from outturn inflation relative to the level assumed in the Final Determination, have reduced the corporation tax due from that assumed in the Final Determination by £36.2 million as shown in the table below.

£million	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Taxation: Final Determination	17.1	5.1	6.1	5.2	3.3	36.8
Taxation charge	0.5	0.1	0.0	0.0	0.0	0.6
Difference	16.6	5.0	6.1	5.2	3.3	36.2

5. Taking into account the above regulatory adjustments, the allowed net debt at 31 March 2015 is £3,609.0 million.
6. The actual debt at 31 March 2015 of £3,424.3 million is as reported in table M2 (lines 2.22 and 2.30).
7. The actual cash balance at 31 March 2015 of £345.4 million is as reported in table M2 (lines 2.17 and 2.18), which gives a net closing debt of £3,078.9 million.
8. To calculate Scottish Water's forecast debt on completion of the outstanding investment programme, two key adjustments are required: firstly to add to the actual 31 March 2015 debt position the forecast costs of completing the outstanding investment programme, and secondly to deduct the cost of the early delivery of SR15 outputs that were financed by expenditure above the SR15 early start allowance included in the 2009 Final Determination. Each of these is covered below:
 - a. Most of the investment programme outstanding at 31 March 2015 is outputs identified in the 2010 to 2015 period that have agreed completion dates in 2015-2021. These outputs, which support investment continuity, include solutions to improve intermittent discharges to the River Clyde. Beyond these outputs there are a small number of projects (37 in total) that were due for completion by 31 March 2015. The forecast cost of completing both the outstanding outputs that have agreed completion dates in 2015-2021 and the 37 projects that were due for completion by 31 March 2015 is £352 million to £367 million, with a best estimate forecast of £357 million. For the purpose of this out-performance assessment we have adopted the most prudent approach of using the upper end estimate of investment completion costs, £367 million. From this the costs included in

completion (£11.5 million) to mirror the finance transferred from SR15 to support the delivery of projects financed through the OMG180 has been deducted giving a net total that has been financed in the SR10 period of £355.5 million.

- b. The innovative regulatory process for the Strategic Review of Charges 2015 that provided greater certainty at an earlier stage of the required outputs has enabled Scottish Water to accelerate output delivery. In two areas we have been able to deliver SR15 outputs prior to the start of the period: sewer flooding (extra 39 properties removed from the sewer flooding at risk register) and renewable generation (1GWh). The £5 million cost of this early delivery, above that included as an SR15 early start allowance in the 2009 Final Determination (£41.8 million, out-turn prices), is deducted from the closing net debt position.
9. Using the prudent estimate of investment completion costs, our forecast net debt on completion of the outstanding investment programme is £3,429.4 million.
 10. Comparing this to the allowed net debt, Scottish Water has generated financial out-performance against the 2009 Final Determination as a whole of £179.6 million.
 11. To assess financial outperformance relative to the five years from April 2010 to March 2015, the financial out-performance against the 2009 Final Determination as a whole needs to be adjusted for the opening net debt position at 1 April 2010. The opening net debt of Scottish Water at 1 April 2010, once the higher Q&S2/3a completion costs forecast in our Annual Return 2010 assessment of outperformance is factored in, was £57.2 million lower than the level set out in the 2009 Final Determination, as set out in the table below.

Opening Net Debt Position	£'m
Opening net debt position relative to Final Determination ⁵	140.6
Less higher Q&S 2/3a completion costs forecast in AR10 ⁶	-83.4
Opening net debt position factoring in Q&S 2/3a overhang forecast in AR10	57.2

12. Scottish Water has therefore generated financial out-performance relative to the five years from April 2010 to March 2015 of £122.4 million (£179.6 million less £57.2 million).

Service levels substantially higher than those required in the Final Determination

Out-performance can also be delivered through higher service levels. The table below highlights areas of service where we have consistently outperformed over the 2010-15 period, including that:

- OPA has consistently out-performed target by over 7% over the regulatory period;
- In the past 3 years customer satisfaction has been 10-14% higher than target;
- Leakage has been consistently been between 5-10% lower than target over the regulatory period;
- Pollution incidents have reduced by over 60% within 5 years; and
- Second tier complaints have reduced by over 90% within 5 years.

⁵ The 2009 Final Determination assumed an opening net debt position at 1 April 2010 of £3,000.4 million. Actual opening net debt was £2,859.8 million, a difference of £140.6 million.

⁶ The 2009 Final Determination forecast the Q&S 2/3a overhang at £173.1 million. Our Annual Return 2010 assessment of outperformance included a forecast of £256.5 million, a difference of £83.4 million.

Output measure specified in Ministerial Directions	2010/11		2011/12		2012/13		2013/14		2014/15	
	Forecast	Actual	Forecast	Actual	Forecast	Actual	Forecast	Actual	Forecast	Actual
Overall Performance Assessment score (OPA)	302	330	317	355	338	368	380	397	380	400
Customer satisfaction	78%	80%	78%	83%	78%	88%	78%	90%	78%	92%
Average annual level of leakage (MI/d)	720	699	670	630	635	575	600	566	600	544
Telephone contacts relating to drinking water quality	24,168	20,510	24,168	25,897	24,168	18,179	24,168	12,285	24,168	14,150
Properties on the low pressure register	2,549	1,962	1,000	902	1,000	198	1,000	56	240	46
Number of failing waste water treatment works	18	11	18	10	18	2	18	1	18	3
Number of pollution incidents	924	824	924	500	924	331	924	265	548	249
Second tier complaints referred to SPSO	121	50	121	44	121	25	121	11	121	4

Appendix B: ASSURANCE STATEMENT

Annual Return 2014/15 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

9/6/15