



Scottish Water

Trusted to serve Scotland

Annual Report and Accounts 2014/15

Serving Scotland
Delivering record
levels of service.



**Listening to
our customers**
Delivering our highest
levels of customer
satisfaction.



Our vital role

Scottish Water provides vital water and waste water services, essential to daily life, to 2.46 million households and 150,000 business premises across Scotland.

Every day we provide 1.34 billion litres of clear and fresh drinking water and take away 847 million litres of waste water, which we treat before returning to the environment.

The quality of drinking water received at customers' taps remains at an all-time high and our investment is helping to support jobs and the economy of Scotland, while protecting and enhancing the environment.

Our average household charges remain among the lowest in Great Britain – £39 lower per year than the average household charge in England and Wales.

We have been delivering one of the largest investment programmes in the UK water industry during 2010–15.

Customer charges go towards maintaining and improving:

29,986 miles of water pipes

249 water treatment works

32,007 miles of sewer pipes

1,826 waste water treatment works

Contents

Overview

Our vital role	
2014/15 Highlights	1
Chair's statement	2
Our strategy	3
Our vision	4

Strategic report

Chief Executive's statement	6
Our business model	7
Delivering Ministerial objectives 2010-15	12
Performance – Value for money	13
Performance – Customer service and satisfaction	14
Performance – Investment overview	16
Performance – Financial summary – group	19
Performance – Scottish Water regulated services	21
Performance – Business customers	23
Performance – Non-regulated businesses	25
Performance – Environment	26
People	29
Performance – Innovation	32
Looking ahead	34

Governance

Board members	36
Corporate governance	38
Audit committee report	43
Remuneration committee	47
Members' remuneration report	48
Members' report	59

Financials

Independent auditors' report	64
Consolidated income statement	70
Consolidated statement of comprehensive income	70
Consolidated statement of changes in equity	71
Company statement of changes in equity	71
Balance sheets As at 31 March 2015	72
Statements of cash flow	73
For the year ended 31 March 2015	
Notes to the financial statements	74
For the year ended 31 March 2015	
Direction by the Scottish Ministers	105

2014/15 Highlights

Leading customer service

Customer service levels reach new high

Best ever environmental performance

Continued investment to protect and enhance Scotland's environment

Investor in Young People award

More apprentices and graduates recruited as part of commitment to developing young people

The UK's most trusted utility

UK Customer Satisfaction Index survey shows Scottish Water is UK's most trusted utility

Great value for customers

Average household charges remain less than £1 a day*

A sustainable future

7 years of continual reduction in carbon footprint

* The average household is between Council Tax Band B and Band C and has a combined bill of less than £1 a day.

Chair's statement



Ronnie Mercer, Chair

Scottish Water has had another excellent year, and I am delighted to introduce our 2014/15 Annual Report and Accounts.

In the last year our employees delivered further improvements to water services in Scotland.

Their hard work, commitment and pride in delivering the very best services for all our customers, has helped us to achieve record levels of customer service and become the UK's most trusted utility.

Having gone from strength to strength in recent years, Scottish Water is now firmly established as one of the UK's top-performing water companies. I'd like to thank all our employees for their hard work and support in reaching this position.

Our customers are benefiting from an average household charge which continues to be lower than the average household charge in England and Wales.

In 2014/15, Scottish Water entered the final stages of our 2010–15 investment programme. This has seen £2.4 billion invested to enhance Scotland's water infrastructure. The programme has included the construction of new water treatment works and the upgrading of water mains and sewers. As well as improved services for our customers, this work has helped to protect and enhance the environment, while supporting vital jobs in construction and other industries.

It has been a pleasure to meet many of the customers and communities benefiting from this investment programme at events to mark the completion of projects around the country.

We are continuing to build an increasingly sustainable business. We have continued to develop our renewable energy portfolio with new wind, hydro and solar power schemes – helping to generate some of the energy we need to run our assets.

In November, the Water Industry Commission for Scotland published its Final Determination of charges. This will allow Scottish Water to build on the achievements of recent years, while ensuring customers continue to receive value for money and further service improvements. This followed publication of our 2015–21 Business Plan which, based on extensive customer engagement, sets out our plans to continue providing high quality services in the areas that matter most to our customers.

In the years ahead, Scottish Water will be taking actions to meet customer expectations of providing continuous, clear and fresh drinking water, at the lowest possible cost. A key aspect of this will be building increased resilience in our supply network so that our customers receive an even more reliable service. We remain committed to protecting and enhancing the environment, while supporting Scotland's economy and communities.

Elsewhere in the Scottish Water group, notwithstanding significant changes and challenges in an open and increasingly competitive market, our retail subsidiary Business Stream is continuing to deliver benefits to business customers. Business Stream is working hard to retain customers by offering innovation, tailored solutions and value for money. Business Stream has also been preparing for the full opening of the English retail market in 2017.

Having served the allowed 2 full terms plus an extra year as Chair of Scottish Water, I will retire at the end of May after 9 thoroughly enjoyable years. The people of Scottish Water are what make this job such a pleasure. I've seen such fantastic progress – building efficiency and improving service which means Scottish Water is now one of the highest performing water companies in the UK. I'm hugely impressed with the increasing focus on customers and how responsive, flexible and agile we have become.

While we have come a long way I know that this is a business which is not content to sit still – it wants to keep moving forward, which comes from the motivation of people across Scottish Water. Looking ahead, I know that the Board, leadership team and all our employees, are firmly focused on continuing to provide all our customers with a consistently high standard of service and great value for money.

I will be succeeded by Lady Susan Rice in June and I wish her every success as she takes up the role.

Our strategy

Scottish Water delivers clear and fresh drinking water, treats waste water and helps protect the environment across Scotland – every day of the year.

We do this in an affordable and sustainable way.

- We aim to put customers at the heart of our plans. Listening to customers' views and building these into our planning is part of an ongoing customer engagement process that allows us to ensure our customers' needs are at the heart of our service delivery.
- We aim to improve our services for customers. We know from our research that customers do not wish to see us compromise existing service levels. Our strategies are geared to help us achieve these aims and further improve our performance and efficiency.
- We aim to provide continuous clear and fresh drinking water, ensuring all our customers – regardless of where they live – can turn on their taps to receive a safe and reliable supply.

- We will work to protect and enhance the environment of Scotland, building on our record environmental performance to achieve further reductions in pollution and flooding.
- We will support Scotland's economy and communities, delivering improved water and waste water infrastructure while supporting employment and meeting new demand for our services.

This annual report highlights our progress during 2014/15. Information on our plans for service improvement from 2015–21 is included on page 34.

Our vision

Scottish Water's vision is to be trusted to care for the water on which Scotland depends. This is supported through 6 pillars:

Serving

Show our customers that we care, achieving year on year improvements in their experience of our service and by having a positive impact on customers and communities.

Strong

Work hard to keep customers' prices low, delivering savings to keep customer price increases below the overall level of CPI inflation.

Responsible

Always do the right thing for Scotland, providing ever better drinking water, implementing plans to boost water supply resilience to all major communities, fulfilling our environmental obligations and reducing our carbon footprint.

Leading

Shape our future for the benefit of customers; listening to our customers, being proactive, working with customers, landowners, local authorities and developers to deliver even more efficient services.

Growing

Enable a thriving Scotland, supporting developers as a leading infrastructure partner, seeking innovative and low cost solutions for businesses to grow in Scotland, and supporting an efficient supply chain through world class procurement.

Committed

Behave safely and have agile, healthy people and workplaces, building our skills and diversity to sustain high performance.

Strategic Report

Chief Executive's statement	6
Our business model	7
Delivering Ministerial objectives 2010-15	12
Performance – Value for money	13
Performance – Customer service and satisfaction	14
Performance – Investment overview	16
Performance – Financial summary – group	19
Performance – Scottish Water regulated services	21
Performance – Business customers	23
Performance – Non-regulated businesses	25
Performance – Environment	26
People	29
Performance – Innovation	32
Looking ahead	34

Chief Executive's statement



Douglas Millican, Chief Executive

Scottish Water has out-performed its key regulatory targets for 2010–15 and is now one of the UK's top performing water companies. Around the clock, homes and businesses in Scotland depend on us to provide clear and fresh drinking water and return waste water safely to the environment.

In 2014/15, customer satisfaction increased to a new record of 92.1%. Once again, we out-performed our regulatory performance target, achieving our best ever score of 400 on the Overall Performance Assessment (OPA). This represents an increase of 21% on the score achieved in the first year of our 2010–15 regulatory programme.

Strong overall financial performance has delivered a group surplus before tax of £110.7 million, an increase of £9.7 million from last year. Scottish Water's regulated surplus increased by £17.1 million to £77.1 million. Scottish Water's regulated surplus is all reinvested in the delivery of current and future services to customers. In 2014/15, we invested a further £470 million in improvements to vital water and waste water infrastructure.

Our continued investment has enabled us to sustain the highest ever level of drinking water provided to our customers. In 2014, 99.89% of samples taken at customers' taps complied with strict regulatory standards. We have also achieved our best ever environmental performance in the last year.

The safety and wellbeing of our employees is very important to us and I am pleased that our continued focus on health and safety has resulted in a 20% reduction in Lost Time Accidents. In 2014, we were awarded the industry health and safety management award by the Royal Society for the Prevention of Accidents (RoSPA) for the third successive year.

We continued to support the development of a low carbon economy in Scotland, growing our renewable energy portfolio with 40 of our treatment works now being either partially or fully self-sufficient in energy. During the year, we increased our installed renewable generation capacity by 60%.

2014 was a memorable year in Scotland with a number of high profile events, including the Ryder Cup and Commonwealth Games. We helped support these events by, for example, carrying out a number of projects in Glasgow to improve water and waste water infrastructure, which will also help to boost regeneration in areas of the city.

While we have made excellent progress, our customers expect us to stretch further. Recognising the trust that our customers place in us, we want every action to be geared to meeting our customers' expectations and being trusted by every customer and community. That's why, following research with our customers, we have updated our vision to be 'trusted to care for the water on which Scotland depends'. Our new vision is set to inspire and encourage all our people, and our delivery partners, to continually earn the trust of our customers.

In November 2014, the Water Industry Commission for Scotland published its Final Determination of charges. This determination confirmed the agreement that we reached with our customers, through the Customer Forum, for improving service while maintaining stable prices across the 2015–21 period. We are therefore committed to charges which reduce by 1.8% relative to inflation across the 6 year regulatory period, and to annual increases of no more than 1.6% in each year from 2014–18. This provides welcome certainty and clarity for our customers, and is a direct consequence of our extensive engagement with customers in recent years. Our average household charges continue to be among the lowest in Great Britain, and are £39 lower than the average in England and Wales.

Throughout 2014/15, we have put in place new investment planning and delivery arrangements to support our future success. We have strengthened our in-house service and investment planning capability while procuring 3 new investment delivery alliances that will each deliver part of our 2015–21 investment programme. We have also embarked on a programme to assess the resilience of all our major water supply systems to ensure that we have a comprehensive understanding of system risks that will inform future investment to boost the resilience of our major water supply systems.

Our achievements this year are all due to the hard work and dedication of our workforce and delivery partners across Scotland. On many occasions, our people have battled against difficult conditions to deliver great service to our customers, and I would like to thank each and every one of them for their contribution to Scottish Water's success in 2014/15.

Finally, I would like to thank Ronnie Mercer, our outgoing Chair, for his calm and wise leadership of our Board, and his extensive engagement with our many stakeholders since 2006. Ronnie has played a crucial role in our progress as a business and, on behalf of everyone at Scottish Water, I wish him every success for the future.

Our business model

Group overview

Our customers expect us to provide excellent customer service by delivering ever higher levels of water quality and environmental performance, all for an affordable price.

Our vision is, therefore, to be trusted to care for the water on which Scotland depends. To achieve this, the overarching strategy for the Scottish Water group of businesses is to provide levels of service and value for money which exceed the expectations of customers, regulators and the Scottish Government while ensuring we maintain our financial strength across all parts of the Scottish Water group.

Group structure

Scottish Water group principal activities during the year were the supply of water and waste water services to around 5 million customers in homes and businesses across Scotland covering an area of more than 30,000 square miles.

The 4 main trading businesses of the Scottish Water group are:

1. Scottish Water, which supplies households and wholesale licensed providers with regulated water and waste water services;
2. Scottish Water Business Stream Ltd (Business Stream), our licensed retail subsidiary which supplies water and waste water services to business customers;
3. Scottish Water Horizons Ltd (Horizons) which provides non-regulated services to customers; and
4. Scottish Water International Ltd (International) which provides non-regulated services to clients outside Scotland.

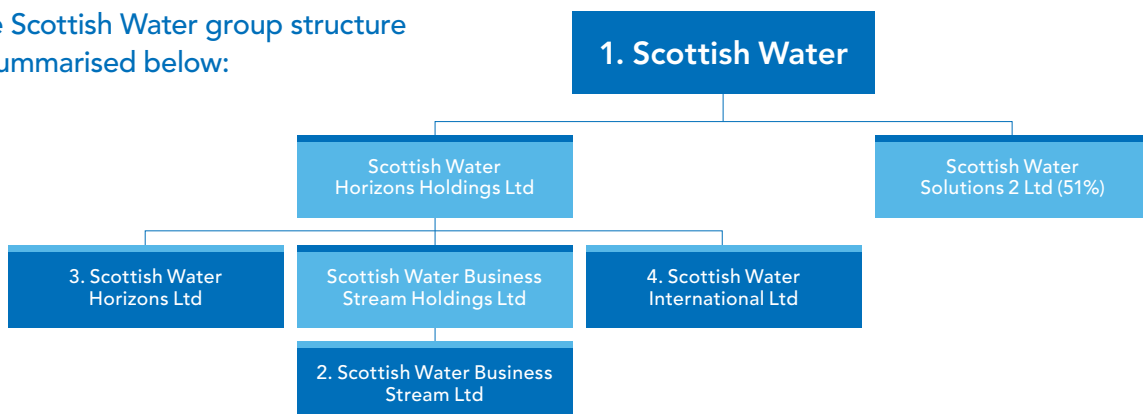
Scottish Water is a public sector body, classified as a corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers. The Members of Scottish Water’s Board are accountable to the Scottish Government. The Board includes 7 Non-executive Members.

