

M Tables – Regulatory Accounts Commentary

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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. Business Stream's results are included in the Licensed column and all other subsidiaries have been added to the non-core non-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'). 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's non regulated activities and all other non-regulated activities within the Scottish Water Horizons Holdings (SWHH) group of companies; 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 2019/20 forecast figures in Table M4 are from Scottish Water's 2015-21 Delivery Plan Update (March 2019) approved by the Scottish Government. The 2019/20 forecast balance sheet figures in Table M5 are from the Delivery Plan Update (March 2019), updated to reflect the:

- actual pension liability (line M5.20); and
- impact of the actual opening tax and reserves balances (lines M5.19 & M5.26) from 31 March 2019.

Similarly, the cash movement in Table M6 has been updated to reflect the cash movement in 2019/20 from the actual opening cash balance at 31 March 2019 of £310.9m (forecast per Delivery Plan Update: £284m), with the offset being in the movement in working capital.

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.

Following WICS' request for additional analysis of revenue, table M7 has been expanded to include an analysis of changes in Household and Wholesale revenue. As agreed with the WICS the analysis provided in table M7 is at a total level only and has not been split into water and wastewater components. In addition table M20 (analysis of borrowing by interest rate & maturity) has been replaced with Table M32 (Embedded debt & interest).

WICS also requested additional analysis of capital maintenance expenditure with the introduction of table M6-T. As agreed with WICS table M6-T will be completed in future years as the relevant information to populate the table is not yet available. However, analysis of capital maintenance expenditure can be found in the G tables.

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 2018/19 at the standard Corporation Tax rate of 19% (2018: 19%) 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. There are no IFRS adjustments in respect of turnover, therefore Table M7 information remains unchanged with the exception of the additional analysis provided on movements, and the total appears in Table M1 and Table M4.

Table 19, "Statement of Comprehensive Income" appears directly under Table 4. The layout follows our practice since 2015/16 to include all of the IAS 19 adjustments in respect of the post employment benefits (which are non-cash) in Table 19.

Additional tables are 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 M32

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 £428.1m were 8.1% or £32.2m higher than in 2017/18. The increase was primarily due to: one-off type costs for Digital transition and Brexit preparation costs; higher power prices; new legislative costs associated mainly with the GDPR and increased pension contributions; weather related incident costs and bad debt charges. 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 £5.9 million (as detailed in the table below).

	March 2019 £m	March 2018 £m	Variance £m	%
Core operating expenditure (line M1.2)	428.9	396.5	-32.4	-8.2%
Less: Internal PFI costs	-0.8	-0.6	0.2	
SW Regulated operating costs	428.1	395.9	-32.2	-8.1%
Digital transition costs	-5.7	-	5.7	
Brexit preparation costs	-1.7	-	1.7	
Power price impact	-3.1	-	3.1	
New legislative costs	-7.7	-1.8	5.9	
Incident & leakage recovery costs	-4.3	-2.9	1.4	
Maintaining supplies during the summer	-6.4	-	6.4	
Household bad debt charge	-18.4	-17.0	1.4	
New operating costs	-1.0	-	1.0	
Like-for-like controllable costs	379.8	374.2	-5.6	-1.5%
Average RPI inflation at 3.06%	-	11.5	-11.5	
Like-for-like real costs reduction	379.8	385.7	5.9	1.5%

The reduction in PFI costs of £11.4m to £146.9m (line 1.3) was mainly attributable to the settlement of the commercial claim raised in 2016/17. The annual contract indexation of service costs has partly offset that benefit.

Depreciation, including infrastructure depreciation, increased by £12.2m to £375.0m (lines 1.4 to 1.7) due mainly to new assets coming into beneficial use.

Other operating income of £0.9m (line 1.8) was the gain on disposal of fixed assets, £6.1m lower than in 2017/18.

The net interest charge was £148.2m (2018: £149.9m) (line 1.11) a decrease of £1.7m.

SW's total tax charge, on a statutory basis, was £19.7m (2018: £17.3m) (lines 1.13 to 1.14). The re-measurement of deferred tax due to the reduction in the corporation tax rate to 17%, effective from April 2020, had already been reflected in 2016/17.

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.

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 (£164.0m, line 2.14).

Investment – other (line 2.3) of £37.6m is SW's investment in SWHH (2017: £37.6m). Historically, that investment had been split between core (£34.6m) and non-core (£3.0m). However, non-core activities are predominantly delivered by SWHH companies, so the total investment has been included as core only, with prior years realigned.

Total cash at bank (lines 2.7 & 2.8) increased by £40.3m to £310.9, of which £274.8m was on short term deposit (2018: £239.0m).

The infrastructure renewals accrual (line 2.14) has increased to £164.0m at 31 March 2019. However, this is offset by the infrastructure maintenance expenditure identified within assets under construction of £174.9m, 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.

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) increased by £11.1m to £49.9m due to an increase in the wholesale income uncertainty provision of £12.5m partly offset by a decrease in the reorganisation provision of £1.4m. The increase in the wholesale income uncertainty balance was due mainly to recognition of additional revenue risk within the wholesale operating arena.

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.

<i>(Increase)/decrease in costs</i>		£m	<i>Note ref.</i>
IAS 16	Infrastructure assets - depreciation & maintenance	(19.8)	1.
IFRIC 12	PFI costs - depreciation & lease liability	6.4	2.
Scottish Water - net increase in costs		<u>(13.4)</u>	

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 2018/19, the infrastructure expenditure charged to the income statement was £130.0m (line 4.10) and the depreciation charge was £18.0m (line 4.8). These charges were partially offset by the reversal of the infrastructure renewals charge of £128.2m in Table M 1 (line 1.5). Therefore, the net increase to costs was £19.8m.

