M Tables – Regulatory Accounts
Commentary

The sections in this document are:

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, as agreed with the WICS, which includes IFRS based information in addition to the 'original' Regulatory based information. The presentation of the IFRS basis information, including the presentation of Tables 4 and 19 were agreed with the WICS.

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. Basis of preparation

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 SW Horizons (SWH) and SW International (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 and Non-Regulated activities have been accounted for separately in SW's general ledger system enabling the production of profit & loss accounts and balance sheets for them. These accounts form the basis for the historical cost figures and the analysis in 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. Commentary on ABM methodology and cost allocation is provided in Appendix 3 of this document.

The 2017/18 forecast figures in Table M4 are from Scottish Water's 2015-21 Delivery Plan Update (March 2017) approved by the Scottish Government. The 2017/18 forecast figures in Table M5 are from the Delivery Plan Update (March 2017), updated to reflect the actual pension liability (line M5.20) and the impact of the actual opening tax and reserves balances (lines M5.19 & M5.26) from 31 March 2017. Similarly, the cash movement in Table M6 has been updated to reflect the cash movement in 2017/18 from the actual opening cash balance at 31 March 2017 of £235.2m (forecast per Delivery Plan Update: £231m), with the offset being in the movement in working capital. All other figures are as reported in the Delivery Plan Update (March 2017).

3. Assumptions

M Table completion

The M Tables are consistent with the basis agreed between Scottish Water and the WICS in 2013, updated by the presentation changes agreed in April 2016. 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 2016/17 at the standard Corporation Tax rate of 20% (2016: 20%) 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 agreed 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.

As agreed with the WICS in April 2016, Table 19 has been renamed to "Statement of Comprehensive Income" and now appears directly under Table 4. The revised layout follows our agreement to include all of the IAS 19 adjustments in respect of the post employment benefits (which are non-cash) in Table 19.

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, M19 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.

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 Tables M4 and M19.

Scottish Water's headline regulated operating costs (i.e. excluding depreciation, PFI charges and costs associated with non-regulated activities) as shown in the table below, of £381.1m were 3.7% or £13.5m higher than in 2015/16. The increase was primarily due to the changes in National Insurance, higher local authority rates charges, higher energy prices and an increase in the bad debt charge. After adjusting for these items and new operating costs associated with capital investment, like-for-like controllable costs decreased in real terms by 1.5% or £4.3m as detailed in the table below.

	March 2017 £m	March 2016 £m	Variance £m	%
Core operating expenditure (line M1.2)	**381.7**	**368.2**	**-13.5**	
Less: Internal PFI costs	-0.6	-0.6	-	
SW Regulated operating costs	**381.1**	**367.6**	**-13.5**	**-3.7%**
Local Authority rates charges (net)	-64.3	-61.6	2.7	
Gaps 3 project costs	-3.9	-2.8	1.1	
National Insurance changes	-2.6	-	2.6	
Energy price (above 2.14% inflation)	-0.8	-	0.8	
SEPA & WICS costs	-15.1	-15.0	0.1	
Bad debt charge	-16.0	-12.8	3.2	
New operating costs	-1.4	-	1.4	
Like-for-like controllable costs	**277.0**	**275.4**	**-1.6**	**-0.6%**
Average RPI inflation at 2.14%		5.9	5.9	
Like-for-like real costs reduction	**277.0**	**281.3**	**4.3**	**1.5%**

The increase in PFI costs of £1.8m to £155.0m (line 1.3). The increase was attributable to the annual indexation of service costs and the lower compliance deduction applied in 2017, partly offset by the lower volumes of waste being treated by the PFI schemes.

Depreciation, including infrastructure depreciation, increased by £15.8m to £363.3m (lines 1.4 to 1.7), due to the profile of the capital investment in the year.

Other operating income of £6.2m (line 1.8) was the gain on disposal of fixed assets, £8.5m lower than in 2014/15.

The net interest charge was £147.7m (2016: £149.6m) (line 1.11) a decrease of £1.9m.

SW's total tax credit, on a statutory basis, was £2.7m (2016: £21.2m credit) (line 1.14). It was announced in the March 2016 UK budget statement that the Finance Act 2016 would reduce the rate of corporation tax, effective from April 2017, to 17%. As this change has been substantively enacted at the balance sheet date, deferred tax balances have been re-measured. The re-measurement of deferred tax due to the reduction in the UK rate of corporation tax from 20% to 18% had already been reflected in the 2015/16 tax credit. Therefore, the re-measurement of the deferred tax due to the reduction in the corporation tax rate to 17% generated the majority of the deferred tax credit in 2016/17. The current tax credit is due group relief following the sale of tax losses in SW, that were previously recognised in deferred tax, to a subsidiary company, which will result in a cash benefit to the regulated business. To date, there has been no cash impact on SW's tax position 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 (£116.7m, line 2.14).

Investment – other (line 2.3) of £37.6m is the investment in SWHH (2016: £37.6m).

The increases in debtors (line 2.6) and creditors (line 2.15) are primarily due to the change made by WICS to Licensed Provider prepayments terms in March 2017. The wholesale provisional invoices for both April and May 2017 were issued during March 2017, with cash in respect of the April invoices received prior to the year end.

Total cash at bank (lines 2.7 & 2.8) decreased by £133.4m to £235.2m, of which £194.0m was on short term deposit (2016: £194.0m).

The infrastructure renewals accrual (line 2.14) has increased to £116.7m at 31 March 2017. However, this is offset by the infrastructure maintenance expenditure identified within assets under construction of £113.8m, awaiting project completion and reclassification.

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 position 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 increased by £9.2m to £34.9m due to an increase in the reorganisation provision of £11.7m partly offset by a net decrease in the wholesale income uncertainty provisions (£2.5m). The increase in the reorganisation provision was due to a reclassification from accruals (within creditors – line 2.15), less the net utilisation of the provision during the year.