Business Stream was formed in preparation for the opening of the Scottish retail market for water and waste water services to non-household premises to competition in 2008. As at March 2015, the company was one of the 18 (2014: 13) competing licensed retailers, while Scottish Water is the wholesaler to the non-household market. Business Stream is operated in accordance with the Governance Code (agreed with the Water Industry Commission for Scotland) which sets out the terms of separation to enable the operation of the licensed retail market for business customers. Business Stream has the same Chair as Scottish Water; however, it has its own independent Board and management team. The Board includes 2 independent Non-executive directors who have no other association with the Scottish Water group.

Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings Ltd (SWBSH). The Board of SWBSH has several directors in common with Scottish Water. The SWBSH Board reviews reports from Business Stream management covering financial performance, business specific risks, dividend policy and strategic plans.

Horizons is a commercial business enterprise, set up to deliver further value from Scottish Water’s considerable physical and intellectual asset base. It operates facilities to test innovation, as well as waste management, infrastructure development and renewable energy development services. Horizons is managed by its own Board of Directors, including 4 Non-executive directors, 3 of whom are senior managers in Scottish Water.

The Scottish Water group structure is summarised below:



International was established to develop business opportunities abroad using the skills and expertise in Scottish Water to offer specialist consultancy services to utilities, foreign governments and other international clients.

Strategic framework

Scottish Water operates within a broad strategic framework set by Scottish Ministers. The targets and milestones that Scottish Water has agreed to meet are set out in our Group Plan. The Group Plan also sets out the resources required and proposals for meeting and out-performing the regulatory targets and delivering on our growth ambitions. Scottish Water aims to maintain a level of financial strength that would be sufficient to enable it to secure commercial debt on cost effective terms, consistent with the Scotland Act 2012.

Scottish Water generates value for our customers by planning for, and delivering, continuous efficiency improvements in operational and capital investment activities associated with regulated water and waste water services. The efficiency improvements that have been agreed with our customers, through the Customer Forum, and assumed by the Water Industry Commission for Scotland in its strategic review of charges, are passed directly to customers through real reductions in water and waste water charges. The value generated by the out-performance of these efficiency targets is retained in Scottish Water until it is returned to customers through further improvements in service or real reductions in water and waste water charges at the next strategic review of charges, or earlier.

The profits generated from the other licensed and commercial activities are all retained within the group and invested in the future development of the business.

Financial framework

The Scottish Water regulated business is subject to incentive-based regulation by the Water Industry Commission for Scotland (the Commission).

In 2009, the Commission carried out a 5 year price review for the 2010–15 period, which caps the prices that Scottish Water charge for water and waste water services. The combination of regulated price caps and firm constraints on borrowing from the Scottish Government creates a clearly defined limit on the financing available to Scottish Water.

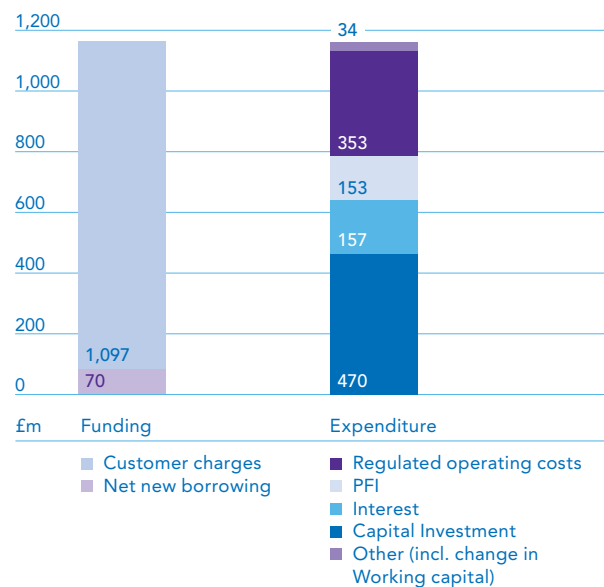
Within this financial framework, Scottish Water has an agreed Delivery Plan with Scottish Ministers that sets out Scottish Water's planned level of investment to deliver the required improvements and the expenditure to run our operation. Scottish Water's aim is to out-perform the targets set out in the Delivery Plan and thereby out-perform the regulatory contract.

The funding and expenditure model for Scottish Water's Regulated Services

Scottish Water is funded through revenue raised from customer charges and borrowing from the Scottish Government. These finance Scottish Water's capital expenditure programme, operating costs, PFI service fees and interest charges on its loans.

The diagram below illustrates Scottish Water's funding and expenditure for the year ended 31 March 2015. The surplus made by Scottish Water is reinvested in the provision of services to customers.

Scottish Water Funding and Expenditure 2014/15



Our approach to risk management, principal risks and uncertainties

Overview

Risk management is integral to Scottish Water’s achievement of our vision and delivery of Ministerial objectives. We recognise that risks, both positive (opportunities) and negative (threats) exist, and have the potential to impact on both the routine operations we undertake and services we provide to our customers. Risks have the potential to affect the achievement of our business objectives, ambitions and ultimately our corporate vision.

In order to efficiently and effectively manage opportunities and threats across the Scottish Water business, we embrace a systematic and structured approach to risk management. This method is based on the principles of the International Standard 31000 Risk Management (ISO 31000) and tailored to meet the needs of our business, the environment in which we operate and the people assuming the responsibilities.

Our approach is designed to provide assurance that the opportunities and threats facing the business are being appropriately identified, assessed and effectively managed; and that all necessary information is reported to the Executive Team, Audit Committee and Board.

Risk Management Approach

Scottish Water has an established risk policy which defines our risk appetite and sets out a clear and consistent approach to the management of risk. This is enabled by the Corporate Risk Register and supporting risk management processes. The Scottish Water Board, supported by the Audit Committee and the Executive Team, has responsibility for this risk management framework and undertakes regular reviews of the most significant risks and the associated strategies to manage risk. All risk management strategies are aligned to risk appetite to ensure the achievement of service delivery and business objectives.

Principal risks and uncertainties

The principal risks and uncertainties facing Scottish Water and its subsidiaries, at the time of this report are set out below. These are the risks that we presently consider to be the most material to our business and our performance at this time. There may be other risks that could emerge in the future. We have also commented on certain mitigating actions that are employed to manage these risks.

Scottish Water Regulated Services

Risk and Consequence	Mitigation
Operational	
Risk of provision of water to customers which has the potential to have an immediate impact on health	As a water utility company, provision of safe drinking water remains our highest priority. Scottish Water undertakes significant operational activity such as monitoring the water in our catchments, monitoring our treatment and distribution activities and carrying out tests on water quality to manage drinking water quality and minimise such risks. We also continue to deliver significant investment to further improve water quality.
Risk to service to customers arising from failure of a critical asset or assets	We operate and maintain significant numbers of assets across Scotland. There is a risk that a critical asset may fail. We seek to manage this risk by identifying critical assets, working to develop our knowledge and understanding of these assets and undertaking operational maintenance and emergency planning activities to minimise the risk of failure. We identify investment to reduce this risk for promotion in our future investment programmes.
Financial	
Scottish Water is engaged in a number of PFI contracts which provide a waste water service to a number of our customers. There is a financial and operational risk should a PFI project fail to deliver in accordance with the contract terms.	We mitigate this risk by maintaining ongoing strong relationships with the PFI companies and through close monitoring and management of PFI company performance. Contingency plans are developed for both the financing and operation of these contracts.

Investment	
Scottish Water delivers circa £500 million of investment every year to maintain and enhance our service to customers. With a programme of this size there is an operational and financial risk arising from contractors not fulfilling their obligations/liabilities.	We manage this risk by firstly assessing the risk in the capital project or programme and setting a procurement strategy for delivery. Contractors are engaged through a robust public procurement process which includes assessment and scoring against safety, quality, commercial and financial criteria. Appropriate contractual arrangements are put in place along with monitoring of our investment programme and ongoing monitoring of contractors performance.
Environmental	
Risk arising from non-compliance with the Urban Waste Water Treatment Directive.	We undertake significant operational activity such as monitoring of waste water treatment and discharges in order to protect the environment and minimise non-compliance risks. We also continue to deliver investment to further improve waste water quality.

In addition to the high impact risks above, we also actively manage a number of other high consequence but lower likelihood risks. Examples of these include:

- Operational and investment risk arising from infrastructure diversions required to facilitate major highway construction
- Investment and operational risk related to single source supply, particularly related to certain water treatment technologies
- Operational risk arising from odour management of waste water treatment works

- Operational risk arising from the rapid growth in the number of licensed providers active in the water retail market
- Operational risk arising from cyber-attack on key Scottish Water networks and/or systems

Notwithstanding our integrated approach to risk management, we acknowledge that we may not always be successful in fully mitigating all our known risks. In the event that such a rare issue occurs, service to customers could be affected. If this situation arises we will do everything we can to restore service promptly to customers.

Scottish Water Non-Regulated Services

Risk and Consequence	Mitigation
Business Stream	
Risk of increasingly competitive Scottish retail market	The number of licensed providers in the non-household retail market has increased from 13 to 18 this year leading to loss of market share and compression of margins. Business Stream is addressing this through development of innovative, tailored, competitive customer offerings, continuous improvement of customer service and focus on cost efficiency, all of which is to the benefit of customers.
Data Accuracy	The risk of incorrect market data impacts negatively on accuracy of customer billings and quality of customer service. Business Stream is engaged in a number of initiatives aimed at improving the completeness and accuracy of customer data.
Bad Debt Risk	Customer bad debts are an inherent risk for Business Stream. The risk is managed by production of accurate and timely billings, agreement of appropriate credit terms, constructive relationship management and effective credit control processes.
Development of the English market framework	The planned opening of the full English non-household retail market to competition in 2017 is a significant growth opportunity for Business Stream. There is a risk that Business Stream's growth ambitions will not be realised if the English market framework does not facilitate the creation of an effective competitive retail market with appropriate margins and a level playing field, or if market opening is delayed beyond 1 April 2017.

Risk and Consequence	Mitigation
Scottish Water Horizons	
Renewable energy	Horizons decision to invest significantly in renewable energy projects creates some exposure to volatile energy price markets and future investment decisions may be affected by changes in government policy. To mitigate this risk, projects, where possible, are fast-tracked to qualify for the fixed subsidy payments prior to any reduction. All investment decisions are subject to meeting specified hurdle rates.
Plant resilience	In order to reduce the risk of operational down time and process interruptions, we have been making further improvements to the Deerdykes Anaerobic Digestion Site. These, and the associated capital investment, should deliver an operation with a lower risk profile and improved financial and regulatory compliance.
Credit risk	The business can be exposed to credit risks where customers are unable to meet payments. When entering into business with a new customer, an extensive credit rating exercise is undertaken and appropriate safeguards put in place.
Testing innovation	The testing of new processes and procedures carries with it the potential for unexpected risk and this requires detailed planning, assessment and mitigating actions. A specialist test centre at Gorthleck has been designed and constructed in such a way that individual tests can be isolated, allowing new technology to be piloted within a safe environment.
Scottish Water International	
Contract performance shortfall	International makes regular checks of client satisfaction with service and responds to feedback to ensure that contract requirements are delivered.
Financial performance shortfall	International has recruited a diverse group of consultants from the Scottish Water business, and has developed a marketing strategy to minimise the risk of operating at a loss.
Exchange rate risk	International is exposed to the risk of currency fluctuations, as most of its contracts are denominated in local currency. It has reviewed policies on the maintenance of cash balances overseas to reduce the risk of future exposures.
Credit risk	International's major contracts are either sub-contracts with large international companies which have a good credit rating and a good relationship with Scottish Water, or are with major municipal authorities with auditable financial strength.

Delivering Ministerial objectives 2010-15

Scottish Ministers set objectives for Scottish Water for the period 1 April 2010 to 31 March 2015. This annual report looks at the fifth and final year of the delivery period 2010–15.

We have been continuing to improve the level of service to our customers and our delivery plan detailed the specific outputs required. These were agreed with the Drinking Water Quality Regulator (DWQR) and the Scottish Environment Protection Agency (SEPA).

These outputs will deliver real benefits to our customers across Scotland – clearer, fresher drinking water at their taps, protecting the natural environment and improving service levels.

To individual customers, this could mean reducing the risk of low pressure which can affect the water-using appliances in their homes, addressing odour issues from waste water treatment works in their local area or reducing the number of customer properties at risk of flooding from overloaded sewers.

We have been delivering benefits to our customers by improving operational practices and processes, maintaining our existing assets and investing in new or enhanced assets.

Across Scotland, we are listening to the needs of communities and delivering investment in the water and waste water networks where it is most needed.