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 £106.1m in 2018/19. The total depreciation charges of £19.3m are in line 4.9 and the finance costs of £19.2m are in line 4.17.

Therefore, the total of the PPP costs in Table M4, as detailed above, is £144.6m whereas the total in Table M1 is £151.0m (lines 1.3 & 1.6). The net reduction to costs of £6.4m 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	2018/19 £m
PPP costs	M1.3	147.0
Amortisation of PPP assets	M1.6	4.0
Total PPP costs in Table M1		151.0
IFRS adjustments:		
Add: Depreciation charges - PPP leased assets		15.3
Less: Finance lease obligation - to balance sheet		(21.7)
Total PPP costs in Table M4	M4.3, 4.9 & 4.17	144.6

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 gross pension liability increased £69.6m to £243.3m (£202.0m net after deferred tax). The increase in scheme liabilities due to experienced liabilities being £127.6m higher than expected, partially offset by higher than expected returns on scheme assets of £77.7m, represent the gross actuarial gain of £49.9m which, net of deferred tax, forms the £41.4m debit in M19.

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 £18.8m is analysed as follows:

	SW £m
Pension service cost adjustments & holiday pay	(17.0)
Interest on pension scheme net liabilities	(5.1)
Deferred tax on IAS 19 adjustments	3.3
	(18.8)

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 £309.0m 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			268.5
Owned assets	(reclassification)		40.5
		M5, line 5.2	<u>309.0</u>
Other loans & borrowings			
Finance lease liability	< 1 year		(22.9)
	> 1 year		(279.2)
	total	M5, line 5.25	<u>(302.1)</u>

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

Other creditors due after one year (line 5.17) consists of payments received in advance (£62.2m).

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)			(243.3)
Deferred taxation on retirement benefit obligations			41.3
Retirement benefit obligations - net		M5, line 5.20	<u>(202.0)</u>

The other provisions total of £33.7m (line 5.21), an increase of £12.6m compared to 2017/18, is made up of restructure (£0.4m), income uncertainty (£32.0m) and property leases (£1.3m).

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 £32.0m 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 2017/18 and 2018/19 as calculated by SW's wholesale team were compared to the forecasts calculated by Business Stream. Overall, there were no material differences. The total of the out-turn positions was therefore agreed with the relevant adjustments being posted by both companies in March 2019.

Retained earnings (line 5.26) consists of the total of the reserve brought forward from 31 March 2018 and the retained profit for 2018/19 (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 6.16).

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 6.16).

Interest paid (line 6.19) of £150.4m includes intercompany interest paid to Business Stream of £0.9m and £1.3m to 3rd party LPs in relation to the settlement of wholesale billing and reconciliation process. Loan interest payments in respect of Government and other borrowings totalled £148.2m.

On the IFRS basis, £21.7m of PFI costs were reclassified as finance lease repayments 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 6.24) and capital maintenance expenditure (line 6.25).

	M Table / line ref	2018/19 £m
Opening short term capital creditor	M11.10 (17/18)	92.3
Add: Capital investment (net of contributions)		653.5
Less: Closing short term capital creditor	M11.10 (18/19)	(109.2)
=> Capital expenditure		636.6
Analysed:		
Capital enhancement expenditure	M6.24	252.3
Capital maintenance expenditure	M6.25	384.3
Capital expenditure (total)		636.6

Capital investment (net of contributions) is analysed further in the table below.

	2018/19 £m
Capital investment (gross Q&S) on a regulatory basis	659.8
Add: PFI investment	0.1
Total capital investment	659.9
Less: Contributions	(6.4)
Capital investment (net of contributions)	653.5

In 2018/19 £0.1m was invested at Dalmeir PFI thereby increasing PFI assets. This expenditure has been included in the capital enhancement total within the cash flow (line 6.24) 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 £20.8m to £881.7m (line 7.1) reflecting the increase in household charges of 1.6%, effective from 1 April 2018, the increase in properties connected to the network. The additional lines (lines 7.13 – 7.15) provide detail on the movements in household revenue.

Turnover from wholesale services provided to Licensed Providers increased by £3.1m, or 1.0%, to £323.6m (line 7.3) reflecting the average tariff increase of 2.0% partly offset by a reduction in consumption. The additional lines (lines 7.17 – 7.22) provide a further analysis of the year on year movements in wholesale revenue.

The additional lines outlined above are new for 2018/19.

Turnover from other sales increased by £1.6m to £11.6m (line 7.7).

Table M11 – Regulatory Accounts Working capital (Core)

All of the balances presented in Table M11 are on an IFRS basis. A separate reconciliation (Appendix 1.3) has been prepared showing the reclassifications of the balances in Table M2 at 31 March 2019 into the regulatory IFRS working capital (Table M11).

Trade debtors increased by £2.1m to £36.5m (line 11.2).

Other trade debtors (line 11.4) relate to wholesale and sundry billing. Due to the change made by the WICS to Licensed Provider prepayment terms in March 2017, the other trade debtors total included the May 2017 provisional invoices which had been issued but were unpaid at 31 March 2017. Since then, all provisional invoices were issued and settled within the same month.

Capital creditors consist of the balances of capital creditors and accruals relating to third parties.

Table M18W and M18WW commentary - see Section 4.2 below

Table M21 – Taxation analysis

The 2017/18 data has been updated to reflect the actual 2017/18 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 £208.6m (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), SWH and the North-East Scotland PFI companies.

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 the North-East Scotland PFI companies.

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.

Tables M30 & M31 – Inventory of loans

Tables M30 and M31 provide a full listing of SW's loans.