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 3.11-3.18) 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. The additional lines provide greater visibility of the relevant cost elements. As agreed with the WICS, line M4.5 reflects the 'normal' annual cost of SW's pension contributions. The non cash pension adjustments, as calculated under IAS 19, have all been included in Table M19.

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

(Increase)/decrease in costs		£m	*Note ref.*
IAS 16	Infrastructure assets - depreciation & maintenance	(12.0)	*1.*
IFRIC 12	PFI costs - depreciation & lease liability	4.0	*2.*
Scottish Water - net increase in costs		**(8.0)**	

1. 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'. These costs, along with the calculated depreciation, replace the original 'Infrastructure renewals charge' (IRC).

In 2016/17, the infrastructure expenditure charged to the income statement was £117.6m (line 4.10) and the depreciation charge was £16.4m (line 4.8). These charges were partially offset by the reversal of the infrastructure renewals charge of £122.0m in Table M 1 (line 1.5). Therefore, the net increase to costs was £12.0m.

2. 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 £114.1m in 2016/17. The total depreciation charges of £19.2m are in line 4.9 and the finance costs of £21.5m are in line 4.17.

Therefore, the total of the PPP costs in Table M4, as detailed above, is £154.8m whereas the total in Table M1 is £158.8m (lines 1.3 & 1.6). The net reduction to costs of £4.0m is due to the offsetting effect of the costs transferred against the finance lease obligation in the balance sheet (Table M5, line 5.25). The table below provides the reconciliation from Table M1 to Table M4.

	M Table / line ref	2016/17 £m
PPP costs	M1.3	155.0
Amortisation of PPP assets	M1.6	3.8
Total PPP costs in Table M1		**158.8**
IFRS adjustments:		
Add: Depreciation charges - PPP leased assets		15.3
Less: Finance lease obligation - to balance sheet		(19.3)
Total PPP costs in Table M4	M4.3, 4.9 & 4.17	**154.8**

Table M19 – Regulatory Accounts - Statement of comprehensive income

This table has been completed on the basis agreed in April 2016 and includes all of the IAS 19 'Employee benefits' adjustments in respect of the post employment benefits. These IFRS adjustments are all non cash.

The profit for the year (line 19.1) is the Core retained profit from Table M4 (line 4.26).

The actuarial gains/losses on post employment plans (line 19.2), net of related deferred taxation, are as reported in the statutory results for Scottish Water. The principal driver of the loss was the impact of the lower discount rate applied to the pension scheme net liabilities, which decreased from 3.55% (2016) to 2.60% in 2017.

The post employment plans (non cash), net of tax (line 19.3) consists of the total service cost and the net financing expense as calculated under IAS 19 which replace the 'normal management' operating costs as charged in tables M1 and M4 (line 4.5). The net adjustment of £12.5m is analysed as follows:

	£m
Pension service cost adjustments & holiday pay	(9.0)
Interest on pension scheme net liabilities	(4.5)
Deferred tax on IAS 19 adjustments	1.0
	(12.5)

There were no other gains or losses (line 19.4).

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 £346.1m 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			299.1
	Owned assets	*(reclassification)*		47.0
			M5, line 5.2	**346.1**
Other loans & borrowings				
	Finance lease liability	< 1 year		(20.5)
		> 1 year		(323.8)
		total	**M5, line 5.25**	**(344.3)**

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 (£56.6m).

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)		(230.5)
Deferred taxation on retirement benefit obligations		39.2
Retirement benefit obligations - net	**M5, line 5.20**	**(191.3)**

The other provisions total of £15.4m (line 5.21), a decrease of £3.3m compared to 2015/16, is made up of restructure (£0.7m), income uncertainty (£13.5m) and other (£1.2m).

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 £13.5m represents the balance associated with Business Stream and 3rd party licenced providers (LPs).

For the purposes of the year end close and group consolidation, the forecast out-turns for 2015/16 and 2016/17 as calculated by SW's wholesale team were compared to the forecasts calculated by Business Stream. Overall, there were no material differences. The out-turn position for 2014/15 and an outstanding unbilled movement from 2013/14 had already been agreed by SW and Business Stream prior to the year end. The total of the out-turn positions was therefore agreed with the relevant adjustments being posted by both companies in March 2017.

Retained earnings (line 5.26) consists of the total of the reserve brought forward from 31 March 2016 and the retained profit for 2016/17 (Table M19, line 19.5).

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. 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 £149.2m 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 £149.0m.

On the IFRS basis, £21.5m 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	2016/17 £m
Opening short term capital creditor		M11.10 (14/15)	101.5
Add:	Capital investment (net of contributions)		616.7
Less:	Closing short term capital creditor	M11.10 (15/16)	(77.7)
=>	**Capital expenditure**		**640.5**
Analysed:			
	Capital enhancement expenditure	M6.25	299.4
	Capital maintenance expenditure	M6.26	341.1
	Capital expenditure (total)		**640.5**

		2016/17 £m
	Capital investment (gross Q&S) on a regulatory basis	625.6
Add:	PFI investment	1.0
	Total capital investment	**626.6**
Less:	Contributions	(9.9)
	Capital investment (net of contributions)	**616.7**

In 2016/17 £1.0m 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 £19.3m to £840.0m (line 7.1) reflecting the increase in household charges of 1.6%, effective from 1 April 2016 and a 0.84% growth in new connected properties.

Turnover from wholesale services provided to Licensed Providers increased by £6.8m, or 2.3%, to £298.3m (line 7.3) reflecting the project to identify and bring into charge unregistered premises (Gaps3) partly offset by an average tariff decrease of 0.4% and a reduction in consumption. Vacancy and gap site incentive payments reduced turnover in the year by £3.5m (2016: £4.6m).

Turnover from other sales increased by £2.5m to £10.7m (line 7.7) due mainly to rental income received from windfarms sited on Scottish Water land.

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 2017 into the regulatory IFRS working capital (Table M11).