The objectives we were set for 2010–15 included:

- Improving the quality, look and taste of drinking water for around 950,000 customers through a mixed programme of cleaning, upgrading or replacing 2,816 miles of water mains.
- Investing £1.2 billion to ensure, as a minimum, that the standards of service provided to our customers are maintained across Scotland.
- Continuing to service new development across Scotland and address water and waste water capacity to allow further growth.

- Continuing to protect Scotland's natural environment by enhancing the waste water treatment processes at 182 works and making improvements at 223 unsatisfactory intermittent discharges to rivers, lochs and coastal waters.
- Reducing odour issues at 4 waste water treatment works.
- Creating and maintaining a register of all properties affected by external sewer flooding.
- Reducing the number of customer properties that have problems with poor water pressure.
- Improving the water supply and demand balance to provide security of supply for over 800,000 customers.

We have been taking steps to deliver a lower carbon water service by reducing consumption of energy, driving energy efficiency and developing our renewable energy capacity.

Our objectives for 2015–21 have now been set, and more information on our plans for the future can be found in the Looking Ahead section on page 34.

Performance

Value for money

Scottish Water customers continue to benefit from an average household charge which is less than £1 a day*.

In April 2015, Scottish Water charges increased for only the third time since 2009. This was limited to an increase of 1.6% – around £6 a year for the average household. It means the average Scottish Water household charge in 2015/16 is £346. This is £39 lower than the average charge in England and Wales.

Income from customer charges will help pay for £3.5 billion investment by Scottish Water in the next 6 years which will further improve clear and fresh drinking water, protect the environment and support the economy and jobs in the construction sector. In the 2010–15 period Scottish Water's charges reduced by 10% relative to the rate of inflation.

At the start of each regulatory period, the Water Industry Commission for Scotland (WICS) sets price limits which enable Scottish Water to deliver Ministerial objectives at the lowest reasonable overall cost for the benefit of customers.

In November 2014, the WICS published its Final Determination of the charges that will apply for water and waste water services from 2015 to 2021.

This Final Determination stated that, in the 6 year period from 2015–16 to 2020–21, Scottish Water charges must increase by no more than 1.8% below the Consumer Prices Index (CPI) rate of inflation.

In the first 3 years from 2015–16 to 2017–18, Scottish Water household charges will increase by 1.6% per year in nominal terms.

This reflected an agreement Scottish Water reached with the Customer Forum for water in January 2014, based on extensive customer feedback about Scottish Water's future priorities. The agreement is focused on providing price certainty and stability for customers.

Comparison with English and Welsh water companies based on OFWAT published average charge

Water and Sewerage Companies	Average household bill 2015/16
South West	£482
Wessex	£460
Welsh	£435
United Utilities	£411
Southern	£410
Anglian	£402
England & Wales average	£385
Northumbrian	£371
Thames	£367
Yorkshire	£360
Scottish Water	£346
Severn Trent	£329

* The average household is between Council Tax Band B and Band C and has a combined bill of less than £1 a day.

Performance

Customer service and satisfaction

Scottish Water is now the UK's most trusted utility¹, with customer satisfaction in the services we provide reaching record levels².

Our customers have wanted to see better service at a lower cost – and we have delivered on both counts.

We are firmly focused on providing a consistently high standard of service for all of our customers, by putting customers at the heart of everything we do and fulfilling the trust placed in us.

We use a measurement known as the Overall Performance Assessment (OPA), which includes a range of indicators, to determine how well we are performing for the benefit of customers. We agreed challenging targets with our regulator – the Water Industry Commission for Scotland – in order to meet the Scottish Government's expectation of improved customer service.

In the first year of the 2010–15 regulatory period we achieved an OPA score of 330. By the end of 2014/15 we had achieved a score of 400 – an increase of 21% since year one and 20 points above our regulatory target. We have become one of the UK's top performing water companies, providing a leading service.

The fact that we have continued to out-perform our OPA target year on year, while household charges have remained lower than the average charge in England and Wales, demonstrates that we are delivering one of the best value services for customers in the water industry.

Since 2010, we have surveyed customers who have been in touch with us after their contact has been resolved to get their views on how we performed. In the first year, customer satisfaction using this measurement was 80.2%. In 2014/15, customer satisfaction reached a new high of 92.1%. Complaints have continued to fall, with a 29% reduction in the last year and a 64% reduction over the course of the 2010–15 regulatory period.

We also saw a 13% reduction in the number of customer telephone contacts in 2014/15, meaning we have seen a 50% reduction over the full period. This reflects our work to further improve service through capital and operational investment, meaning fewer customers have needed to contact us.

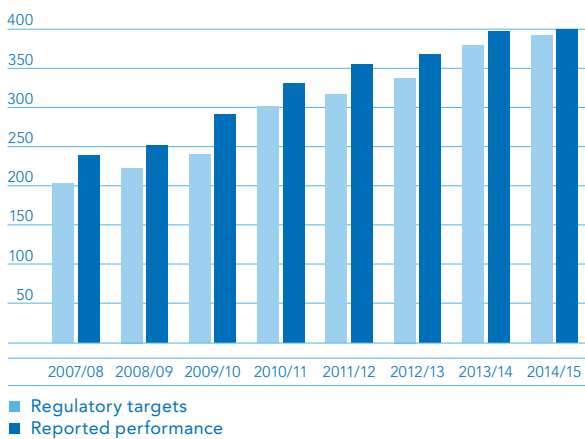
We are now using a new multi-channel system, which provides daily access to customer feedback. This means that we can now carry out surveys using different channels – including by email, telephone or SMS text message. This provides easy and accessible ways for customers to provide their views on the service they have received. We are also developing a new Customer Experience Measure (CEM) which will help to ensure a continued focus on improvements in service in the right ways, at the right times and in the right places.

More and more customers are choosing to find out information about services using digital media, and our customer service Twitter account now has more than 12,500 followers – an increase of 48% in the last year, and we have received 8,824 Tweets, an increase of 63% on the number received a year earlier.

¹ Results from the Institute of Customer Service in January 2015 show that satisfaction with Scottish Water has increased by 3 points, to its highest level. Results from the UK Customer Satisfaction Index in January 2015 also showed that we are the UK's most trusted utility.

² A survey of 40,336 customers who have been in touch with us showed that, in 2014/15, customer satisfaction reached a new high of 92.1%.

Overall Performance Assessment



A number of service improvements were achieved in 2014/15:

- We reduced the number of environmental pollution incidents by 5.66% on last year.
- We reduced the number of aggregate properties affected by interruptions to supply lasting longer than 6 hours by 1,655 – a 15.66% improvement from last year.
- We continue to ensure no customer restrictions on water use by maintaining water supplies at all times.
- We reduced the percentage population equivalent affected by non-compliant waste water treatment works from 0.29% to 0.25%.
- We have scored maximum OPA points for sludge disposal by ensuring all our sludge is treated according to regulations.
- The number of internal flooding incidents from main sewers due to heavy rain decreased by 17%. The number of internal flooding incidents from main sewers due to other causes decreased by 23%.
- We scored maximum points on the Assessed Customer Service indicator, which takes into account our performance on customer specific activities such as our Additional Support Register, Supply Pipe Repair Policy and Compensation Policy.

In 2015/16, we will continue to build on these successes to make further improvements to the services our customers receive.

Performance

Investment overview

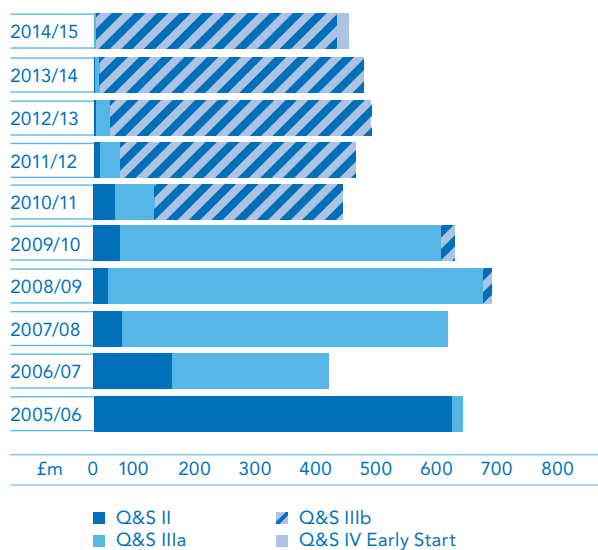
The fifth and final year of Scottish Water's 2010–15 investment programme saw £470 million of investment in regulatory improvements to Scotland's essential water and waste water infrastructure.

Across the 5 years, around £2.4 billion has been invested in the upgrading of treatment works, water mains, sewers and networks. This has seen the successful delivery of more than 3,300 capital projects ranging in size from the modernisation of pumping stations in the Scottish Borders and Highlands, to a major new water treatment works that serves Edinburgh and extensive upgrades to water mains.

The involvement of supply chain partners, contractors and construction companies in many of these projects has helped sustain employment opportunities and support local economies.

We have continued to invest in research and innovation across core aspects of our water and waste water services, which will increase in the next regulatory period. We have, for example, developed a range of standardised equipment to achieve benefits such as reduced design and site commissioning time, less disruption to customers, higher build quality, reduced health and safety risk and lower costs.

Total Quality and Standards (Q&S) Capital Investment



For 2014/15, £469.9 million is split £436.5 million for Q&S IIIb, £1.3 million for Q&S IIIa, £0 million for Q&S II and £32.1 million for Q&S IV.

Drinking water quality standards

In 2014/15, we invested £40 million to continue providing a high standard of drinking water to 2.45 million households throughout Scotland.

In the Scottish Borders, we opened a new £1.8 million water treatment works to provide clear and fresh drinking water to the communities of Innerleithen, Walkerburn and Cardrona.

In Fife, we completed a £4 million project to deliver an increasingly reliable supply of water to thousands of customers. This involved the creation of a new transfer pipeline which can pump up to 25 million litres of water a day – enough to fill 10 Olympic-sized swimming pools – eastwards from the Ochil Hills to the water treatment works at Glendevon.

Environmental quality enhancements

To ensure we continue playing a key role in protecting the natural environment of Scotland, we invested £65.6 million on waste water treatment works and infrastructure.

We completed a £1.8 million package of improvements to our waste water infrastructure in Gourrock to improve the environment and tackle sewer flooding.

In the Highlands, customers in Kingussie are now benefitting from a £4 million waste water treatment works which will ensure the ongoing protection of the River Spey as a Special Area of Conservation (SAC) and help support development and economic growth in the area.

Enabling growth and development

We invested £35.1 million to increase capacity in our infrastructure and at water and waste water treatment works, as well as reducing water leaking from pipes. This helps support economic growth and development of communities across Scotland. This included investment at waste water treatment works in Kingussie, Kinross and Alyth.

Capital maintenance

We invested £266.5 million in the maintenance of treatment works and infrastructure to help sustain high levels of performance for our customers. This included investing £8.9 million on the completion of a filter replacement programme at our water treatment works to ensure the continued delivery of high clear and fresh drinking water to our customers.

We have also delivered £9.5 million of replacements to manhole covers on roads across Scotland.

Service improvements

Investment of £29.4 million was provided to help improve service levels for customers, such as reducing the number of customers affected by low pressure.

In 2010–15 we have been carrying out a £37 million hydro generation programme which involves the installation of hydro turbines to generate electricity at a number of water treatment works around Scotland. A further £13.9 million was invested in this in 2014/15.

Completion programme

We invested £1.3 million in our completion programme to deliver the small number of remaining projects from the previous Q&S II and Q&S IIIa programmes. These programmes are now substantially complete with only one project outstanding. We plan to have this concluded in the coming year.

Q&SIV early start

We invested £32.1 million in early start projects ahead of the upcoming 2015–21 capital programme. In particular we invested £13.9 million in advancing a number of projects to protect our customers from sewer flooding.

We are continuing to progress with our £250 million, 5 year programme of work we announced in February 2013 which will continue to improve river water quality and the natural environment of the River Clyde and its tributaries, enable the Greater Glasgow area to grow and develop, alleviate sewer flooding and deal with the effects of increased rainfall and climate change. Projects completed as part of this programme in the last year included work to address flooding in the Shettleston and Temple areas of the city.

The table below shows the performance highlights delivered in 2014/15.

Targets specified in Ministerial Objectives

	Actual 2014-15	Cumulative Values 2010-15	Ministerial Objectives 2010-15
Customer service			
Number of sites where odour is reduced	0	4	4
Number of properties removed from low pressure register	69	2,540	2,309
Number of properties removed from low pressure register (exclusions under Water (Scotland) Act 1980)	10	546	128
Number of properties alleviated from external sewer flooding	0	68	68
Growth			
Water strategic capacity (population equivalent)	0	52,210	- ¹
Waste water strategic capacity (population equivalent)	7,577	36,219	- ¹
Drinking water quality			
Number of water treatment works receiving improved disinfection controls	4	28	28
Number of zones with reduced lead levels	1	62	64
Number of backflow prevention devices installed	1	268	268
Number of sites covered by drinking water safety plans	0	196	174
Environment			
Number of unsatisfactory intermittent discharges improved (excluding 7 stage)	3	24	24
Number of unsatisfactory intermittent discharges improved (7 stage)	55	126	196
Number of waste water treatment works' discharges improved to meet new licence requirements	11	57	78
Number of waste water treatment works upgraded to meet existing licence requirements	2	24	24
Number of waste water pumping stations upgraded to comply with existing licence requirements	1	20	20
Number of waste water treatment works brought into compliance with licence non-sanitary requirements	21	81	83
Number of waste water network assets made compliant with licence requirements	35	224	224

¹ Scottish Water is required to provide new strategic capacity to meet all new housing development and the domestic requirements of commercial and industrial customers.