Table M30 details the loans which are repaid in full at their maturity dates. The listing includes details of loans repaid during 2018/19 (£119.7m) as well as those with maturity dates beyond 31 March 2019.

Table M31 details the loans which have period repayment of the principal throughout the term of the loan.

Tables M32 – Embedded Debt and Interest

Tables M32 shows the book value of loans outstanding for all debt drawn prior to 2013/14. The table also details the interest payable on the outstanding loan in the year and the amount repaid.

All debt drawn prior to 2013/14 is expected to be repaid by April 2063.

Table M32 is new for 2018/19

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 and the results of all non-regulated activities excluding Business Stream.

SW Group Statutory Accounts

	£m	£m
Cost of Sales	1,047.4	
Admin Expenses	<u>166.6</u>	
SW Group Expenditure		1,214.0
Less Business Stream		(231.3)
IFRS adjustments		<u>(15.7)</u>
Total Expenditure (excluding Business Stream and IFRS)		<u>967.0</u>
Represented by		
SW Regulated		949.9
Non Regulated Activities (from M18W and M18WW)		17.1

M18W & WW Tables include the costs of Scottish Water Regulated activities, Scottish Water's Non-Regulated activities and all other non-regulated activities within the SWHH group of companies.

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

(£m)	Statutory Accounts		Regulatory Accounts		
	SW SWHH group*	Diff SW/SWH - M18	M18W/WW Tables		
			Total	M18 W	M18 WW
Employment	229.1		439.5	253.8	185.7
Other	215.4				
Opex	444.5	(5.0)	439.5	253.8	185.7
PFI	147.7	5.2	152.9	0.0	152.9
Infrastructure depreciation	128.2	(1.5)	126.7	85.7	41.0
Depreciation charges	244.9		249.5	122.5	127.0
Grant amortisation	(1.3)	1.5	(1.3)	(0.9)	(0.4)
Amortisation of PFI assets	4.0				
Gain on sale of assets	(0.9)				
Expenditure **	967.0	0.3	967.3	461.1	506.2

* Excludes Business Stream & IFRS adjustments

** Table References - lines:

[M18W.55] [M18WW.56]

The line differences are table presentation differences explained as follows:

- £5.2m 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 (£2.7m); terminal pumping station costs pumping to PFI works and inlet headworks (£1.4m) and ABC support costs of (£1.1m);
- The expenditure totals differ slightly due to charges to SWBS for support being excluded in the preparation of the M18 tables.

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

Commentary

Total operating costs increased by £37.6m (4.0%) to £967.3m.

Total Operating Costs	2018/19 £m	2017/18 £m	Variance £m
Operating expenditure - Water M18w.43	253.764	234.454	(19.310)
Capital maintenance - Water M18w.54	207.308	198.877	(8.431)
Operating expenditure - Waste M18ww.44	338.596	338.715	+0.119
Capital maintenance - Waste M18ww.55	167.595	157.657	(9.938)
	967.263	929.703	(37.560)

Activity Analysis

	2018/19 £m	2017/18 £m	Variance £m
Wholesale	895.775	858.682	(37.093)
Retail	54.341	52.133	(2.208)
Non Regulated	17.147	18.888	+1.741
	967.263	929.703	(37.560)

Wholesale activity costs increased by £37.1m (4.3%) from 2017/18 to £895.8m reflecting the following key movements:

- An increase in direct employment costs of £2.9m, primarily relating to pay progression, pension cost increases (£2.6m) and overtime to maintain compliance at WWTW (£0.3m);
- An increase in power costs of £3.1m. This was due to a tariff increase of £3.0m, an increase in consumption of £0.5m mainly due to increased pumping requirements, partially offset by a reduction in Carbon Reduction Commitment (CRC) charges of £0.4m;
- An increase in hire and contracted services in the year of £7.0m. This related primarily to maintaining water supplies through the prolonged period of dry weather (£3.3m) and recovering associated leakage targets (£3.8m) as a consequence of severe winter weather at the start of 2018;
- A reduction in PPP costs of £9.4m due mainly to the settlement of a one off commercial claim raised in 2016/17 (£13.8m), partially offset by an indexation of service costs of £3.1m and an increase in inter-site sludge tankering (£0.5m);
- Materials and consumables increased £2.0m in the year due mainly to Brexit preparations (£1.1m) and an increase in chemical dosing costs in order to maintain compliance during the prolonged period of dry weather conditions (£0.8m);
- General and support costs increased by £11.7m in the year. £7.2m related to one off IT partner transition costs, costs associated with the move to cloud based applications and GDPR requirements. Support employment costs increased £2.7m due to pay progression and pension cost increases. There was also a £1.6m increase in the hire of vehicles and plant in order to maintain water supplies through the prolonged period of dry weather;
- Costs associated with scientific services increased £1.6m, primarily due to an increased number of FTEs to meet increased service demand (£1.0m) and additional laboratory consumables in preparation for Brexit (£0.5m);
- Local authority rates increased £1.8m as a result of the inflation increase in the Uniform Business Rate;
- Infrastructure renewals expenditure increased by £2.9m largely due to increased capital maintenance of sewers and combined sewage outfalls (CSO); and
- Non-infrastructure depreciation charge increased by £13.4m, due primarily to increased capital expenditure on IT systems (£5.0m) and less profit from asset disposals during the year (£6.0m), along with a general increase due to the completion of capital projects £2.4m.

Retail activity costs increased by £2.2m (4.2%) to £54.3m reflecting:

- An increase of £1.0m in the bad debt charge;
- An increase of £1.3m in IT support cost reflecting an increase in employment and pension costs;

Non-Regulated costs have decreased by £1.7m mainly as a consequence of lower revenues within Scottish Water non-regulated and Scottish Water Horizons. In the year, turnover reduced £2.3m to £17.7m.