Trade debtors increased by £4.5m to £32.8m (line 11.2). The table below provides a breakdown of the household gross balances and bad debt provisions by age:

	96/12 £m	12/13 £m	13/14 £m	14/15 £m	15/16 £m	16/17 £m	Total £m
Gross Debt outstanding	**300.0**	**27.7**	**29.6**	**31.9**	**36.0**	**53.7**	478.9
Bad Debt Provision	(297.6)	(26.7)	(28.1)	(29.4)	(31.0)	(33.8)	(446.6)
Net Debt	**2.4**	**1.0**	**1.5**	**2.5**	**5.0**	**19.9**	**32.3**

Other trade debtors (line 11.4) relate to wholesale and sundry billing. The increase of £28.6m is primarily reflects the change made by the WICS to Licensed Provider prepayment terms in March 2017. The change to these terms is also reflected in the increase in the wholesale charge prepayment (line 11.8) where the balance of £52.2m represents the total of the provisional invoices for April 2017 and May 2017.

Capital creditors consist of the balances of capital creditors and accruals relating to third parties (£75.5m) and the balance due to SW Solutions 2 (£2.2m).

Table M18W and M18WW commentary - see Section 4.2 below

Table M21 – Taxation analysis
The 2015/16 data has been updated to reflect the actual 2015/16 tax computation submitted.

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 £278.7m (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. 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 two holdings companies (SWBSH & SWHH - interest and taxation), SWH and SWI.

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).

There were no intercompany loans.

Non-core / non licensed includes the remaining non regulatory business within SW (as per table M2), the balance sheets for the two holdings companies (SWBSH & SWHH – 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 Commentary & Reconciliation – Tables M18W & M18WW

Trading Results & Reconciliation

Scottish Water produces consolidated accounts incorporating the results of Business Stream. However the M18 table financials are produced for Scottish Water Regulated and Non-Regulated activity, excluding Business Stream. M18 tables are prepared on a historic cost basis and exclude IFRS adjustments.

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		805.7	
Admin Expenses		141.0	
SW Group Expenditure			**946.7**
Less	Business Stream		(37.3)
	IFRS adjustments		4.2
Total Expenditure (excluding Business Stream and IFRS)			**913.6**
Represented by			
SW Regulated			893.8
SW Non Regulated			1.8
Horizons			16.4
International			1.6

M18W & WW Tables include the costs of Scottish Water Regulated, Scottish Water Non-Regulated, Scottish Water Horizons (Non-Regulated), and Scottish Water International (Non-Regulated).

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

(£m)	Statutory Accounts SW SWH & SWI*	Diff SW/SWH - M18	Regulatory Accounts M18W/WW Tables Total	M18 W	M18 WW
Employment	**195.4**		**397.3**	228.8	168.5
Other	**204.9**				
Opex	**400.3**	**3.0**	**397.3**	**228.8**	**168.5**
PFI	**155.6**	**(3.1)**	**158.7**	0.0	158.7
Infrastructure depreciation	**122.0**	**0.4**	**121.6**	88.5	33.2
Depreciation charges	**239.0**		**237.1**	120.2	116.9
Grant amortisation	**(1.1)**		**(1.1)**	(0.8)	(0.3)
Amortisation of PFI assets	**3.9**	**(0.4)**	**0.0**		
Gain on sale of assets	**(6.1)**		**0.0**		
Expenditure **	**913.6**	**(0.1)**	**913.6**	**436.7**	**476.9**
Explained by					
Charges to SWBS for support		0.1			

* Excludes Business Stream & IFRS adjustments
** Table References - lines: [M18W.55] [M18WW.56]

The line differences are table presentation differences explained as follows:

- £3.1m difference between the SW Board report and the M18 Tables re PFI costs is due to the transfer of costs from Customer Operations for inter-site sludge tankering from Scottish Water wastewater treatment works to PFI works (£2.0m); terminal pumping station costs pumping to PFI works and inlet headworks (£1.0m); and support costs for the PFI team (£0.1m).

For detailed commentary on the M18 table methodology and cost allocation see Appendix 3.

Commentary

Total operating costs increased by £41.3m (4.7%) to £913.6m.

Table G01 : Total Operating Costs	2016/17 £m	2015/16 £m	Variance £m
Operating expenditure - Water M18w.43	228.818	221.046	(7.772)
Capital maintenance - Water M18w.54	207.897	186.271	(21.626)
Operating expenditure - Waste M18ww.44	327.168	318.204	(8.964)
Capital maintenance - Waste M18ww.55	149.763	146.861	(2.902)
	913.646	**872.382**	**(41.264)**

Activity Analysis

	2016/17 £m	2015/16 £m	Variance £m
Wholesale	842.597	805.466	(37.131)
Retail	51.387	48.943	(2.444)
Non Regulated	19.662	17.973	(1.689)
	913.646	**872.382**	**(41.264)**

Wholesale activity costs have increased by £37.1m (4.6%) from 2015/16 to £842.6m reflecting the following key movements:

- An increase in direct employment costs of £1.6m due primarily to higher employer national insurance contributions as a result of UK budget changes.
- An increase in hired and contracted service costs of £1.3m mainly due to cost inflation and an increase in planned maintenance and statutory inspections.
- An increase in general and support costs of £2.0m. This includes the impact of several one-off project costs (£5.4m), the largest of which is associated with pressure management, and additional pension costs in relation to IAS 19 (£1.0m) offset by reductions in VR costs (£1.8m) and additional procurement rebates (£1.3m). Lease costs for Scottish Water's main laboratory have been transferred from 'general and support' to 'scientific services' (£1.0m).
- An increase in scientific costs of £1.2m due to the transfer of laboratory lease costs from 'general and support' (£1.0m) and increased waste water self-monitoring activities (£0.2m).
- An increase in local authority rates charges of £2.9m.
- Additional net depreciation charges of £26.3m primarily due to a higher level of non-infrastructure investigations in the early part of the regulatory period to identify needs;
- An increase in PPP costs of £1.2m due mainly to contract price inflation.
- A £0.6m increase in other costs including higher chemical dosing to maintain compliance.