We are now looking forward to delivering our £3.5 billion 2015–21 investment programme. To achieve this we have developed a new delivery model which involves working in partnership with 3 new alliances to deliver both maintenance and improvements to our existing assets.

Caledonia Water Alliance, a partnership of Morrison Utility Services and Aecom, is our water infrastructure alliance partner. They will be responsible for the delivery of investment projects to improve our water supply networks.

aBV Alliance, a partnership of Black and Veatch and Byzak (part of Amey), is our waste water infrastructure alliance partner. They will be responsible for investment projects to improve our waste water networks.

Efficient Service Delivery (ESD), a joint venture between Galliford Try, MWH Treatment and Black and Veatch, has been named as our non infrastructure alliance partner. ESD will oversee the delivery of projects including work on reservoirs, water treatment works and pumping stations, which will help build on the significant improvements made to water services for the benefit of Scottish Water customers in recent years.

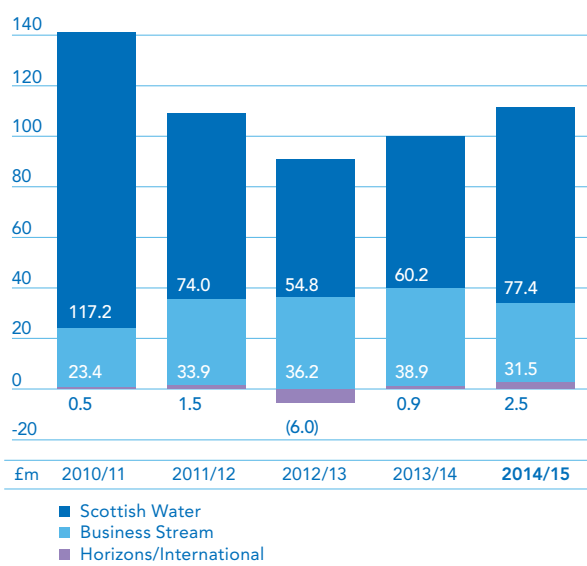
We are also developing rural frameworks which will allow us to work with smaller contractors to ensure efficient delivery of improvements to our assets at a local level.

Performance

Financial summary – group

The group surplus before tax for the year to 31 March 2015 was £110.7 million (2014: £101 million). The chart below illustrates the group surplus before tax by entity covering the 2010 to 2015 regulatory period.

Surplus before tax by entity



The split of the group surplus over the period reflects the impact of below inflation price increases for Scottish Water customers. The increased competition within the business retail sector has reduced Business Stream’s share of the group surplus to 28.3% in 2014/15. Horizons and International share of the surplus has grown from 0.3% in 2010/11 to 2.2% in 2014/15.

Further coverage of the financial performance by entity is shown on pages 21 to 25.

Consolidated revenue in the year increased by £7.7 million to £1,187.4 million (2014: £1,179.7 million). This benefit was partly offset by a £2.1 million increase in costs to £890.1 million (2014: £888 million). Net finance costs of £186.6 million were £4.1 million lower than in 2014.

In the year, consolidated net debt decreased by £4.8 million to £2,932.9 million (2014: £2,937.7 million). The decrease was driven by additional borrowing from the Scottish Government of £70 million, with cash balances increasing by £74.8 million to £491.4 million. The movement in cash is summarised below:

	Scottish Water £m	Business Stream group £m	Horizons & SW International group £m	Total £m
Opening balance at 1 April 2014	270.3	129.8	16.5	416.6
New loan from Scottish Government – net	70.0	–	–	70.0
Cash generated/ (utilised)	5.1	(16.7)	16.4	4.8
Closing balance at 31 March 2015	345.4	113.1	32.9	491.4

Cash balances within Scottish Water increased by £75.1 million to £345.4 million. Since the year end, £237.4 million of borrowing has been repaid by Scottish Water leaving a balance that equates to approximately one month’s expenditure. Cash balances are planned to be consumed significantly over the period to March 2021 under the agreed Delivery Plan.

Cash balances within the Business Stream group of companies decreased by £16.7 million over the year to £113.1 million primarily due to the lower level of prepayments made by business customers associated with 2015/16.

Borrowing limit

Scottish Ministers set Scottish Water’s (consolidated) maximum net new borrowing limit at £70 million for 2014/15. Actual net new borrowings in 2014/15 were £70 million.

Taxation

The consolidated tax charge on the income statement was £19.7 million (2014: £64.5 million credit). Other taxes incurred by the group, and included in the cost base, totalled £78.2 million (2014: £75.2 million) and are summarised in the table below:

	2014/15 £m	2013/14 £m
National insurance	9.9	9.5
Local Authority rates	61.8	60.1
Carbon reduction commitment	4.2	2.9
Landfill tax	2.3	2.7
Normalised annual cost	78.2	75.2

Group pension arrangements

Scottish Water is a participating employer in the Local Government Pension Schemes (LGPS) across 3 funds – Strathclyde Pension Fund, the North East Scotland Pension Fund and the Lothian Pension Fund. These funds are administered by Glasgow, Aberdeen and Edinburgh City Councils respectively. Business Stream is a participating employer in the Strathclyde Pension Fund.

The administering authority for each fund is required to conduct a triennial valuation of the assets and liabilities of the fund in line with LGPS regulations. This must be conducted by a qualified actuary. The purpose of the valuation is to review the financial position of the fund and specify the employer contribution rates for the next 3 year period. The last full actuarial valuations were carried out as at 31 March 2014 and were updated at 31 March 2015 by a qualified, independent actuary, to take account of the requirements of IAS 19 'Employee Benefits'.

Under IAS 19 a snapshot is taken of pension fund assets and liabilities at a specific point in time. Movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities. At 31 March 2015, after taking account of deferred taxation, there was a shortfall of assets over respective liabilities of £161.1 million (2014: £109.8 million). Further detail is included in note 22 to the financial statements.

Performance

Scottish Water regulated services

Financial performance for the Regulatory Period

In 2009 the Water Industry Commission for Scotland (the Commission) carried out a 5 year price review for the 2010–15 period. Its Final Determination capped the prices that Scottish Water charge for water and waste water services.

The Final Determination is the baseline used by the Commission to determine Scottish Water’s performance over the 2010–15 period. This together with firm constraints on borrowing from the Scottish Government, defines the funding available for the regulatory period. Scottish Water then agreed a Delivery Plan with Scottish Ministers which set out the planned investment and operating costs to deliver service improvements for customers.

The Final Determination forecast that Scottish Water’s revenue over the 2010–15 period would be £5.3 billion and that Scottish Water’s net debt at the 31 March 2015 would be £3,565 million.

Actual funding for the 2010–15 period was lower than the Final Determination due primarily to household charges being held at a lower level, enabling an overall real reduction in household prices of 10.2% compared to the planned reduction in the Final Determination of 5%. While outturn indexation relative to the level assumed in the Final Determination lowered the cost of capital investment this was partially offset by adverse non-domestic rates and carbon charges that occurred after the Final Determination.

An assessment of Scottish Water’s out-performance against the Final Determination will be submitted to the Commission in June 2015, and its conclusions will be published later this year.

Financial performance

The surplus before tax in the year for Scottish Water was £17.1 million higher at £77.1 million (2014: £60 million). This surplus is used to fund the capital investment programme and customer service improvements, as demonstrated in the chart on page 8.

Regulated revenue

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

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

Revenue from services supplied to household customers increased by £21.9 million to £800.8 million reflecting the 1.6% tariff increase, effective from 1 April 2014, and the increase in connected properties. Revenue from wholesale services supplied to Licensed Providers decreased by £4.4 million or 1.5% to £289.2 million reflecting the planned reduction in wholesale tariffs. Revenue from other sales increased by £1.2 million to £6.9 million.

Operating costs

Total operating costs increased by £5.2 million to £832 million (2014: £826.8 million).

Headline regulated operating costs for Scottish Water decreased by £11.9 million to £353.1 million. The decrease was primarily due to a £14.5 million reduction in local authority rates charges, reflecting a one-off refund associated with a successful revaluation appeal. After adjusting for this, the movement in landfill taxes and the increase in energy and carbon prices, like-for-like costs, as planned, increased in real terms by 1.6% or £4.9 million. The planned increase reflected the uplift in household income collection charges from Scottish Councils, additional funding to improve data quality processes in the wholesale arena and improvements to water quality processes.

The operating cost of the PFI schemes in the year, including associated depreciation and amortisation charges, was £130.2 million, £3 million higher than in 2013/14. The increase was attributable to the annual indexation of service costs of £1.4 million and the higher volumes of waste being treated by the PFI schemes.

Depreciation and infrastructure maintenance costs increased by £27.3 million to £361.8 million (2014: £334.5 million). Infrastructure maintenance costs, as planned, were £24.4 million higher than last year, reflecting the phasing of the planned maintenance investment programme for infrastructure assets across the 2010–15 regulatory period. Non-infrastructure depreciation charges increased by £2.8 million due to the profile of capital investment. The gain on asset sales was £0.4 million higher than in 2013/14.

Capital investment

Reported capital investment under IFRS for Scottish Water in the year was £317.7 million (2014: £354.8 million). However, 2014/15 capital investment, as measured on a regulatory accounting basis, was £470 million (2014: £475.2 million). The table below reconciles investment as stated in the statutory accounts with investment on a regulatory accounting basis.

	2014/15 £m	2013/14 £m
2014/15 investment on a regulatory accounting basis	470.0	475.2
Less base infrastructure maintenance included in operating costs under IAS 16	(136.2)	(111.9)
Less investment financed by infrastructure charges & contributions	(27.2)	(13.2)
Add PFI capital additions	11.1	4.7
Company capital additions per note 9 to the financial statements	317.7	354.8

Finance costs

As at 31 March 2015, the weighted average interest cost of the outstanding long-term debt reduced to 4.86% (2014: 4.93%). Net interest payable increased £0.7 million to £156.6 million reflecting increased borrowings over the year. Interest charges are analysed as follows:

	2014/15 £m	2013/14 £m
Scottish Consolidated Fund	99.5	94.8
National Loans Fund	45.8	46.2
Public Works Loan Board	12.0	14.9
Other – net	(0.7)	–
Net interest payable	156.6	155.9

Finance costs associated with finance lease liabilities on PFI assets and the interest on pension scheme net liabilities decreased by £5.7 million to £29.8 million (2014: £35.5 million).

During the year, net debt decreased by £5.1 million to £3,078.9 million (being loans of £3,424.3 million less cash balances of £345.4 million). The decrease was driven by a £75.1 million increase in cash balances, partly offset by a £70 million increase in borrowing from the Scottish Government.

Principal risks and uncertainties

Scottish Water has established a risk policy that sets out a consistent approach to the management of risk and the Board has defined its risk appetite. Details of our approach to risk management and principal risks and uncertainties are set out on pages 9 to 10.

Performance

Business customers

Scottish Water actively facilitates all entrants to the competitive water market in Scotland as the wholesale supplier of water and waste water services.

Wholesale services

The retail market for water and waste water services to non-household premises is open to competition, giving the customer choice of provider. In the case of non-household premises, Scottish Water acts as the wholesaler, providing water and waste water services to Licensed Providers who, in turn, provide services to non-household premises.

During the 2014/15 financial year, the number of companies licensed to provide water and waste water services to business customers in Scotland increased from 13 to 18. A full list of providers licensed to sell to business customers is available on the website of the Water Industry Commission for Scotland or the Scotland on Tap website.

Scottish Water has actively supported the development of the market throughout the financial year, making a number of change proposals which were approved and implemented.

The 2 incentive schemes relating to vacant sites, namely the Vacancy Charging Admin Scheme and the Vacant Properties Incentive Scheme, continue to have a beneficial impact on the market.

A change to the Gap Site Incentive Scheme was implemented in March 2014.

The Open Water programme aims to facilitate the implementation of market reform in the water sector in England. Scottish Water participated in the Open Water Programme Development Board and a number of workshops, as well as in more detailed experience-sharing meetings. This has also been supported through the secondment of a Scottish Water General Manager.

Business Stream

Business Stream is Scottish Water's licensed retail subsidiary, which supplies water and waste water services to business customers and public sector organisations in Scotland and to a limited number of sites in England.

Business Stream offers a wide range of water and waste water management services, including water audits, waste water treatment, new connections, trade effluent, treatment hire kit and automatic meter reading.

Competition in the industry has intensified this year, with 18 licensed providers now operating in the market. Business Stream has worked hard to retain customers by offering them innovative, tailored solutions and value for money.

By introducing innovative services, supported by continued investment in customer service improvements, Business Stream has steadily increased customer satisfaction levels over the past 7 years. This year it launched a myBusinessStream app and an end of call satisfaction monitoring tool using the market leading service, Rant and Rave.

Performance review

2014/15 was the most challenging year to date, due to the increasingly competitive landscape. Notwithstanding this Business Stream's performance remains strong. Profit before tax in 2014/15 was £31 million. Although this was lower than last year (£38.3 million) it was in line with expectations. An additional £6.5 million of gross profit was returned to customers this year in the form of increased discounts.

The gross profit from Business Stream's solutions business, which provides water and waste water advice and services to a range of customers across the UK, increased by 5.5% from last year.

Improving economic conditions, coupled with improved internal processes resulted in a £2 million, or 9% reduction, in aged debt.

Administrative costs reduced by £5.8 million from last year, largely due to lower bad debt charges.

Strong cash flow performance enabled Business Stream to repay £23 million of debt in the year which reduced net interest payable by £0.4 million relative to 2013/14.