5. Reconciliation of cash balances from Final Determination to actual results 2019

The closing cash balance forecast in the Final Determination for 31 March 2019 was £94.7 million. The actual cash balance as at 31 March 2019 was £310.9 million. The £216.2 million increase in cash to 31 March 2019 compared to the Final Determination is summarised in the table below.

Closing cash	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	Total £m
Final Determination 2014	265.0	216.3	165.0	114.1	94.7	
Actual results	345.4	368.6	235.3	270.6	310.9	
Difference	80.4	152.3	70.3	156.5	216.2	
Generated / (utilised) in prior years	0.0	80.4	152.3	70.3	156.5	
Generated / (utilised) in year	80.4	71.9	(82.0)	86.2	59.7	216.2
Timing differences	50.5	9.3	-150.8	2.8	-11.8	-100.0
Available to support investment	29.9	62.6	68.8	83.4	71.5	316.2
	80.4	71.9	(82.0)	86.2	59.7	216.2

Timing differences that can be expected to reverse out over the remainder of the regulatory period total £100.0 million as at 31 March 2019 relative to the Final Determination. The increase in cash balances, excluding timing differences, of £316.2 million will, as set out in our 2019 Delivery Plan update, be used to:

- support exceptional capital maintenance associated with the Ayrshire Resilience Scheme and Strategic Mains diversions;
- augment IR18 allowances;
- augment capital maintenance to address emerging risks to customer service and to manage any cost pressures in the overall investment programme; and
- support SR21 early start.

The forecast of cash as at 31 March 2021 remains consistent with our 2019 Delivery Plan update (£249 million).

The table below reconciles the cash balances from the Final Determination to the actual results for 2018/19 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.

2018/19 Variances

Comparison of cash in 2018/19 to the Final Determination

	Cash generated during 2018/19	Timing Impacts				Residual contribution to additional investment
		Working Capital	Capex	Government Borrowing	Indexation etc.	
	£m	£m	£m	£m	£m	£m
Revenue	40.0					40.0
Opex & PFI (excl. rates & new legislative costs)	11.8					11.8
Asset Disposals	0.6					0.6
Interest	27.1					27.1
Rates Reduction net of new legislative costs	(3.3)					(3.3)
Tax paid	(4.7)					(4.7)
Working Capital etc.	23.4	(23.4)				-
Customer Contributions	6.4		(6.4)			-
Capex	(91.6)		91.6			-
Government Borrowing	45.3			(45.3)		-
Indexation etc.	4.7				(4.7)	-
2018/19 total	59.7	(23.4)	85.2	(45.3)	(4.7)	71.5
Brought forward at 1 April 2018	156.5	(43.5)	(99.8)	280.0	(48.5)	244.7
Cumulative total carried forward at 31 March 2019	216.2	(66.9)	(14.6)	234.7	(53.2)	316.2

Our net wholesale revenue position for 2018/19 was £22.1m greater than anticipated in the Final Determination, this being £22.3m additional revenue less additional cost incurred in identifying and bringing gap sites into charge (£0.2m).

The cumulative net benefit in pursuing additional wholesale revenue, relative to the Final Determination is:

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	Total £m
Additional revenue generated	10.7	18.6	25.0	22.3	76.6
Opex costs incurred	-2.6	-2.7	-3.3	-0.2	-8.8
Capex costs incurred	-1.6	-1.6	0.0	0.0	-3.2
Net additional cash	6.5	14.3	21.7	22.1	64.6

Scottish Water

Year ended 31 March 2019

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		
Line	Description	Core	IAS 16	IFRIC 12	Category	Core	Line	Description	
		£m	£m	£m	reallocation	£m			
			Infra costs	PFI					
			£m	£m	£m	£m			
1.1	Turnover	1,216.896				1,216.896	4.1	Turnover	
1.2	Operating expenditure	(428.872)			35.748	(393.124)	4.2	Operating expenditure	
1.3	PPP costs	(146.943)		40.900		(106.043)	4.3	PPP costs (excluding PPP interest costs)	
					(0.723)	(0.723)	4.4	SW internal costs re PPP contracts	
					(35.025)	(35.025)	4.5	Pension contributions (ongoing contribution)	
1.4	Historical Cost Depreciation	(243.780)				(243.780)	4.7	Depreciation charges - non infra assets	
			(18.000)			(18.000)	4.8	Depreciation charges - infra assets	
1.5	Infrastructure Renewals charge	(128.200)	(1.800)			(130.000)	4.10	Capital maintenance charge (infra t/f from AUC)	
1.6	Amortisation of PFI assets	(4.015)		(15.300)		(19.315)	4.9	Depreciation charges - PPP assets	
1.7	Amortisation of deferred income	0.986				0.986	4.11	Amortisation of deferred income	
1.8	Operating income	0.930				0.930	4.14	Profit on disposal of fixed assets	
1.11	Net interest receivable less payable	(148.226)				(148.226)	4.16	Net interest receivable less payable	
				(19.200)		(19.200)	4.17	PPP interest payable	
						-	4.18	Net pension financing income/expense	
1.12	Profit on ordinary activities before taxation	118.776	-	(19.800)	6.400	-	105.376	4.19	Profit before taxation
1.13	Taxation - current	(2.965)				(2.965)	4.20	Taxation - current	
1.14	Taxation - deferred	(16.701)				(16.701)	4.21	Taxation - deferred	
1.19	Retained profit for year	99.110	-	(19.800)	6.400	-	85.710	4.26	Profit retained
			IFRS adjustments - IAS 19 Pension adjs				Table M19		
			Actuarial	Service	Interest	Tax	Core	Line	Description
			losses	costs adj			£m		
			£m	£m	£m	£m			
			(41.431)				85.710	19.1	Profit for the year
				(16.981)	(5.116)	3.353	(41.431)	19.2	Actuarial gains/losses on post employment plans
							(18.744)	19.3	Post emp. plans non cash IAS19 adjs, net of tax
			-	-	-	-	-	19.4	Other gains and losses
			(41.431)	(16.981)	(5.116)	3.353	25.535	19.5	Total comprehensive income for the year