Retail activity costs have increased by £2.4m (5.0%) to £51.4m reflecting:

- An increase of £3.3m in the bad debt charge.
- Reduced customer awareness advertising and marketing costs (£0.6m).
- Other cost decreases of £0.3m which includes lower customer billing costs.

Non-Regulated turnover increased by £1.4m from £20.0m in 2015/16 to £21.4m in 2016/17. Consequently**,** activity costs have increased by £1.7m (9.4%) to £19.7m (£1.8m Scottish Water, £16.4m Horizons, and £1.5m International). Additional costs over and above the increased activity to generate turnover are related to:

- Increased contractor costs associated with developer construction projects including Tornagrain.

5. Reconciliation of cash balances from Final Determination to actual results 2017

The closing cash balances forecast in the Final Determination for 31 March 2015, 2016 and 2017 were £265.0m, £216.3m and £165.0m respectively. Actual cash balances for the years were £345.4m, £368.6m and £235.2m respectively.

The £70.2 million increase in cash to 31 March 2017 compared to the Final Determination is summarised in the table below.

Closing Cash	**2014/15 £m**	**2015/16 £m**	**2016/17 £m**	**Total**
FD	265.0	216.3	165.0	
Actual results	345.4	368.6	235.2	
Difference	**80.4**	**152.3**	**70.2**	
Generated during 2014/15		80.4	80.4	
Generated during 2015/16		**71.9**	71.9	
Utilised during 2016/17			**(82.1)**	
Timing Differences	50.5	9.3	(150.8)	(91.0)
Available to support investment	29.9	62.6	68.8	161.3
	80.4	**71.9**	**(82.1)**	**70.2**

Timing differences that can be expected to reverse out over the remainder of the regulatory period have reduced the cash position by £91.0m at 31 March 2017 relative to the Final Determination, primarily due to the re-phasing of Scottish Government borrowing. The increase in cash balances, excluding timing differences of £161.3m, will as set out in our 2017 Delivery Plan update, be used to:

- support exceptional capital maintenance associated with the Ayrshire Resilience Scheme and Strategic Mains diversions;
- augment IR18 allowances subject to OMG approval in relation to the release of the £100m Dalmarnock and Daldowie risk provision; and
- augment capital maintenance to address emerging risks to customer service and to manage any cost pressures in the overall investment programme.

Cash forecasts to 2021 continue to be in line with those presented in our 2017 Delivery Plan update.

The table below reconciles the cash balances from the Final Determination to the actual results for 2016/17 by the category of variance and whether it is a timing impact or a residual contribution to additional investment. It then shows the variances for prior years and the cumulative position back to the Final Determination.

2016/17 Variances

Comparison of cash in 2016/17 to the Final Determination

	Cash generated during 2016/17	Timing Impacts					Residual contribution to additional investment
		Wholesale Income	Working Capital	Capex	Government Borrowing	Indexation etc.	
	£m	£m	£m	£m	£m	£m	£m
Revenue	33.5						**33.5**
Opex & PFI (excl. rates)	9.5						**9.5**
Asset Disposals	1.3						**1.3**
Interest	21.0						**21.0**
Rates Reduction	3.5						**3.5**
Working Capital etc.	(1.5)		1.5				**0.0**
Customer Contributions	9.9			(9.9)			**0.0**
Capex	(60.1)			60.1			**0.0**
Government Borrowing	(120.0)				120.0		**0.0**
Indexation etc.	20.8					(20.8)	**0.0**
2016/17 total	**(82.1)**	**0.0**	**1.5**	**50.2**	**120.0**	**(20.8)**	**68.8**
2014/15 outturn brought forward	80.4	0.0	0.0	-90.5	40.0	0.0	29.9
2015/16 outturn brought forward	71.9	-6.5	-0.2	-109.2	120.0	-19.9	56.1
2015/16 reclassification of wholesale income timing difference to suport investment		6.5					6.5
Cumulative total	**70.2**	**0.0**	**1.3**	**-149.5**	**280.0**	**-40.7**	**161.3**

The figures for 2015/16 have been reclassified from that set out in our 2015/16 Annual Return to reflect that the £6.5 million greater wholesale revenue received in that year has been moved to 'Residual contribution to additional investment' following the introduction of charges for vacant non-domestic properties.

Our net wholesale revenue position for 2016/17 was £14.3m greater than anticipated in the Final Determination, this being £18.6m additional revenue less additional costs incurred in identifying and bringing gap sites into charge (£4.3m - £2.7m opex and £1.6m capex).

The cumulative net benefit in pursuing additional wholesale revenue, relative to the final determination is:

	2015/16 £m	2016/17 £m	Total £m
Revenue	10.7	18.6	29.3
Opex	-2.6	-2.7	-5.3
Capex	-1.6	-1.6	-3.2
Net	**6.5**	**14.3**	**20.8**

Scottish Water
Year ended 31 March 2017
Reconciliation of Historic Accounts Income Statement (Table M1) to IFRS Regulatory Income Statement (Table M4) & Statement of Comprehensive Income (Table M19)