Future developments

The outcome of the contract for the provision of water and waste water services to Public Sector bodies in Scotland, which accounts for around 25% of Business Stream's revenue, has still to be determined. In the interim period, Business Stream has been granted a 3 month extension until the 30 June 2015.

Although the market in Scotland is fully open to competition, it will be at least 2 more years before the retail market opens in England. As a consequence, competitors continue to mobilise and look to take market share in Scotland at a time when Business Stream is unable to replace lost profits due to the current market constraints in England.

At this point in time there is still a number of 'unknowns' regarding the English market which may impact on Business Stream's corporate strategy. These include: the mechanisms for ensuring a level playing field; the creation of a set of common standards to help create a single, unified market; and whether the retail margins will be set at a level which enables retailers to enter the market to deliver benefits to customers including reduced charges, service enhancements and innovation. Business Stream is proactively engaging with key stakeholders to seek resolution on these issues. After opening fully to competition, the English market represents a significant opportunity given its market size of circa £2 billion.

Principal risks and uncertainties

Details of our approach to risk management and principal risks and uncertainties is set out on page 10.

Performance

Non-regulated businesses

Horizons

Scottish Water Horizons uses innovative ideas, knowledge and Scottish Water assets to encourage economic growth and the use of sustainable technologies across Scotland.

The activities of Horizons are aligned to support Scottish Water's core objectives, with particular emphasis on supporting Scottish Water's innovation agenda and renewable energy projects. The focus of the business is to identify, develop and deliver innovative, profitable and sustainable growth opportunities for Scottish Water that maximise commercial gain for the Scottish Water Group from Scottish Water's intellectual and property assets. In doing so, Horizons contributes to Scottish Water's key stakeholder requirements including Scottish Government initiatives such as Zero Waste and the Hydro Nation agenda.

Horizons' working capital requirements are financed by organic cash flow, loans from Scottish Water Horizons Holdings Ltd, grant funding and asset disposals.

The principal activities conducted during the year included capital investment in renewable energy technology, waste management and water and waste water infrastructure development and consultancy services.

Performance review

Horizons continued to build on the opportunities identified during the strategic review carried out in 2013/14 returning a profit before tax for the 2014/15 financial year of £2 million (2014: £0.7 million). Horizons also performed well during the year against the key performance indicators set by the Horizons Board. Some highlights from the year include:

- The third party waste business performed extremely well during the year, doubling sales volume;
- Invested £2.5 million in renewable energy schemes;
- The food waste recycling service continued to develop over the year and supplied around 12% of food waste into the Deerdykes Anaerobic Digestion (AD) site; and
- The development of a water innovation testing facility at Gorthleck treatment works, near Inverness, with plans now in place for a similar facility focussed on waste water at Bo'ness. These will be used to test new products and processes associated with the treatment of drinking water and waste water.

International

Our International subsidiary was established in 2012 to develop business opportunities abroad using the skills and expertise in Scottish Water to offer specialist consultancy services to utilities, foreign governments and other international clients.

Scottish Water International is well placed to support public utilities and governments because it can export the learning experiences of Scottish Water in the fields of: public sector ownership; independent economic regulation; and major transformation of service and efficiency. International also contributes to Scottish Water's key stakeholder requirements including the Scottish Government's Hydro Nation agenda.

Performance review

In 2014/15, International's third year of operation, the company made a profit before tax of £0.4 million (2014: loss of £0.2 million), clearing all previous years' start-up trading losses. This performance reflects growing recognition of International's capability and expertise and was achieved through a strong portfolio of assignments.

During the year, International continued with its major assignment in Qatar where it is helping to oversee management of a 5 year programme to transform drainage and waste water services. International also completed its first assignment for the City of Calgary within its Water Services unit. In addition, International provided advice and support for the creation of Irish Water, Ireland's new water utility, to help develop its operations and maintenance functions.

Principal risks and uncertainties

The management of the businesses and execution of strategy are subject to a number of risks. Risks are formally reviewed by the boards of Horizons and International and the appropriate processes put in place to monitor and mitigate them. These are set out on page 11.

Performance Environment

In providing our essential services, Scottish Water depends on and contributes to a high-quality natural environment.

In the first instance, we take water from our supply sources, before treating it to the highest standard and ensuring it is ready for customers to drink and use. We then collect and treat waste water, before safely returning it to the environment. As a result, we have a fundamental interest in protecting and enhancing Scotland's natural environment.

Improving services

Drinking water quality

Throughout 2014, we carried out over 318,000 quality tests on regulatory samples from our water treatment works, service reservoirs and customers' taps across Scotland.

Of these samples, 99.90% of all tests met the strict microbiological and chemical regulatory standards. While this is a small reduction from 2013, the level is higher than in every other year. Meanwhile, the quality of water at customers' taps remains at the high level achieved in 2013 of 99.89%.

We have been making extensive improvements in water supply networks and treatment processes. We have also been improving the appearance and taste of drinking water for our customers.

We continue to work to ensure all our customers can enjoy the look and taste of their clear, refreshing Scottish drinking water.

Clear, fresh drinking water – water quality

Overall compliance with microbiological and chemical standards.

2014	99.90%
2013	99.91%
2012	99.88%
2011	99.86%
2010	99.86%
2009	99.83%
2008	99.81%
2007	99.81%
2006	99.76%
2005	99.64%
2004	99.57%
2003	99.44%
2002	99.36%

Sustainable land management

Our work on Sustainable Land Management (SLM) helps to protect and improve source water quality in our drinking water catchments.

During 2014/15 we visited catchments that supply 24 water treatment works to assess and report on the condition of the land around watercourses and make suggestions to improve source water quality. Our SLM Incentive Scheme, launched in 2012, provides financial assistance to improve and protect source water quality within a catchment. There are currently 9 catchments across Scotland where land managers are eligible to apply, with 98 applications approved so far.

In 2014/15 we responded to 174 consultations and notifications on activities that take place within the vicinity of our drinking water sources, including new developments, forest management and the aerial application of pesticide. We continue to work in close partnership with a number of agencies to deliver sustainable land management and ensure that source water quality is protected and the status of the environment is enhanced.

Leakage management

Water is a precious resource and considerable effort has been put into minimising leakage from our network of almost 30,000 miles of water pipes in recent years. We respond to reported bursts as quickly as possible and work to detect and fix underground leaks. In 2014/15 reported leakage was reduced by over 20 million litres a day – out-performing our target by 9%. This means that, since the introduction of a targeted approach in 2006, leakage has been reduced by one half. As a result we continue to operate in the economic level of leakage range – the point where the cost of reducing leakage becomes greater than the savings from reduced water production.

We are continuing our work to influence research and development in leakage management. We have also continued investing in pressure management systems to reduce the chances of burst pipes disrupting customers' supplies.

Improving the environment

Water efficiency

Our wider approach to water efficiency is geared towards improving the security of a sustainable supply for both our present and future customers. Our website features an interactive online water use calculator, while we also have a range of water efficiency films that provide advice on how to use water wisely in the kitchen, bathroom and garden.

Our Water Efficiency Trial is steadily progressing with monitors having been installed in homes to understand how customer consumption behaviour responds to a range of water efficiency measures.

We continue to work with key stakeholders, including housing associations, and are running a rainwater harvesting trial in Inveraray. This involves monitoring water consumption in 12 new properties. We will monitor and compare the water consumption, effectiveness and customer acceptability of the systems for 3 years to determine how such systems can help reduce household water use in the future.

We have been working with community groups to support their energy efficiency projects by highlighting the link between water use and energy costs. We have given out shower timers to encourage people to reduce their water consumption and intend increasing this activity.

Cycle campaign

First launched in 2013, our Cycle campaign aims to highlight ways in which customers can help to keep Scotland's water cycle moving by taking simple steps to save water and prevent blockages in pipes.

Around 80% of blockages in drains and sewers across Scotland are caused by the wrong items being flushed down toilets or poured down sinks – such as baby wipes or cooking fats.

A further 2 phases of the campaign ran in 2014/15, using channels including advertising and social media to highlight the correct ways of disposing of such items. This actively supports our work to alleviate the consequences of sewer flooding. We also continue to promote easy ways to save water in the home – for example turning off taps while brushing teeth or taking a shower instead of a bath.

A wide range of activities have taken place during 2014/15, working with local schools and communities in areas such as Inverness, Thurso, Edinburgh, Gretna and Stranraer. We continue to work in partnership with organisations such as local authorities and the NHS to raise awareness of how everyone can play their part to help keep the water cycle running smoothly.

Waste water

Due to the unique nature and scale of our services, Scottish Water has more environmental permits and licensed discharges than any other organisation in Scotland. Through investment of over £1 billion in environmental quality measures since 2002, we have delivered substantial improvements to Scotland's environment.

Since 2002 we have reduced the number of waste water treatment works which do not fully comply with discharge standards across Scotland from more than 70 to just 4. Our ambition is to consistently have zero failing works.

The effective operation of our sewers and waste water treatment works contributed to 71 bathing waters achieving full compliance.

We continue to collaborate with SEPA, our environmental regulator, to focus and target our operational activities towards further improving environmental performance.

In our new, 6 year investment programme, we are planning around £500 million of investment to further protect and enhance the environment.

We maintain a list of properties that have been affected by flooding from an overloaded sewer. We use a UK water industry standard method to identify those properties at the highest risk of being flooded again, which is based on the intensity of the rainfall. A key target in 2010–15 was to ensure the register did not rise above 341 properties. As of March 2015, the register had been reduced to 302.

The number of internal flooding incidents from main sewers due to heavy rain decreased by 17%. The number of internal flooding incidents from main sewers due to other causes decreased by 23%.

The overall number of incidents of overloaded internal sewer flooding due to heavy rain decreased by 17%. The overall number of incidents of internal sewer flooding due to other causes, such as blockages, decreased by 18%.

In our investment plans for 2015–21, we are proposing around £45 million to start to deliver solutions to external sewer flooding problems and around £100 million for further solutions to internal flooding issues.

Renewable energy

A significant amount of energy is needed to provide essential water and waste water services to our customers in Scotland. We have a 3-pronged approach to energy management and development:

- Reducing consumption by improving capability of our assets and operations;
- Increasing self-generation where there is a good return for customers – deploying innovation and technologies that maximise value from our asset base;
- Hosting private renewable energy investment on our land.

Our strategy is aligned with the Scottish Government's ambitions for a Hydro Nation and is an essential part of our desire to reduce the long-term costs of delivering water and waste water services.

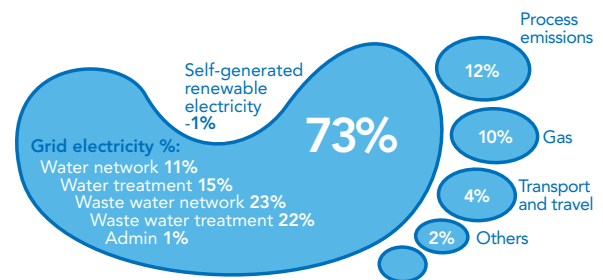
We have installed more than 4,000 smart meters at Scottish Water sites, and this is now enabling us to target energy efficiency opportunities. In the new regulatory period we aim to reduce base energy consumption by over 10 Gigawatt hours (GWh).

We can now generate 45GWh of the 450GWh of electricity we need every year, with the use of renewable technologies playing a key role. Last year we increased our renewable installed capacity by 60% to 45GWh. We have been continuing to increase and diversify our renewable portfolio to include hydro, wind, photovoltaic solar and combined heat and power (CHP). We currently have 27 hydro schemes in operation, while 6 other sites are in development. More than 40 of our treatment works are now either partially or fully self-sufficient in relation to how much energy is generated versus the amount of energy they consume.

We have also installed 13 small or medium-scale wind turbines, 16 photovoltaic solar and 2 combined heat and power schemes, helping to produce some of the energy needed to power our treatment works. In the next regulatory period we will be piloting the recovery of heat from waste water and the use of biomass for heating at treatment works.

Scottish Water already hosts 350GWh of third party wind schemes and is working with several developers on other sites. We expect to be facilitating more energy generation than we consume by 2018/19.

Scottish Water Greenhouse Gas Emissions Footprint 2013/14



Climate change

We are continuing work to assess the extent to which climate change will affect our assets and the resultant impact on services to customers. It is important we are able to adapt to potential changes to continue meeting customers' expectations of reliable services. A changing climate could impact on water and waste water services in a variety of ways. For example, changing rainfall patterns could affect the available quantity of raw water supplies. Our waste water network has to deal with the alternate pressures of increased rainfall intensity resulting in a higher risk of property flooding from sewers, and of periods of dry weather resulting in siltation that leads to blockages in sewers or a need for increased sewer cleaning.

We are committed to reducing our greenhouse gas emissions and to ensuring all parts of the business consider carbon and wider sustainability within decisions and actions.

In 2014, we undertook an exercise to recalculate all our past years' carbon footprints based on new factors published by Defra (the Department for Environment, Food and Rural Affairs). This made our carbon footprint more comparable from year to year. It showed that, despite continued investment to enhance our services, we have reduced our carbon footprint for 7 consecutive years, by a total of 18%. This is in line with the carbon footprint reduction of Scotland as a whole.

Our carbon footprint for 2013/14, the most recently reported year, showed a decrease of 3.3%, or over 13,000 tonnes of carbon dioxide equivalent (tCO₂e), compared with 2012/13. Our water service continues to have the lowest carbon intensity in the UK, largely due to the opportunity to use gravity to supply many of our customers rather than pumping.

People

Scottish Water is committed to playing a positive role in the lives of our customers and our people – now and in the future.