Scottish Water

Year ended 31 March 2019

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

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:			TABLE M5	
Line	Description	Core	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/depm	IFRIC12 PFI assets/ finance lease	Infra renewals accrual	Various - other	Operating working capital	Line	Description
		£m (3dp)							£m (1dp)	
	<i>Fixed Assets</i>									<i>Fixed Assets</i>
2.1	Tangible Assets	6,200.259		(160.6)	309.0	(164.0)			5,875.7	5.1 Tangible Assets
									309.0	5.2 PPP assets (IFRS)
							(10.9)	(i)	(10.9)	5.3 Third party contributions
2.3	Investment - Other	37.643					(37.6)	(ii)		
2.4	<i>Total fixed assets</i>	<u>6,237.902</u>								
2.5	Stocks	2.890						(2.9)	(iii)	
2.6	Debtors	110.557	(32.6)					(77.9)	(iii)	
								(310.3)	(iii)	5.4 Working capital
2.7	Cash at bank and in hand	36.088							36.1	5.5 Cash
2.8	Short term deposits	274.800							274.8	5.6 Short term deposits
2.10	Assets transferred to PPP contractors	40.489			(40.5)					
2.12	<i>Total current assets</i>	<u>464.824</u>							<u>6,174.4</u>	5.9 <i>Net operating assets</i>
2.14	Infrastructure Renewals accrual	(164.034)				164.0				
2.15	Creditors	(388.609)	(2.5)					391.1	(iii)	
							37.6	(ii)	37.6	5.12 Investment - other
2.17	Corporation tax payable	0.866							0.8	5.13 Corporation tax payable
2.19	<i>Total creditors</i>	<u>(551.777)</u>							<u>38.4</u>	5.15 <i>Non-operating assets & liabilities</i>
2.20	Net current assets	(86.953)								
2.21	<i>Total assets less current liabilities</i>	<u>6,150.949</u>								
2.22	Borrowings (excl. Govt. loans)	(1.000)							(1.0)	5.16 Borrowings
2.23	Other creditors	(62.200)							(62.2)	5.17 Other creditors
2.24	<i>Total creditors</i>	<u>(63.200)</u>							<u>(63.2)</u>	5.18 <i>Creditors > 1 year</i>
	<i>Provision for liabilities & charges</i>									
2.25	Deferred tax provision	(404.458)							(404.5)	5.19 Deferred tax provision
2.26	Deferred income - grants and contributions	(10.967)					10.9	(i)		
2.27	Post employment assets / (liabilities)	-	(202.0)						(202.0)	5.20 Post employment assets / (liabilities)
2.28	Other provisions	(49.874)	16.2						(33.7)	5.21 Other provisions
2.29	<i>Net Assets employed</i>	<u>5,622.450</u>	<u>(220.9)</u>	<u>(160.6)</u>	<u>268.5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,509.4</u>	5.23 <i>Net assets</i>
	<i>Capital and reserves</i>									<i>Capital & reserves</i>
2.30	Govt. loans	3,708.615							3,708.6	5.24 Government loans
					302.1				302.1	5.25 PPP debt/lease (IFRS)
2.31	Income and Expenditure account	1,780.405	(220.9)	(160.6)	(33.6)				1,365.3	5.26 Retained earnings
2.32	Other reserves	133.430							133.4	5.27 Other reserves
2.33	<i>Capital & reserves</i>	<u>5,622.450</u>	<u>(220.9)</u>	<u>(160.6)</u>	<u>268.5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,509.4</u>	5.28 <i>Capital & reserves</i>

Scottish Water
Year ended 31 March 2019
Reconciliation of Working Capital between M Tables

TABLEM2				IFRS	Expand	Table	Table	Line	Description
Line Description	Total	Non Core	Core	Adjs	categories	M11	M5		
	£m	£m	£m	£m	£m	£m	£m		
2.5 Stocks	2.9	-	2.9			2.9		11.1	Stocks
2.6 Debtors	110.9	0.3	110.6	(32.6)	(78.0)				
					36.5	36.5		11.2	Trade debtors - household
					6.7	6.7		11.4	Other trade debtors
					34.8	34.8		11.6	Prepayments & other short term debtors
2.15 Creditors	(381.5)	7.1	(388.6)	(2.5)	391.1				
					(16.1)	(16.1)		11.7	Trade creditors
					(58.5)	(58.5)		11.8	Wholesale income prepayment
					(109.2)	(109.2)		11.10	Short-term capital creditors
					(34.0)	(34.0)		11.11	Credit note provisions
					(173.4)	(173.4)		11.12	Accruals & other creditors
2.23 Other creditors	(62.2)	-	(62.2)				(62.2)	5.17	Other creditors
	(329.9)	7.4	(337.3)	(35.1)	(0.1)	(310.3)	(62.2)		