TABLE M1			IFRS adjustments				Table M4		
				IAS 16	IFRIC 12	Category			
Line	Description	Core		Infra costs	PFI	reallocation	Core	Line	Description
		£m	£m	£m	£m	£m	£m		
1.1	Turnover	1,148.989					1,148.989	4.1	Turnover
1.2	Operating expenditure	(381.709)				26.686	(355.023)	4.2	Operating expenditure
1.3	PPP costs	(154.992)			40.875		(114.117)	4.3	PPP costs (excluding PPP interest costs)
						(0.626)	(0.626)	4.4	SW internal costs re PPP contracts
						(26.060)	(26.060)	4.5	Pension contributions (ongoing contribution)
1.4	Historical Cost Depreciation	(238.337)					(238.337)	4.7	Depreciation charges - non infra assets
				(16.400)			(16.400)	4.8	Depreciation charges - infra assets
1.5	Infrastructure Renewals charge	(122.000)		4.380			(117.620)	4.10	Capital maintenance charge (infra t/f from AUC)
1.6	Amortisation of PFI assets	(3.875)			(15.300)		(19.175)	4.9	Depreciation chargs - PPP assets
1.7	Amortisation of deferred income	0.942					0.942	4.11	Amortisation of deferred income
1.8	Operating income	6.136					6.136	4.14	Profit on disposal of fixed assets
1.11	Net interest receivable less payable	(147.679)					(147.679)	4.16	Net interest receivable less payable
					(21.530)		(21.530)	4.17	PPP interest payable
							-	4.18	Net pension financing income/expense
1.12	Profit on ordinary activities before taxation	107.475	-	(12.020)	4.045	-	99.500	4.19	Profit before taxation
1.13	Taxation - current	2.609					2.609	4.20	Taxation - current
1.14	Taxation - deferred	0.122					0.122	4.21	Taxation - deferred
1.19	Retained profit for year	110.206	-	(12.020)	4.045	-	**102.231**	4.26	Profit retained

IFRS adjustments - IAS 19 Pension adjs				Table M19		
Actuarial	Service					
losses	costs adj	Interest	Tax	Core	Line	Description
£m	£m	£m	£m	£m		
				102.231	19.1	Profit for the year
(90.245)				(90.245)	19.2	Actuarial gains/losses on post employment plans
	(9.068)	(4.496)	1.045	(12.519)	19.3	Post emp. plans non cash IAS19 adjs, net of tax
-	-	-	-	-	19.4	Other gains and losses
(90.245)	(9.068)	(4.496)	1.045	**(0.533)**	19.5	Total comprehensive income for the year

Scottish Water
Year ended 31 March 2017
Reconciliation of Historic Accounts Balance Sheet (Table M2) to IFRS Regulatory Balance Sheet (Table M5)

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:					TABLE M5		
			IAS19	IAS16	IFRIC12	Infra			Operating				
			Pension /	Infrastructure	PFI assets/	renewals	Various		working				
Line	Description	Core	holiday pay	assets/deprn	finance lease	accrual	- other		capital			Line	Description
		£m (3dp)									£m (1dp)		
	Fixed Assets												*Fixed Assets*
2.1	Tangible Assets	5,624.894		(112.4)		(116.7)					5,395.7	5.1	Tangible Assets
					346.1						346.1	5.2	PPP assets (IFRS)
							(12.7)	(i)			(12.7)	5.3	Third party contributions
2.3	Investment - Other	34.643					(34.6)	(ii)					
2.4	*Total fixed assets*	5,659.537											
2.5	Stocks	2.299							(2.3)	(iii)			
2.6	Debtors	127.011	(23.6)						(103.5)	(iii)			
									(249.8)	(iii)	(249.8)	5.4	Working capital
2.7	Cash at bank and in hand	41.213									41.2	5.5	Cash
2.8	Short term deposits	194.000									194.0	5.6	Short term deposits
2.10	Assets transferred to PPP contractors	46.973			(47.0)								
2.12	*Total current assets*	411.496									5,714.5	5.9	*Net operating assets*
2.14	Infrastructure Renewals accrual	(116.700)				116.7							
2.15	Creditors	(353.335)	(2.3)						355.6	(iii)			
							34.6	(ii)			34.6	5.12	Investment - other
2.17	Corporation tax payable	0.761									0.7	5.13	Corporation tax payable
2.19	*Total creditors*	(469.274)									35.3	5.15	*Non-operating assets & liabilities*
2.20	Net current assets	(57.778)											
2.21	*Total assets less current liabilities*	5,601.759											
2.22	Borrowings (excl. Govt. loans)	(1.000)									(1.0)	5.16	Borrowings
2.23	Other creditors	(56.600)									(56.6)	5.17	Other creditors
2.24	*Total creditors*	(57.600)									(57.6)	5.18	*Creditors > 1 year*
	Provision for liabilities & charges												
2.25	Deferred tax provision	(372.092)									(372.1)	5.19	Deferred tax provision
2.26	Deferred income - grants and contributions	(12.698)					12.7	(i)					
2.27	Post employment assets / (liabilities)	-	(191.3)								(191.3)	5.20	Post employment assets / (liabilities)
2.28	Other provisions	(34.925)	19.5								(15.4)	5.21	Other provisions
2.29	*Net Assets employed*	5,124.444	(197.7)	(112.4)	299.1	-	-		-		5,113.4	5.23	*Net assets*
	Capital and reserves												*Capital & reserves*
2.30	Govt. loans	3,423.275									3,423.3	5.24	Government loans
					344.3						344.3	5.25	PPP debt/lease (IFRS)
2.31	Income and Expenditure account	1,567.739	(197.7)	(112.4)	(45.2)						1,212.4	5.26	Retained earnings
2.32	Other reserves	133.430									133.4	5.27	Other reserves
2.33	*Capital & reserves*	5,124.444	(197.7)	(112.4)	299.1	-	-		-		5,113.4	5.28	*Capital & reserves*

Scottish Water
Year ended 31 March 2017
Reconciliation of Working Capital between M Tables

TABLE M2 Line	Description	Total	Non Core	Core	IFRS Adjs	Expand categories	Table M11	Table M5	Line	Description
		£m	£m	£m	£m	£m	£m	£m		
2.5	Stocks	2.3	-	2.3			2.3		11.1	Stocks
2.6	Debtors	127.2	0.2	127.0	(23.6)	(103.4)				
						32.3	32.3		11.2	Trade debtors - household
						33.3	33.3		11.4	Other trade debtors
						37.8	37.8		11.6	Prepayments & other short term debtors
2.15	Creditors	(349.5)	3.8	(353.3)	(2.3)	355.6				
						(33.5)	(33.5)		11.7	Trade creditors
						(52.2)	(52.2)		11.8	Wholesale income prepayment
						(77.7)	(77.7)		11.10	Short-term capital creditors
						(33.3)	(33.3)		11.11	Credit note provisions
						(158.8)	(158.8)		11.12	Accruals & other creditors
2.23	Other creditors	(56.6)	-	(56.6)				(56.6)	5.17	Other creditors
		(276.6)	4.0	(280.6)	(25.9)	0.1	(249.8)	(56.6)		