Our people

Scottish Water has a strong and committed workforce with a diverse range of skills and talents in areas such as science, engineering, finance, regulation, law, customer service, project management, information technology and asset management. Everyone plays a vital role across communities in demonstrating that we are trusted to care for the water on which Scotland depends.

Employee engagement

We are committed to engaging our employees and monitor how well we are doing through regular employee opinion surveys. In our latest survey both the overall response rate and level of employee engagement have continued to rise. This is because our employees know that their views will be taken seriously and, where appropriate, acted upon. We use a wide range of channels to communicate across Scottish Water and in late 2014 held a number of employee engagement events for all of our employees across Scotland. This was an opportunity for all employees to hear about our new Vision, participate in activities, meet with our executive leadership team and discuss our future ambitions as we seek to sustain high performance levels for the benefit of our customers.

Learning and Development

To sustain high performance levels we are committed to ensuring our people are developed to their full potential. We work hard to create opportunities for people to develop their skills, talents and experiences.

One of the ways we are doing this is through our new skills academy model which will help to develop the skills of engineers and operatives from around Scotland. The model taps into skills and knowledge of our experienced people with 5 of our long-serving employees – with more than 120 years of combined experience between them – recruited into our academy to pass on their skills and expertise.

We have built a new academy training and testing facility, within an existing water treatment works and equipped this with a test rig that simulates actual situations, such as shut downs and repairs on water mains, to provide employees with real-life training scenarios.

We also recognise the importance of attracting and developing the next generation of people to work in the water industry in Scotland. In collaboration with our partners and relevant skills bodies, we have created qualifications, modern apprenticeship frameworks, graduate schemes and other career development opportunities, such as leadership development programmes, as well as supporting youth employment and schools and business partnerships.

By actively supporting the development of Science, Technology, Engineering and Maths (STEM) related skills among young people through our internship programme, we aim to develop future engineers and scientists and we have a very specific focus on encouraging more women to take up STEM related careers.

We are supporting the career academies UK model in Scotland, which is providing paid work experience for groups of school pupils. We are currently working with our partners to create a Knowledge Centre of Engineering Excellence as part of our £250 million Glasgow environmental programme.

We currently have 75 modern apprentices and 33 graduates on structured development programmes, with a further 30 new apprentices and 18 STEM graduates set to join us by September 2015. Our group of management graduates completed their traineeships in March 2015 and have moved into permanent roles.

We have collaborated with organisations such as the Scottish Qualifications Authority to create apprenticeship pathways, and encouraged entry routes into our contracting base. We have also worked in partnership with Clyde College, The Open University and Heriot Watt University to create a qualification pathway from HNC through to Ordinary Degree and further onto MSc level.

This will help to widen access, entry and progression opportunities for people seeking qualifications within the water industry.

We are building a pool of Scottish Water Career Ambassadors to support school visits, career events and community events around Scotland, and to promote the broad range of career opportunities that exist in the water industry. Our organisational commitment and approach to the development of Scotland's young people has recently been recognised in the form of an award as an "Investor in Young People", one of the first public sector organisations to receive this prestigious award.

Wellbeing

We are keen to ensure Scottish Water and our people have the adaptive capacity, agility and resilience to cope with pace of change and to deliver sustainable out-performance. Our wellbeing programme provides support for employees in respect of:

- Physical wellbeing – promoting positive health and bodily functioning, exercise and good nutrition, physical safety and access to good health care and information
- Emotional wellbeing – emotional resilience, promoting feelings of self-confidence, self-esteem, trust and co-operation and supportive relationships
- Agility in the workplace – enabling employees to work in a way that enhances employees' lifestyles
- The energised person – belief in our vision and values, being part of a meaningful enterprise and supporting active engagement in life and wider society.

In 2014/15, we ran a men's health initiative to coincide with the 'Movember' campaign, which was targeted at operational delivery teams. In December, our health and safety conference included a wellbeing session focused on the link between safety at work, health and wellbeing and how improved health and personal resilience can reduce the risk of workplace accidents.

Agile working is a key driver of employee engagement. We know from our recent employee survey that one of the things our people value most about working for Scottish Water is that employees are trusted to work in an agile way and that we offer flexible working arrangements and family-friendly policies.

Equality

Scottish Water strives to be a leader in behaviour and attitudes to diversity and inclusion. We are continuing to integrate equality into our policies, procedures and corporate systems so that it is part of our core structures, behaviours and culture. As a family friendly employer, we have been awarded the Carers Positive kite mark. We have developed new policies on shared parental leave and introduced new online modules to create a respectful working environment. Partnerships with organisations such as the Business Disability Forum have given us increased understanding of the needs of disabled employees and candidates to ensure we have barrier free recruitment.

In March 2015, Scottish Water was named as Scotland's Best Large Public Sector Employer at the inaugural Scottish Top Employers for Working Families Awards. The awards, which are organised by Family Friendly Working Scotland with support from the Scottish Government, celebrate progressive organisations which recognise how family friendly and flexible working can bring benefits to employees, while also delivering high performance and successful businesses. They recognise how through such working practices employers can help achieve increased productivity and performance, reduced absenteeism, better morale and wellbeing, as well as improving staff retention and recruitment. Our women in leadership network events – aimed at inspiring, supporting and encouraging women – continue to attract good support. We have run internal workshops for women interested in taking up Board positions with external organisations, charitable and social enterprises. In the recruitment of new employees we are achieving an increasingly balanced gender profile, both as candidates and new starts for graduate level opportunities.

Education

Giving our customers the opportunity to learn about the value of water and how it is produced is a great way of bringing these essential services to life. In recent years we have continued to develop our suite of education materials.

Our approach to education is focused on:

- Engaging with our customers now and in future generations;
- Looking at innovative educational opportunities and partnerships; and
- Promoting the career opportunities in Scottish Water and the water industry.

We recently launched a suite of 9 mobile education exhibits which can be taken into communities around Scotland. These exhibits, developed in partnership with Glasgow Science Centre, each provide a fun, hands-on, interactive opportunity to have conversations about Scottish Water and what we do with our customers of all ages. The modules are initially being piloted in the Glasgow area and the intention is that these can be used in schools, at community groups and events around Scotland, helping people to engage with Scottish Water and build their understanding about the work that goes on behind the scenes to supply homes and business premises across Scotland with the vital water and waste water services that they depend on every day. Three of our fun water and waste water related mobile exhibits are games, which have been developed so they can also be played on the Scottish Water website and are available as free apps for mobile devices so people can download them and play on the go.

These complement our package of educational resources and online activities, which have been developed based around the requirements of the national curriculum and can be downloaded from our website for use in schools. Our Water Ways exhibit at Glasgow Science Centre continues to bring the message of water's journey from source to tap alive in a fun and interactive environment.

In 2014/15, we also teamed up with the Scottish Professional Football League Trust to develop and pilot the H2-O programme. Working with 3 professional clubs – East Fife FC, Elgin FC and Queen of the South FC – this innovative primary schools project delivered fun, interactive sessions about the water cycle and the relationship between water, hydration and physical activity, to around 3,000 children within the selected club areas.

Volunteering

Since the launch of our volunteering programme in 2011, Scottish water employees have been getting involved in volunteering work to develop skills and teamwork. Each employee is entitled to up to 2 days paid leave each year, which helps strengthen relationships with communities, while supporting equality and diversity outcomes. More than 2,500 volunteers have been involved to date, with opportunities focused on:

- Education;
- Environment; and
- Local community volunteering.

In 2014/15, employees contributed 4,000 working hours for the benefit of charitable, environment or community work across Scotland. This included a beach clean at Prestwick, South Ayrshire, and helping to spruce up an area of woodland at Callendar Estate, near Falkirk. In Glasgow, we helped load a Mary's Meals container headed for Malawi, while residents at a care home in Edinburgh enjoyed a selection of Christmas carols performed by some of our employees.

We have also been recruiting 'I Am Scottish Water Ambassadors' from within our workforce to help engage with communities and support the roll out of our education programme.

WaterAid Scotland

Scottish Water's charity of choice is WaterAid, the UK's specialist development charity working to help provide some of the poorest communities in Africa and Asia with safe drinking water and better sanitation. Our employees contribute much of their own time in supporting the charity's efforts to raise vital funding.

In 2014/15, employees raised in excess of £170,000 to support WaterAid's work in Zambia. An employee based at our Inverness office, who raises over £1,000 a year by running a tuck shop, visited Uganda during the year to see for himself how this fundraising is helping to make an impact.

Performance Innovation

Innovation can help us develop knowledge to improve services and continue delivering value to our customers.

Our innovation strategy identifies the need for a focused research and development programme, seeks to accelerate new technology identification, evaluation and adoption, and looks to develop our corporate culture so that it is supportive of our innovation efforts.

Developing a culture that supports innovation is critical and we are refreshing our leadership and staff development programmes as well as putting in place the right resources and infrastructure to support this. We will also be looking to engage more effectively with our supply chain, alliance partners and academia to improve our approach to collaboration to achieve mutual benefit.

Innovation from within

Productisation

We have developed a range of standardised equipment to support off-site manufacture capability. This will achieve a number of benefits including reduced design, installation and site commissioning time, less disruption to customers, higher build quality, reduced health and safety risk and lower costs.

In collaboration with our supply chain, we are putting in place strategic framework partnering arrangements for the manufacture and supply of standard products. This will include key asset types such as chemical dosing, water and waste water pumping stations and water sampling kiosks.

Scientific Services

Our analytical science teams monitor the quality of drinking water 365 days per year to ensure the water we supply is safe to drink and meets the tight regulatory standards. They also monitor the effluent quality from our waste water treatment works to ensure we meet environmental standards. They are continually looking at developing new methods of analysis to enhance the response rate in event of failure and to improve our ability to prevent issues. They have recently developed new techniques for cryptosporidium analysis, introduced flow cytometry to ensure we meet bacteriological standards, and developed techniques for measuring halo acetic acids (a potential by-product of disinfection).

Dock valve

Two Byelaws inspectors designed a prototype valve that prevents backflow from industrial processes to the water distribution systems. This valve has the potential to provide more cost-effective solutions for byelaws compliance for harbours and marinas when filling boats and ships with drinking water.

Research and innovation activity

We continue to invest in research and innovation across core aspects of our water and waste water services. Our investment in this area will increase in the next regulatory period in line with our business plan.

As mentioned earlier on page 25, Scottish Water Horizons has been developing innovation testing facilities at Gorthleck and Bo'nness to test new products and processes associated with the treatment of drinking water and waste water.

United Kingdom Water Industry Research (UKWIR)

We are active contributors to the UKWIR programme that looks at cross industry topics that look to address climate change, leakage, asset management and compliance.

STREAM

We support the STREAM Industrial Doctorate Centre (stream-idc.net) that seeks to deliver practical applied research projects and develop high calibre employees for the water industry. We have 11 projects running including sustainable catchment management, improving drinking water quality, enhancing the efficiency of our treatment systems and understanding what value (energy, heat, nutrients) can be recovered from our waste water streams.

Technology pilot trials

We conducted pilot trials of 2 exciting new technologies to enhance waste water treatment. We ran trials on a sludge recycling system to explore the value of recovering cellulose based material from the waste water stream. The results were encouraging with potential reduced load on downstream processes (reducing energy requirements and sludge production) and recovering material that has the potential (subject to market and regulatory approvals) of generating energy or revenue streams.

We are also conducting trials at 2 sites in Glasgow of a novel waste water treatment process that has the potential to improve the effluent quality and reduce the overall size of the treatment works, as well as reducing energy consumption.

International collaboration

We have been involved in 2 European research projects – TRUST and NoMiNOR. TRUST is a pan-European project funded by the EU looking at the transition from current practices to future sustainable urban systems for water and waste water. This project involved 34 partners from 11 countries with a mix of academic, supply chain and water company/municipality partners. This project has developed a range of tools, technologies and techniques that can be utilised to assess current performance and plan for the future.

NoMiNor is a collaborative project between Scottish Water and partners from the Nordic regions (Norway and Sweden) and Cranfield University looking at factors influencing levels of Natural Organic Matter (NOM) in drinking water sources and how to optimise treatment. NOM, if not removed effectively, results in colour, taste and odour and disinfection by-products.

Looking ahead

The 2010–15 regulatory period has seen more than 3,300 capital investment projects delivered by Scottish Water, coupled with significant improvements to drinking water quality and waste water performance around Scotland. We are providing one of the best water and waste water services in the UK – for lower than average household charges.

In the years ahead, we are determined to build on the transformation in service levels and efficiency that we have achieved for the benefit of our customers. In doing so, we will demonstrate that we are trusted to care for the water on which Scotland depends.

Our business plan for 2015–21 is geared towards ensuring the ongoing efficient delivery and improvement of our services in priority areas that will give our customers a leading service experience. It delivers the first steps of our strategy for future water and waste water services, while preparing for the key challenges and opportunities facing Scotland's water industry, such as climate change.

Our plan has been informed by extensive research with our customers, discussions with the Customer Forum and stakeholders including the Water Industry Commission for Scotland, Drinking Water Quality Regulator, SEPA and Scottish Government, as well as our 'Your Views Count' customer consultation, held in the winter of 2012/13.

This was an opportunity for us to set out our thinking – based on earlier customer feedback – on our future plans.

Customer engagement has therefore helped shape our new business plan – ensuring we have the strategies in place to continue providing fresh and clear drinking water, enhance the environment and support the economy of Scotland through our new £3.5 billion investment programme.