Scottish Water
Year ended 31 March 2019
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M27			IFRS	Statutory Accounts (IFRS)	
Line	Description	Consolidated	adjustments	Consolidated	
		£m	£m	£m	
27.1	Turnover	1,469.1	-	1,469.1	Revenue
27.2	Operating costs	(671.1)			
27.3	PPP costs	(147.0)			
27.4	Historical Cost Depreciation	(250.7)		(1,047.4)	Cost of sales
27.5	Infrastructure Renewals charge	(128.2)			
27.6	Amortisation of PFI assets	(4.0)		(166.6)	Administrative expenses
27.7	Amortisation of deferred income	1.3			
27.8	Operating income	0.9			
27.10	Other income	0.5			
		<u>(1,198.3)</u>	<u>(15.7)</u>	<u>(1,214.0)</u>	
	Operating profit	270.8	(15.7)	255.1	Operating surplus
				2.1	Finance income
				(171.1)	Finance costs
27.11	Net interest receivable less payable	(147.8)	(21.2)	(169.0)	
27.12	Profit on ordinary activities before taxation	123.0	(36.9)	86.1	Surplus before taxation
27.13	Taxation - current	(3.5)			
27.14	Taxation - deferred	(16.3)			
		(19.8)	1.9	(17.9)	Taxation
27.19	Retained profit for year	103.2	(35.0)	68.2	Surplus for the year

Scottish Water

Year ended 31 March 2019 - Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M28			IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Consolidated	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/depm	IFRIC12 PFI assets/ finance lease	Infra Renewals Prepayment	Deferred / Current tax presentation	Rec-pay realloc / & Split <> 1yr	Consolidated	
		£m	£m	£m	£m	£m	£m	£m	£m	
	<i>Fixed Assets</i>									<i>Non-current assets</i>
2.1	Tangible Assets	6,264.3		(160.6)	275.0	(164.0)			6,214.7	Property, plant & equipment
2.3	Investment - Other	21.7			(11.7)				10.0	Intangible asset
							1.8		1.8	Deferred tax asset
2.4	Total fixed assets	6,286.0							6,226.5	
	<i>Current Assets</i>									<i>Current assets</i>
2.5	Stocks	3.7							3.7	Inventories
2.6	Debtors	237.0	(32.6)						204.4	Trade & other receivables
							2.7		2.7	Current tax asset
2.7	Cash at bank and in hand	160.0							434.8	Cash & cash equivalents
2.8	Short term deposits	274.8								
2.10	Assets transferred to PPP contractors	40.5			(40.5)					
2.12	Total current assets	716.0							645.6	
	<i>Creditors: amounts falling due within one year</i>									<i>Current liabilities</i>
2.14	Infrastructure Renewals accrual	(164.0)				164.0				
2.15	Creditors	(465.0)	(2.6)					5.5 (i)	(462.1)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	(4.7)			(20.1)				(24.8)	Other loans & borrowings
2.17	Corporation tax payable	2.6					(2.7)		(0.1)	Current tax liabilities
								(10.4) (ii)	(10.4)	Provisions for liabilities
2.19	Total creditors	(631.1)							(497.4)	
2.20	Net current assets	84.9							148.2	
2.21	Total assets less current liabilities	6,370.9							6,374.7	
	<i>Creditors: amounts falling due after one year</i>									<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(40.9)			(236.5)				(277.4)	Other loans & borrowings
2.23	Other creditors	(72.5)						(16.5) (i)	(89.0)	Trade & other payables
2.24	Total creditors	(113.4)							(366.4)	
	<i>Provision for liabilities & charges</i>									
2.25	Deferred tax provision	(407.0)	42.2		(1.5)		(1.8)		(368.1)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(11.0)						11.0 (i)		
2.27	Post employment assets / (liabilities)	-	(248.3)						(248.3)	Retirement benefit obligations
2.28	Other provisions	(41.3)	16.2					10.4 (ii)	(14.7)	Provisions for liabilities
2.29	Net Assets employed	5,798.2	(225.1)	(160.6)	(35.3)	-	-	-	5,377.2	<i>Net assets</i>
	<i>Capital and reserves</i>									<i>Equity</i>
2.30	Govt. loans	3,708.6							3,708.6	Government loans
2.31	Income and Expenditure account	1,964.7	(225.1)	(160.6)	(35.3)				1,543.7	Retained earnings
2.32	Other reserves	124.9							124.9	Other reserves
2.33	Capital & reserves	5,798.2	(225.1)	(160.6)	(35.3)	-	-	-	5,377.2	

Scottish Water

Year ended 31 March 2019 - Reconciliation of Historic Accounts / M Tables to Consolidated Statutory Accounts (Company only)