Scottish Water
Year ended 31 March 2017
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

Line	Description	TABLE M27 Consolidated	IFRS adjustments	Statutory Accounts (IFRS) Consolidated	
		£m (3dp)	£m (1dp)	£m (1dp)	
27.1	Turnover	1,213.564	-	1,213.5	Revenue
27.2	Operating costs	(436.816)			
27.3	PPP costs	(154.992)			
27.4	Historical Cost Depreciation	(240.562)		(805.7)	Cost of sales
27.5	Infrastructure Renewals charge	(122.000)			
27.6	Amortisation of PFI assets	(3.875)		(141.0)	Administrative expenses
27.7	Amortisation of deferred income	1.107			
27.8	Operating income	6.147			
		(950.991)	4.2	(946.7)	
27.9	Operating profit	262.573	4.2	266.8	Operating surplus
				1.8	Finance income
				(174.4)	Finance costs
27.11	Net interest receivable less payable	(146.654)	(25.9)	(172.6)	
27.12	Profit on ordinary activities before taxation	115.919	(21.7)	94.2	Surplus before taxation
27.13	Taxation - current	0.947			
27.14	Taxation - deferred	(0.048)			
		0.899	1.1	2.0	Taxation
27.19	Retained profit for year	116.818	(20.6)	96.2	Surplus for the year

Scottish Water
Year ended 31 March 2017
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M28			IFRS adjustments:			Reallocations / Reclassifications:				Statutory Accounts (IFRS)	
			IAS19	IAS16	IFRIC12	Infra	Deferred /	Rec-pay realloc /			
			Pension /	Infrastructure	PFI assets/	Renewals	Current tax	&			
Line	Description	Consolidated	holiday pay	assets/depm	finance lease	Prepayment	presentation	Split <> 1yr		Consolidated	
		£m (3dp)								£m (1dp)	
	Fixed Assets										*Non-current assets*
2.1	Tangible Assets	5,641.642		(112.4)	346.1	(116.7)				5,758.6	Property, plant & equipment
2.3	Investment - Other	0.042									
							1.2			1.2	Deferred tax asset
2.4	Total fixed assets	5,641.684								5,759.8	
	Current Assets										*Current assets*
2.5	Stocks	2.624								2.6	Inventories
2.6	Debtors	172.902	(23.5)							149.4	Trade & other receivables
							2.6			2.6	Current tax asset
2.7	Cash at bank and in hand	185.603								429.6	Cash & cash equivalents
2.8	Short term deposits	244.000									
2.10	Assets transferred to PPP contractors	46.973			(47.0)						
2.12	Total current assets	652.102								584.2	
	Creditors: amounts falling due within one year										*Current liabilities*
2.14	Infrastructure Renewals accrual	(116.700)				116.7					
2.15	Creditors	(397.325)	(2.4)					4.8	(i)	(394.9)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	-			(20.5)					(20.5)	Other loans & borrowings
2.17	Corporation tax payable	2.617					(2.6)			-	Current tax liabilities
								(5.4)	(ii)	(5.4)	Provisions for liabilities
2.19	Total creditors	(511.408)								(420.8)	
2.20	Net current assets	140.694								163.4	
2.21	Total assets less current liabilities	5,782.378								5,923.2	
	Creditors: amounts falling due after one year										*Non-current liabilities*
2.22	Borrowings (excl. Govt. loans)	(1.000)			(323.8)					(324.8)	Other loans & borrowings
2.23	Other creditors	(56.600)						(17.5)	(i)	(74.1)	Trade & other payables
2.24	Total creditors	(57.600)								(398.9)	
	Provision for liabilities & charges										
2.25	Deferred tax provision	(373.152)	39.8				(1.2)			(334.5)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(12.698)						12.7	(i)		
2.27	Post employment assets / (liabilities)	-	(234.2)							(234.2)	Retirement benefit obligations
2.28	Other provisions	(30.763)	19.5					5.4	(ii)	(5.9)	Provisions for liabilities
2.29	Net Assets employed	5,308.165	(200.8)	(112.4)	(45.2)	-	-	-		4,949.7	*Net assets*
	Capital and reserves										*Equity*
2.30	Govt. loans	3,423.275								3,423.3	Government loans
2.31	Income and Expenditure account	1,751.460	(200.8)	(112.4)	(45.2)		-			1,393.0	Retained earnings
2.32	Other reserves	133.430								133.4	Other reserves
2.33	Capital & reserves	5,308.165	(200.8)	(112.4)	(45.2)	-	-	-		4,949.7	

Scottish Water
Year ended 31 March 2017
Reconciliation of Historic Accounts / M Tables to Consolidated Statutory Accounts (Company only)