A major aspect of our Business Plan is ensuring we increase the resilience of the services we provide so that all customers reap the benefits of a consistently high standard of continuous, high-quality services. In particular, this will address customers' highest priorities for service improvement such as minimising interruptions to water supplies, further improvements to drinking water quality, reducing flooding and reducing visible leakage.

Scottish Water's Business Plan for the 2015–21 period was agreed with Scottish Ministers and the Water Industry Commission for Scotland, thereby confirming Scottish Water's funding from borrowing and customer charges for the next 6 years.

Key strands of our plan for 2015 to 2021 include:

High quality service

We will continue to deliver high service levels so that both household and business customers continue to receive water and waste water services that are among the best in the UK, improving service in all their priority areas.

Customer experience

We will further improve customers' experience of their service from us so that it is as good as that provided by leading suppliers of other essential products and services.

Delivering value

We will build on our leading levels of employee engagement to continually improve the effectiveness and efficiency of our service delivery to customers.

Household prices

In the first 3 years (2015–18), we have committed to annual household prices which increase by 1.6%. Thereafter prices will be set to ensure they increase by no more than 1.8% below the Consumer Prices Index (CPI) rate of inflation across the 2015–21 period. This will be achieved by delivering further efficiencies and will keep household charges lower than the average charge in England and Wales.

Wholesale charges

For our wholesale customers, we are also planning below CPI price increases within the 2015–21 regulatory period.

Innovation

Our plans are based on a detailed assessment of the most cost-effective way to deliver customers' expectations and improved compliance. We will continue to develop new and innovative approaches to operating and investment solutions.

Governance

Board members	36
Corporate governance	38
Audit committee report	43
Remuneration committee	47
Members' remuneration report	48
Members' report	59

Board members



Executive Members

1. Douglas Millican, Chief Executive

Douglas was appointed as Chief Executive on 1 February 2013. Douglas had previously been Finance and Regulation Director since Scottish Water was formed in April 2002. He was formerly with East of Scotland Water, initially as Financial Controller and latterly as Commercial Director. Prior to this, he worked with Price Waterhouse and Tyco. He is a Chartered Accountant with a BCom from the University of Edinburgh and is an Associate Member of the Association of Corporate Treasurers.

2. Alan Scott, Finance Director

Alan joined Scottish Water in September 2013 from Balfour Beatty Regional where he was Finance Director, having previously held the roles of Finance Director and Interim Managing Director of Balfour Beatty Engineering Services. Alan was Finance Director of Miller Construction for 8 years and has also held Finance Director positions in the oil service industry.

Alan has an MA in Economics and Accounting from Aberdeen University. He qualified as a Chartered Accountant with Arthur Andersen where he spent 10 years in the Corporate Recovery Services Team.

3. Geoff Aitkenhead, Executive Director Capital Investment

Geoff was formerly Asset Management Director from 2012–15, and prior to that General Manager, Customer Services and Networks, at East of Scotland Water (ESW). He is a graduate of Newcastle University, a member of the Chartered Institute of Water and Environmental Management and a Fellow of the Institution of Civil Engineers. Geoff is Chairman of Scottish Water Solutions and also sits on the Board of Scottish Canals.

Geoff is a former Chairman of WaterAid (Scotland), an organisation dedicated to the provision of clean water and sanitation in the developing world.

4. Peter Farrer, Chief Operating Officer

Peter was appointed Chief Operating Officer in 2013. He was formerly Customer Service Delivery Director from 2008 and, prior to that, General Manager of Business and Asset Planning.

Prior to this, Peter was General Manager of Operations and has held various other operational and engineering roles within Scottish Water's predecessor organisations, East of Scotland Water and Lothian Water and Drainage.

He has 31 years' experience in the water industry since graduating from Heriot Watt University as a Civil Engineer in 1984. He is a Chartered Civil Engineer, gained an MBA from the Edinburgh Business School in 2001 and is a Fellow of the Institution of Civil Engineers and a Vice-President of the Institute of Customer Service.

Non-executive Members

5. Ronnie Mercer CBE

Ronnie was appointed Chair of Scottish Water in October 2007 after having been Interim Chair of Scottish Water since April 2006. Until his retirement from Scottish Power in March 2006 he was Executive Vice President – Operations at Scottish Power's PacifiCorp subsidiary and an Executive Team Member of Scottish Power. Ronnie moved to Scottish Power from British Steel in 1994 as Generation Director. In 1998 he became Managing Director of Scottish Power's Southern Water subsidiary, after which he became a Group Director in the company.

6. Donald Emslie

Donald Emslie is Chair of CHMC Ltd, which manages hotels across the UK and Ireland. He is also Chair of Thorpe Hall Leisure Ltd which owns the Lifehouse Spa & Hotel in Essex. He was previously Chief Executive of SMG Plc and Chair of ITV Network Ltd. Donald is a Fellow of the Royal Society of Arts and The Royal Television Society and has been awarded an Honorary Doctorate from Robert Gordon University for his services to television and media.



7. James Spowart

Jim Spowart was the founder and Chief Executive of Direct Line Financial Services, Standard Life Bank and Intelligent Finance. Jim has considerable corporate experience and retired from Intelligent Finance in 2002. He was awarded an Honorary Doctorate from Edinburgh Napier University for his contribution to banking and also to the economic development of the central belt of Scotland where he created over 5,000 banking jobs. Since he retired, he has been involved in various consultancy projects and currently he is the Chairman of a Church of Scotland Charity We-evolution. Jim was also a Commissioner to the Church of Scotland during 2012 and 2013.

8. Alan Bryce

Alan was formerly Managing Director of Energy Networks and Generation at Scottish Power, and a Non-executive Director of Iberdrola USA in New York. He is currently Chair of Viking Energy Shetland, a Non-executive Director of Infinis Energy plc, and an advisor in the utilities industry. Alan holds a Masters degree in Electrical Power Engineering from the University of Strathclyde and is a Fellow of the Institution of Engineering and Technology.

9. Andrew Wyllie CBE

Andrew is Chief Executive of Costain Group PLC, the worldwide construction and engineering group. Prior to taking up this role in 2005, he worked for Taylor Woodrow where he was Managing Director of the construction business and was a member of the Group Executive Committee. He is a graduate of the University of Strathclyde, has an MBA from London Business School and is a Fellow of the Institution of Civil Engineers. He is also a Fellow of the Royal Academy of Engineering, a member of the CBI Construction Council and a Companion of the Chartered Management Institute.

10. Lynne Peacock

Lynne is a former Chief Executive of Clydesdale and Yorkshire Banks, a role that she held from 2004 until 2011. She started her career in banking in 1983 with the Woolwich, joining the Woolwich Board in 1996, and became Chief Executive in 2000.

Lynne became a Non-executive Director of Nationwide Building Society in July 2011 and joined the Board of Standard Life as a Non-executive Director in April 2012.

11. Matt Smith OBE JP

Matt was Scottish Secretary of UNISON until 2010 and STUC President in 1999/2000. He currently serves as a Scottish Human Rights Commissioner, a Member of the Standards Commission for Scotland, a Member of the Employment Appeal Tribunal, a Director of Irvine Bay Regeneration Company and Director of UNITY Enterprise. He is an Honorary Fellow and Executive Committee Member of the Scottish Council for Development and Industry. Matt has served as a Justice for 29 years and is a JPAC Member. He serves as a public interest member on the disciplinary schemes of ICAS and CIPFA.

Corporate governance

Members

The Chair and other Non-executive Members are appointed by Scottish Ministers. Executive Members are appointed by Scottish Water after receiving consent to their appointment from Scottish Ministers. The Members as at the date of the Annual Report and their biographies are set out on pages 36 to 37.

Executive Board appointments are based on merit and future candidates will be considered against objective criteria, having due regard for the benefits of diversity on the Board including gender. Non-Executive Board appointments are made by the Scottish Government in accordance with equal opportunities guidance 'Diversity Delivers' introduced by the Commission for Ethical Standards in Public Life in Scotland and applicable to all public appointments.

The Board of Scottish Water comprised 12 members: 8 Non-Executive Board Members and 4 Executive Members from 1 April 2014, until the resignation of Douglas Reid as a Non-Executive Member on 31 December 2014. For the remainder of the 2014/15 financial year the Board composed 7 Non Executive Members and 4 Executive Board Members. The Board has a formal schedule of matters specifically reserved to it for decision making. Reporting to the Board are the Chief Executive and the Executive Members who have responsibility for the management of Scottish Water, and the Board Committees detailed below.

In accordance with the best practice recommended in the UK Corporate Governance Code, there is a clear division of responsibilities between the Chair and the Chief Executive. Scottish Water benefits from the expertise of its Non-executive Members whose range of experience brings independent judgement on issues of strategy and performance, which are vital to the success of Scottish Water.

During the financial year of 2014/15, the Board met on 10 occasions to review Scottish Water's operational and financial performance, business strategy and risk management.

UK Corporate Governance Code

Scottish Water complies with the UK Corporate Governance Code so far as applicable to its status as a Statutory Public Corporation. As Scottish Water is not a company registered under the Companies Act, the FCA listing rules are not applicable and an Annual Consultative Meeting with stakeholders is held in place of an Annual General Meeting. The arrangements for appointment and termination of Board Members and their remuneration are derived from the underlying statutory regime and set out in the Members' Remuneration Report. No Senior Independent Director has been appointed as other arrangements are in place to consult with stakeholders. The Audit Committee Report on pages 43 to 46 covers the appointment of the external auditors.

Board and Committees

Attendance at the Board and the two principal Board committees is shown in the table below.

Name	Board 10 meetings held	Audit Committee 4 meetings held	Remuneration Committee 4 meetings held
	Attended	Attended	Attended
Ronnie Mercer	10	–	–
Geoff Aitkenhead	10	–	–
Alan Bryce (i)	10	1	4
Donald Emslie	10	–	4
Peter Farrer	10	–	–
Douglas Millican	10	–	–
Lynne Peacock	9	4	–
Douglas Reid (ii)	7	3	–
Alan Scott	10	–	–
Matt Smith	10	–	4
James Spowart	10	4	–
Andrew Wyllie	9	4	–

(i) Alan Bryce attended all Audit Committee meetings held following his appointment to the Committee on 1 March 2015.

(ii) Douglas Reid attended all Board and Audit Committee meetings up to the date of his resignation on 31 December 2014.

Audit Committee

The Audit Committee reviews the financial reports of Scottish Water and considers the results of the Auditors' examination and review of the financial statements. It meets with management and with internal and external auditors to review the effectiveness of internal controls and business risk management. The Chair of the Audit Committee reports to the Board on internal control and risk management matters following each Audit Committee meeting. The Committee adheres to the requirements of the Audit Committee Handbook. Each year the Committee presents an annual report of its activities to the Board prior to the Board's consideration of the Annual Report.

A more detailed report of the Audit Committee's activities is provided on pages 43 to 46.

Remuneration Committee

The Remuneration Committee, in accordance with requirements of the Scottish Water Governance Directions 2009, monitors the contract terms, remuneration and other benefits for each of the Executive Members including performance related incentive schemes. The Committee has access to external independent advice as it sees fit.

A more detailed report of the Remuneration Committee's activities is provided on page 47.

Board and Committee performance

A formal external review of Board and Committee performance was carried out in 2014, and actions arising from it are being implemented. Formal annual evaluation processes are in place for all Members including the Chair. Induction and ongoing training is provided for Members with specific emphasis on finance, regulation and risk analysis.

Executive Leadership Team

The Chief Executive is responsible for the management and operation of Scottish Water within the strategy determined by the Board and is supported by an Executive Leadership Team which he chairs. The members of the Executive Leadership Team, who are also Executive Directors, are:

Douglas Millican	Chief Executive
Geoff Aitkenhead	Executive Director Capital Investment
Peter Farrer	Chief Operating Officer
Alan Scott	Finance Director

Internal control

The Members of the Board recognise their responsibility for establishing, maintaining and reviewing the systems of internal control and risk management from a financial and operational perspective. These systems are designed to manage, rather than eliminate, the risk of failure to achieve business and operational objectives and to provide reasonable, but not absolute, assurance against material misstatement or loss.

The systems of internal control are compliant with the relevant sections of the UK Corporate Governance Code and the Scottish Water Governance Directions 2009. They are based on an ongoing process designed to identify those risks material to the achievement of Scottish Water's policies, aims and objectives, to evaluate those risks and to manage them effectively in accordance with good risk management practices.

The risk management process has been in place for the full year under review and up to the date of approval of the Annual Report and financial statements.

Risk management

Scottish Water has established a risk policy that defines risk appetite and sets out a consistent approach to the management of risk.

The business identifies key risks at corporate and functional levels. Risks are evaluated by considering their consequences, in terms of impact and likelihood, against risk appetite for the achievement of service delivery and business objectives. Existing arrangements for managing the risks are considered and, where these are not perceived to be effective, action plans are drawn up which aim to achieve the right balance between risk and control.

Key risks in relation to monitoring water quality, major supply interruptions, water supply resilience and planning for and managing water quality incidents are being managed in a reasonable and prudent manner, having regard to the current regulatory framework and available resources.

Risk management is integral to the business and financial planning process in Scottish Water and this continues to develop in line with business needs. Escalation procedures are in place.

The risk register and risk management processes are reviewed annually by the Board and twice a year by the Audit Committee and the Executive Leadership Team. In addition, each quarter, the Board reviews the status of the most significant business risks.