TABLE M2		IFRS adjustments:			Reallocations / Reclassifications:			Statutory Accounts (IFRS)	
Line	Description	Total	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/depm	IFRIC12 PFI assets/ finance lease	Infra Renewals Prepayment	Deferred / Current tax presentation	Rec-pay realloc / & Split <> 1yr	Company
		£m	£m	£m	£m	£m	£m	£m	£m
	Fixed Assets								<i>Non-current assets</i>
2.1	Tangible Assets	6,200.3		(160.6)	309.0	(164.0)			6,184.7 Property, plant & equipment
2.3	Investment - Other	37.6							37.6 Investments
2.4	Total fixed assets	6,237.9							6,222.3
	Current Assets								<i>Current assets</i>
2.5	Stocks	2.9							2.9 Inventories
2.6	Debtors	110.9	(32.6)						78.3 Trade & other receivables
2.7	Cash at bank and in hand	36.1					0.8		0.8 Current tax asset
2.8	Short term deposits	274.8							310.9 Cash & cash equivalents
2.10	Assets transferred to PPP contractors	40.5			(40.5)				
2.12	Total current assets	465.2							392.9
	Creditors: amounts falling due within one year								<i>Current liabilities</i>
2.14	Infrastructure Renewals accrual	(164.0)				164.0			
2.15	Creditors	(381.5)	(2.5)					(1.5) (i)	(385.5) Trade & other payables
2.16	Borrowings (excl. Govt. loans)	(0.5)			(22.9)				(23.4) Other loans & borrowings
2.17	Corporation tax payable	0.8					(0.8)		- Current tax liabilities
2.19	Total creditors	(545.2)						(13.5) (ii)	(13.5) Provisions for liabilities
2.20	Net current assets	(80.0)							(422.4)
2.21	Total assets less current liabilities	6,157.9							(29.5)
	Creditors: amounts falling due after one year								<i>Non-current liabilities</i>
2.22	Borrowings (excl. Govt. loans)	(0.5)			(279.2)				(279.7) Other loans & borrowings
2.23	Other creditors	(62.2)						(9.5) (i)	(71.7) Trade & other payables
2.24	Total creditors	(62.7)							(351.4)
	Provision for liabilities & charges								
2.25	Deferred tax provision	(405.5)	41.3						(364.2) Deferred tax liabilities
2.26	Deferred income - grants and contributions	(11.0)						11.0 (i)	
2.27	Post employment assets / (liabilities)	-	(243.3)						(243.3) Retirement benefit obligations
2.28	Other provisions	(49.9)	16.2					13.5 (ii)	(20.2) Provisions for liabilities
2.29	Net Assets employed	5,628.8	(220.9)	(160.6)	(33.6)	-	-	-	5,213.7 <i>Net assets</i>
	Capital and reserves								<i>Equity</i>
2.30	Govt. loans	3,708.6							3,708.6 Government loans
2.31	Income and Expenditure account	1,786.8	(220.9)	(160.6)	(33.6)				1,371.7 Retained earnings
2.32	Other reserves	133.4							133.4 Other reserves
2.33	Capital & reserves	5,628.8	(220.9)	(160.6)	(33.6)	-	-	-	5,213.7

Appendix M18 Methodology and Cost Allocation

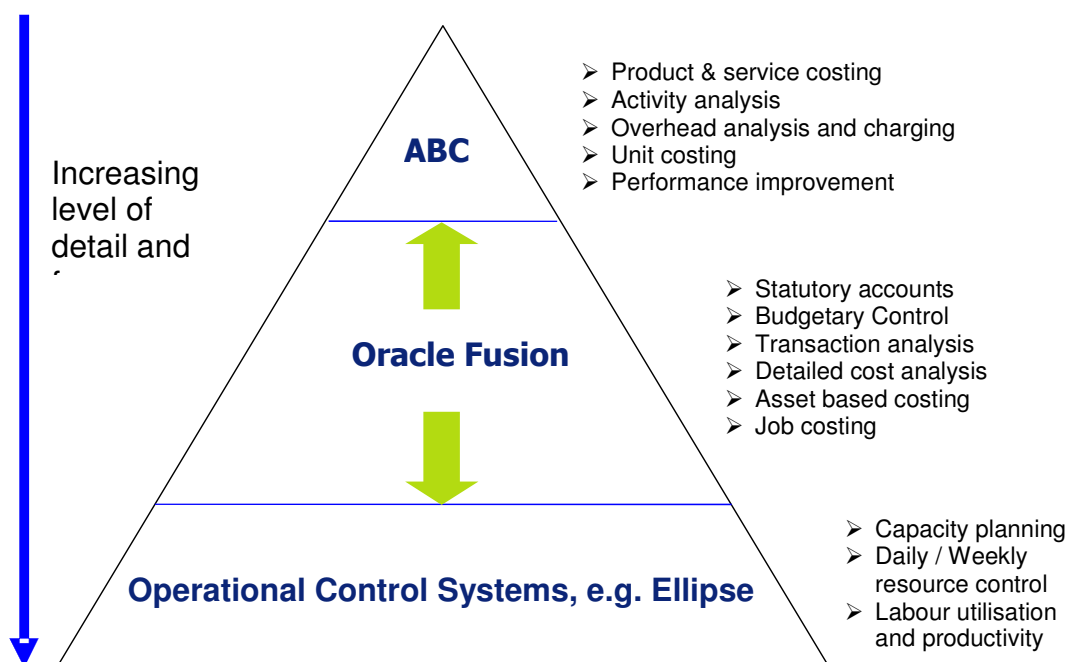
Methodology

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.

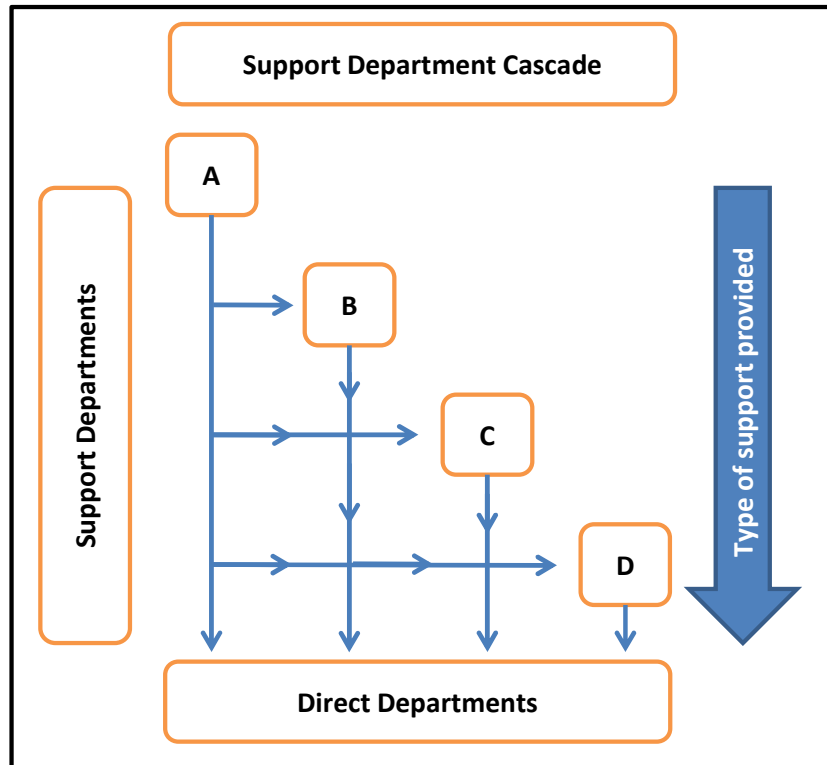
Activity Based Management data (financial and non financial) is captured in various corporate systems. The key systems which provide ABM analysis for the M18 Tables are:



System	ABM Process Overview
Ellipse Works & Asset Management System	<p>Ellipse is used to hold Scottish Water’s Asset Inventory and to manage operational activity by individual job (work order), activity and asset.</p> <p>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.</p> <p>Time and materials are then costed and interfaced to the Oracle Fusion Financial System on a daily basis.</p> <p>See overview diagram below.</p>

<p>Oracle Fusion Financial & Procurement System</p>	<p>Oracle Fusion 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 and Payroll.</p> <p>Accounting separation within the Scottish Water group of companies has been enabled within Oracle Fusion.</p> <p>Business Units are the highest level entity in Oracle Fusion and are used to securely separate data whilst providing access to data and processes. Business units have been used to separate all subsidiary companies from Scottish Water. Cross-business unit transactions can only be made via inter-company invoicing. This ensures there is sufficient governance surrounding any inter-company transactions.</p> <p>Within Scottish Water capture of activity based information within Oracle Fusion has been maximised through the set up of our coding structure, systems and processes.</p> <p>Cost codes have been set up within Oracle Fusion to capture and sub-analyse costs by:</p> <ul style="list-style-type: none"> • Individual work order; • Individual asset; • Each capital or non regulated project; • Each support department; and • Expense subjective (account). <p>All costs are held in Oracle Fusion and costed either directly through Oracle Fusion Procurement or operational costing through the Ellipse-Oracle Fusion interface.</p> <p>Oracle Fusion, 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.</p>
<p>Excel (ABC) Activity Allocation Models</p>	<p>During 2018/19 Scottish Water has replicated the ABC calculation, previously within Hyperion Profitability & Cost Management (HPCM), within an excel model to increase transparency of cost allocations and reduce processing time whilst maintaining a consistent approach. The overall cost allocation method is broadly unchanged and uses the same cost inputs, cost drivers and processing logic with one specific change to the way in which support costs are allocated to activities.</p> <p>Support costs (for example, IT or finance costs) were allocated in HPCM using logic which allowed costs to flow from support departments to other support departments in an iterative way. This allocation of costs between support departments was repeated five times to allow support costs to gradually find their way to direct activities by being passed backwards and forwards between support departments.</p> <p>Instead, the excel model processes support department costs against support activities in a ‘cascade’ in order of the nature of support provided, those departments providing the most support to other support departments first, and then cascades costs in one direction only, as shown</p>

in the diagram below.



The ABC allocation models incorporate the various activity allocation processes previously produced through Hyperion Profitability and Cost Management (HPCM) system, and is structured around Scottish Water's key (c.250) activities.

ABC is run periodically (typically annually) to cover all profit and loss expenditure.

Oracle Fusion feeds total expenditure directly into the modelling process.

Where activity splits have already been captured, e.g. Ellipse effort by activity / asset, these are also fed directly into the model process.

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 the allocation models these drivers are used to allocate costs to services.

Output from allocation models provides analysis of the full cost of services. These services have been structured to match E & M Table activity classifications, and therefore the output directly feeds these tables.

Non financial driver data is collected from a variety of corporate systems and input to relevant allocation model.

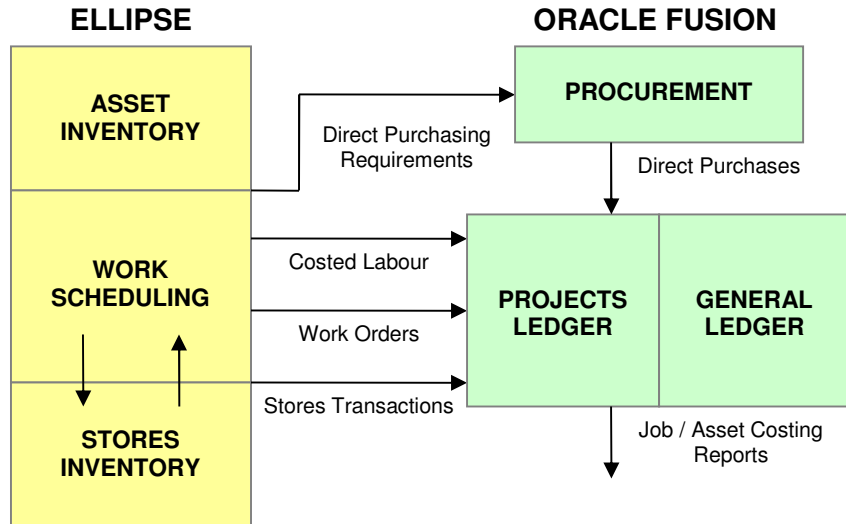
Driver Data Systems

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
- Oracle Fusion – Number of invoices, purchase orders, customer bills, man hours.

Ellipse / Oracle Fusion 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 Holdings Limited (SWHH) group of companies carry out the majority of Scottish Water Group non-regulated activities, excluding Business Stream. 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 Oracle Fusion. 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 2018/19 72% 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.