TABLE M2			**IFRS adjustments:**			**Reallocations / Reclassifications:**				**Statutory Accounts (IFRS)**	
			IAS19 Pension / holiday pay	IAS16 Infrastructure assets/deprn	IFRIC12 PFI assets/ finance lease	Infra Renewals Prepayment	Deferred / Current tax presentation	Rec-pay realloc / & Split <> 1yr			
Line	**Description**	**Total**								**Company**	
		£m (3dp)								**£m (1dp)**	
	Fixed Assets										*Non-current assets*
2.1	Tangible Assets	5,624.894		(112.4)	346.1	(116.7)				5,741.8	Property, plant & equipment
2.3	Investment - Other	37.643								37.6	Investments
2.4	Total fixed assets	5,662.537								5,779.4	
	Current Assets										*Current assets*
2.5	Stocks	2.299								2.3	Inventories
2.6	Debtors	127.245	(23.6)							103.7	Trade & other receivables
							0.7			0.7	Current tax asset
2.7	Cash at bank and in hand	41.214								235.2	Cash & cash equivalents
2.8	Short term deposits	194.000									
2.10	Assets transferred to PPP contractors	46.973			(47.0)						
2.12	Total current assets	411.731								341.9	
	Creditors: amounts falling due within one year										*Current liabilities*
2.14	Infrastructure Renewals accrual	(116.700)				116.7			{(i)/		
2.15	Creditors	(349.579)	(2.3)					(1.4)	{(iii)	(353.2)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	-			(20.5)					(20.5)	Other loans & borrowings
2.17	Corporation tax payable	0.761					(0.7)				
								(8.8)	(ii)	(8.8)	Provisions for liabilities
2.19	Total creditors	(465.518)								(382.5)	
2.20	Net current assets	(53.787)								(40.6)	
2.21	Total assets less current liabilities	5,608.750								5,738.8	
	Creditors: amounts falling due after one year										*Non-current liabilities*
2.22	Borrowings (excl. Govt. loans)	(1.000)			(323.8)					(324.8)	Other loans & borrowings
2.23	Other creditors	(56.600)						(11.3)	(i)	(67.9)	Trade & other payables
2.24	Total creditors	(57.600)								(392.7)	
	Provision for liabilities & charges										
2.25	Deferred tax provision	(373.104)	39.2							(333.9)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(12.698)						12.7	(i)		
2.27	Post employment assets / (liabilities)	-	(230.5)							(230.5)	Retirement benefit obligations
2.28	Other provisions	(34.925)	19.5					8.8	(ii)	(6.6)	Provisions for liabilities
2.29	Net Assets employed	5,130.423	(197.7)	(112.4)	(45.2)	-	-	-		4,775.1	*Net assets*
	Capital and reserves										*Equity*
2.30	Govt. loans	3,423.275								3,423.3	Government loans
2.31	Income and Expenditure account	1,573.718	(197.7)	(112.4)	(45.2)					1,218.4	Retained earnings
2.32	Other reserves	133.430								133.4	Other reserves
2.33	Capital & reserves	5,130.423	(197.7)	(112.4)	(45.2)	-	-	-		4,775.1	

Appendix 3

M18 Methodology and Cost Allocation

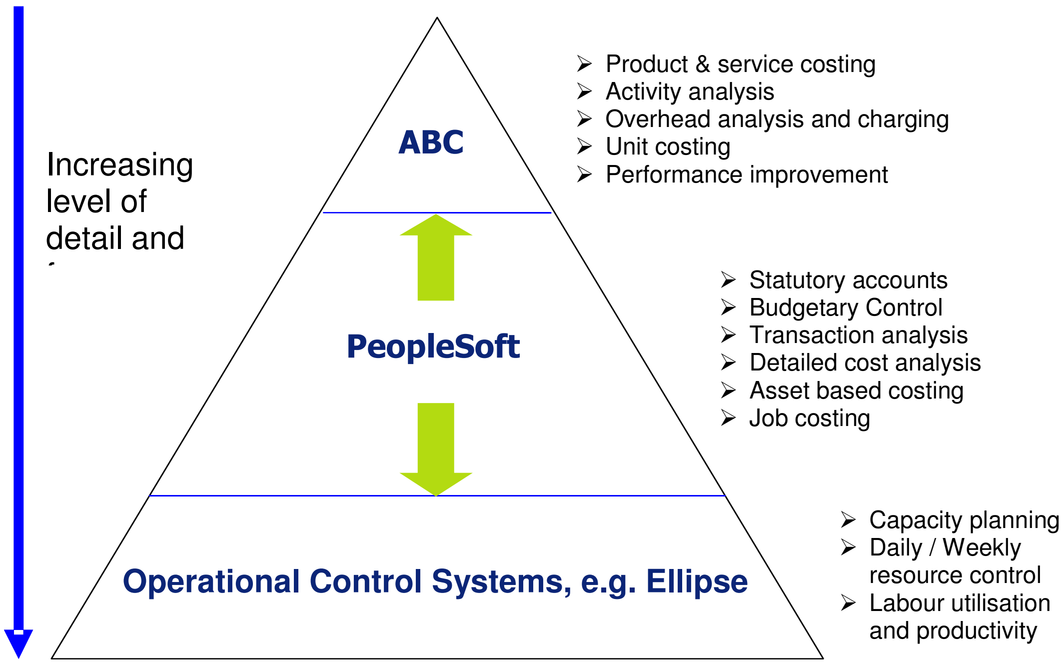
Methodology

Cost analysis in the M18 Tables (M18W and M18WW) was prepared using reports from Scottish Water's Activity Based Management (ABM) systems.

ABM provides analysis of the costs of key activities and processes, and links these to the factors that cause or drive our level of cost. This allows us to develop an understanding of the full cost of providing services, either internally within Scottish Water, or to our external customers.

Scottish Water has built an ABM toolkit founded upon consistent principles which apply across some key core systems and processes.

Activity Based Management data (financial and non financial) is captured in various corporate systems. The key systems which provide ABM analysis for the M18 Tables are:

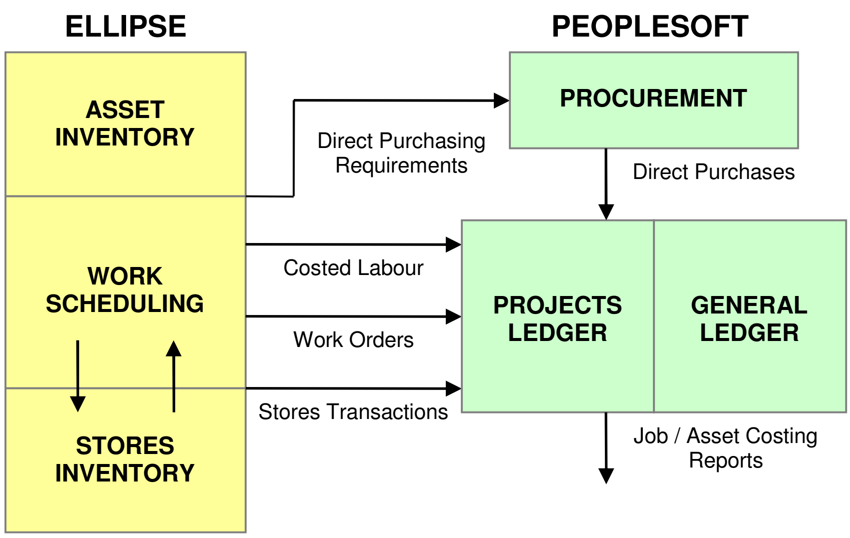


System	ABM Process Overview
Ellipse Works & Asset Management System	Ellipse is used to hold Scottish Water's Asset Inventory and to manage operational activity by individual job (work order), activity and asset. Time spent working on work orders is captured in Ellipse via timesheets, integrated mobile devices or laptops. Material issued to jobs from stock is also captured by work order. Time and materials are then costed and interfaced to the PeopleSoft Financial System on a daily basis.

	See overview diagram below.
PeopleSoft Financial & Procurement System	PeopleSoft is Scottish Water's primary financial and procurement system. The key modules utilised by Scottish Water are Procurement, Accounts Payable, Projects, Timesheets, Billing, Accounts Receivable, General Ledger & Fixed Assets. Accounting separation within the Scottish Water group of companies has been enabled within PeopleSoft. Business Units are the highest level entity in PeopleSoft and are used to securely separate data and access to data and processes. Separate business units have been used to separate Scottish Water Horizons from Scottish Water, and in turn from Scottish Water Solutions. Cross-business unit transactions can only be made via inter-company invoicing. Within Scottish Water capture of activity based information within PeopleSoft has been maximised through the set up of our coding structure, systems and processes. Cost codes have been set up within PeopleSoft to capture and sub-analyse costs by: • Individual work order; • Individual asset; • Each capital or non-regulated project; • Each support department; and • Expense subjective (account). All costs are held in PeopleSoft and costed either directly through PeopleSoft Procurement or operational costing through the Ellipse-PeopleSoft interface. PeopleSoft, therefore, provides comprehensive costing analysis, on a monthly basis, of the costs directly attributable (including some key support activity recharges) to each team, asset, zone, project, service and job.
Hyperion Activity Based Costing (ABC) System	Hyperion Profitability and Cost Management (HPCM) is an ABC system structured around Scottish Water's key (c.250) activities. ABC is run periodically (typically annually) to cover all profit and loss expenditure. PeopleSoft feeds total expenditure directly into Hyperion. Where activity splits have already been captured, e.g. Ellipse effort by activity / asset, these are also fed directly into Hyperion. Costs are analysed by activity and for each activity a non financial driver is captured. The non financial driver is the measurable factor which drives activity cost, or the level of resource consumption. In Hyperion these drivers are used to

	allocate costs to services. Output from Hyperion provides analysis of the full cost of services. These services have been structured to match E & M Table activity classifications, and therefore Hyperion output directly feeds these tables. Non financial driver data is collected from a variety of corporate systems and input to Hyperion.
Driver Data Systems	Examples of systems and drivers are: • LIMS – Lab tests processed and samples taken; • Oracle CRM – Customer calls and written contacts; • Gemini – Waste movements; • Ellipse – Number of jobs, man hours, stores issues, etc; and • PeopleSoft – Number of invoices, purchase orders, customer bills, man hours.

Ellipse / PeopleSoft Integration



Cost Allocation

Consistent with prior years, costs are captured or allocated in line with Regulatory Accounting Rules including modifications, agreed with the Commission, to reflect the Scottish retail market.

Transfers between Separate Entity Associates

Transfers between our separate legal entities are invoiced in accordance with specified service agreement prices or contracts. The prices in these agreements are in accordance with Regulatory Accounting Rules on Transfer Pricing, and prices reflect the full cost of providing the service to the entity. Activity Based Management output has been used extensively in determining the costs which should be included in transfer prices.

Transfers to Non-Regulated Activities

Scottish Water Horizons Limited (SWH) along with Scottish Water International (SWI) are responsible for the majority of the Scottish Water Group's non-regulated activities. Transfers to non-regulated activities are undertaken as described in the section above "Transfers between Separate Entity Associates".

A residual number of non-regulated activities remain within Scottish Water. These are activities which are incidental or integral to the regulated business activities. For example, rechargeable works on core assets and use of laboratory services for third party sampling and analysis.

Within Scottish Water, non-regulated activity is separately reported in a non-regulated ledger tree within PeopleSoft. Non-regulated costs are either directly captured and reported in the Non-Regulated ledger tree, or are charged to non-regulated through cost recharges.

Operational staff working on non-regulated activities, e.g. rechargeable works, charge costs to non-regulated through Ellipse works orders as described in the methodology section.

Support cost recharges for fleet, IT and property are transferred on a regular basis, to reflect actual consumption of support costs. A further cost recharge is made on top of this, to cover areas, which are not regularly recharged. These recharges are made on the basis of ABC analysis.

Wholesale Cost Allocation by WICS Activity

Scottish Water's coding structure follows Regulatory Activity classifications, i.e. Water Treatment, Water Distribution, etc. by individual asset.

The majority of operational costs are directly captured against the individual assets, either by direct charging, e.g. Power, Chemicals, or through Ellipse works orders as described in the methodology section, e.g. labour costs. In 2016/17 84% of costs, directly attributable to wholesale assets, were charged to assets. The shortfall against 100% was due to some gaps in labour costing. These gaps are addressed, for the purposes of regulatory reporting, via activity analysis undertaken with team leaders.

Fleet inventory costs are recharged to teams on a regular basis, and ABC then calculates the fully allocated costs of wholesale activities, including all support activity costs based on actual activity costs and driver volumes.