Control activities

Scottish Water's Internal Control Framework incorporates:

- Policy-making and strategic direction at Board level. There is a formal schedule of matters reserved for decision by Board Members.
- An organisational structure which clearly defines lines of authority and accountability.
- Financial authority limits governing delegation of authority by the Board.
- Regular review by the Board and management of service, quality and financial performance compared to plan.
- Development of procedure manuals for staff instruction and guidance.
- Project approval, monitoring and control processes specifically developed for capital expenditure.
- High profile given by the Board and management to Health & Safety issues.

High quality personnel are an essential part of the control environment. Ethical behaviour is incorporated into staff conditions of service and demanding recruitment criteria and a policy for the development and training of staff supports ethical standards.

Control effectiveness review

Reviewing control effectiveness is a continuous process throughout the financial year. The Board gains assurance as to the effectiveness of internal control through a collaborative approach, based on the work of internal and external audit, other internal and external review agencies, and Executive Members' reports. The controls assurance process is co-ordinated by Internal Audit and incorporates independent assessment by audit and annual statements of assurance from senior management.

Sustainable development

Scottish Water recognises the importance of fulfilling its social responsibilities. To this aim the Board has a Sustainable Development Policy that includes social, economic and environmental aspects. The Board considers sustainable development as part of its ongoing activities and in the development of its business plans.

The Board is committed to providing an active but appropriate level of support to community projects.

Information and communication

Scottish Water has developed an annual budgeting and financial and performance reporting system that compares results with budget on a monthly basis, providing information for internal and external reporting. Key performance targets have been agreed with Regulators and the Scottish Government.

Performance against these targets is reported monthly to the Board and quarterly to the Regulators and the Scottish Government. Scottish Water has an ongoing programme of developing systems to assist customer service and decision making in financial and operational areas of the business. The overall aim is to produce relevant, reliable and timely operational, financial, and compliance related information, consistent with the objectives of the business, to enable management to exercise effective control and direction.

Scottish Water has, following widespread consultation, recently updated a Consultation Code setting out how it consults external stakeholders in relation to proposals for, and the undertaking of, significant core business activities.

Members of the Board meet quarterly with officials from the Scottish Government to discuss a range of business issues.

External Auditors

PricewaterhouseCoopers LLP chartered accountants and registered auditors were appointed as auditors by the Auditor General for Scotland in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Independence of external auditors

The Auditor General for Scotland is responsible to the Scottish Parliament for securing the audit of the financial statements of Scottish Water. For 2011/12 to 2015/16, the Auditor General re-appointed PricewaterhouseCoopers LLP as the auditors of Scottish Water.

Under the terms of PricewaterhouseCoopers LLP's appointment, they may not carry out any non-audit work for Scottish Water without the prior approval of Audit Scotland.

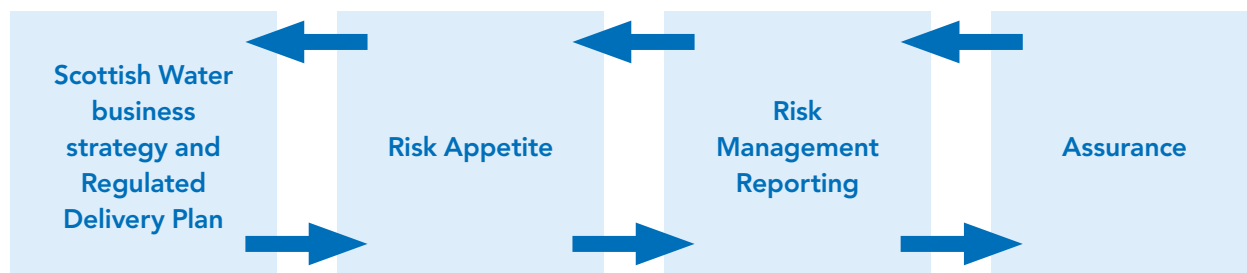
Audit committee report

I am pleased to present this report covering the role and function of the Audit Committee for the year ended 31 March 2015. I am the Chair of the Audit Committee and I am supported by 3 other Non-executive Members; Alan Bryce (who replaced Douglas Reid from 1 March 2015), James Spowart and Andrew Wyllie. I have relevant financial experience and my Committee members have been selected with the aim of providing the wide range of financial and commercial expertise necessary to fulfil the Committee's duties and obligations. Tom Axford, Scottish Water's Corporate Secretary, is Secretary to the Committee.

Audit Committee Role and Responsibilities

The Audit Committee was established by the Board to support them in their responsibilities for issues of risk, control and governance and associated assurance through a process of constructive challenge. Although Scottish Water is not a quoted company it does adopt and follow, as far as is appropriate, the accounting and disclosure practices of a quoted company.

The governance framework adopted by the Audit Committee links the objectives of Scottish Water's business strategy through the stages, outlined below, with the sources of assurance received from senior management and other assurance providers on the operation of key financial and risk management controls.



The Committee's main responsibilities are to review:

- The strategic processes for risk, control and governance;
- The accounting policies, the accounts, and the annual report;
- The planned activity and results of both internal and external audit, including the approval of the annual Internal Audit plan;
- The adequacy of management response to issues identified by audit activity;
- The effectiveness of the internal control environment;
- The corporate governance requirements for the organisation;
- Anti-fraud policies, whistle blowing processes and arrangements for special investigations;
- Scottish Water's arrangements for complying with legislation and Directions issued by the WICS, including the Annual Return; and
- The annual report prepared by the compliance officer.

The Terms of Reference of the Committee are approved by the Board and in accordance with Scottish Government Audit Committee Handbook are reviewed annually by the Committee. The Committee Terms of Reference are available on the Scottish Water website.

Committee Meetings

The Committee meets at least 4 times during the year. In addition to the Committee members, the Board Chair, Chief Executive, Finance Director, Head of Internal Audit and the external audit partner from PricewaterhouseCoopers LLP (PwC) also attend the meetings by invitation. The Committee also invites other senior management to present to the Committee on a regular basis on a variety of topics. In addition, the Committee meets in private, excluding any Executive Members, with the external auditor and the Head of Internal Audit on an annual basis, or more frequently if required.

The Audit Committee annually reviews its own effectiveness and reports the results to the Board.

The Committee met on 4 occasions during 2014/15.

Committee Activities

The Committee agrees an annual work programme including reports to be received from senior management, Internal Audit and external audit during the year. The main activities of the Committee during the year are set out below:

Financial reporting

In order to inform the Committee's reports to the Board, the Committee reviewed and considered the following areas in respect of financial reporting and the preparation of the interim and annual report and accounts:

- The appropriateness and quality of accounting policies;
- The adoption of IFRS 10 covering the consolidation of subsidiary companies;
- Compliance with financial reporting standards and clarity of associated disclosures; and
- Material areas in which primary judgements have been applied.

To assist in the discharge of its duties the Committee considers reports from the Group Financial Controller and reports from PwC on the outcomes of their half-year review of interim financial statements, including confirmation that the accounts are prepared on a going concern basis. The Committee was satisfied by the annual joint paper prepared by the Group Financial Controller and the external auditor covering the financial statements which included a section from Management supporting the going concern basis which the external auditor confirmed was appropriate. Our view was also supported by Scottish Water's Delivery Plan, which was accepted by Scottish Ministers on 21 April 2015, which set out funding requirements for Scottish Water for the 2015–2021 regulatory period.

The Finance Director and external auditor of Scottish Water Business Stream are also in attendance when the Committee reviews the consolidated interim and annual financial statements. As a consequence of the regulatory framework, the independence of the Business Stream Board, and the associated limited disclosure regarding the activities of Business Stream, the Audit Committee is in large part reliant on the Board of Business Stream to provide much of the necessary assurance and governance requirements. Additional assurance is gained through governance exercised through Scottish Water Business Stream Holdings Ltd (SWBSH). The Board of SWBSH has several directors in common with Scottish Water. The SWBSH Board reviews reports from Business Stream management covering financial performance and specific risks facing Business Stream, for example the impact of increased competition and competitive tendering within the Scottish business retail market. In addition, the SWBSH Board approves Business Stream's dividend policy and strategic plans and confirms appointment of Business Stream directors.

The primary areas of judgement considered by the Committee in relation to the 2015 accounts were:

- Risks within the corporate risk register which could impact on the financial statements and judgments therein. The primary areas of focus included the sensitivities on future household cash collection rates and the associated level of bad debt provisioning;
- The delivery costs associated with Scottish Water's capital investment programme and the associated expenditure classifications; and
- The key assumptions associated with determining the actuarial valuation of pension obligations, and the ring-fencing of the Scottish Water element of each pension fund.

After discussion of these with management and the external auditor the Committee was satisfied that the issues raised had been properly dealt with and that appropriate disclosures have been included in the accounts. The external auditor carried out their work using an overall materiality of £10.8 million, representing 1% of total expenses (including interest) in the consolidated income statement. However, we agreed with the external auditor that they would report any misstatements identified during the audit above £200,000, as well as misstatements below that amount that, in their view, warranted reporting for qualitative reasons. The external auditor confirmed to the Committee that there were no unadjusted misstatements that warranted reporting. In addition, the Head of Internal Audit and Head of Economic Strategy and Regulation carried out a review to verify that the Annual Report and Accounts are fair, balanced and understandable, the results of which were considered by the Committee prior to recommending Board approval of the Annual Report and Accounts.

Consequently, and supported by a comprehensive management and statutory accounts process, with written confirmations provided by senior management on the 'health' of the financial control environment, the Committee and the Board are satisfied that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary to assess Scottish Water's performance, business model and strategy.

Internal Control and Risk Management

The Committee reviews the framework of internal controls and the processes by which the organisation's control environment is evaluated. To support this, the Committee receives and considers:

- Reports from Internal Audit on the effectiveness of internal controls and issues requiring improvement, including reported fraud allegations;
- Observations from the external audit on the internal control environment and any specific control issues identified;
- Corporate risk reports summarising key risks in the corporate risk register including mitigating actions, risk trends, and summarising compliance with Scottish Water's risk appetite;
- An annual report from the compliance officer;
- An annual corporate governance report;
- An Internal Audit annual opinion and report; and
- An annual report on regulatory compliance.

In addition, during the year the Committee requested specific reports on Scottish Water Solutions 2 Limited investment delivery performance, capital cost auditing, cyber and IT risks, water quality and fraud risk.

The Committee also considered a refresh of Scottish Water's risk appetite for the 2015–2021 period.

The Committee provides the Board with an annual report on the effectiveness of the internal control framework. To support this, the Committee receives an annual report and opinion from the Head of Internal Audit.

Internal Audit

The Committee approves the annual Internal Audit plan, with any subsequent changes requiring Committee approval, and reviews the scope and results of Internal Audit reviews and its effectiveness throughout the year. At each Committee meeting reports were received from the Head of Internal Audit. These reports included progress in delivering the Internal Audit plan, audit findings and management action plans to address these, performance in implementing management action plans, any fraud allegation investigations and details of relevant Audit Scotland reports. During the year the Committee also approved a revised Internal Audit Charter, which will be tabled for annual approval. In addition to the private meetings with the Committee members, the Chair of the Audit Committee also meets the Head of Internal Audit outside of the formal Committee meetings.

External Audit

Audit Scotland is responsible for the appointment of the external auditors. PwC was re-appointed external auditors for the 5 year period from 2011/12 to 2015/16. PwC provides a taxation advisory service to Scottish Water Business Stream but no other non-audit services are provided by them.

The Committee receive from PwC an audit plan, including their assessment of key risks and confirmation of their independence. Following completion of their interim review and annual audit, the Committee receive an internal control report highlighting any internal control weaknesses and the management actions to address these.

Annually the Committee assess, with input from management, and provide feedback to Audit Scotland on the effectiveness of the external auditor. In addition to the private meetings with the Committee members, the Chair of the Audit Committee also meets the external audit partner outside of the formal Committee meetings.

Lynne Peacock

Chair of the Audit Committee

Remuneration committee

Annual Statement by the Chair of the Remuneration Committee

It is my pleasure to present the Directors' remuneration report for the year ended 31 March 2015. I chair the Remuneration Committee and I am supported by two other Non-executive Members: Alan Bryce and Matt Smith.

As required, the Committee receives internal advice and information from the Chair of Scottish Water, the Chief Executive, the Director of People and Organisational Development and the Corporate Secretary. During the year the Remuneration Committee did not engage advisers external to Scottish Water.

The Remuneration Committee meets regularly to consider the remuneration arrangements for Executive Members, and other related remuneration matters, making recommendations to the Board. There were four meetings of the Committee in 2014/15. At each meeting a quorum of independent, Non-executive Members was present. No Executive Member was present during discussions about their own remuneration.

We operate a simple remuneration structure made up of base salary and benefits, an annual out-performance incentive plan (AOIP) and a single long-term incentive plan (LTIP) which provide a clear link between pay and our key strategic priorities.

The key decisions made by the Committee over the 2014/15 period were as follows:

Decisions / remuneration for 2014/15

- Approving the base salary increase of 2.2% of the Executive Members and Chief Executive.
- 2015 AOIP payment calculated at 34% of the 40% maximum opportunity for Executive Members and Chief Executive.
- Reviewing management's proposed salary increases for Scottish Water staff.
- Set the performance criteria for the SR15 period 2015–21.
- Reviewing employee demographic information and considering implications for employee resourcing, such as recruitment activity and retirement flexibility.

Changes / remuneration for 2015/16

- Setting base salary increases for Executive Members, with effect from 1 April 2015, at 1.8%.
- Set the performance criteria for the 2015/16 AOIP.
- Agree level of LTIP payment for the 2010–15 period, to be paid January 2016.

Our Remuneration Policy and our Annual Report on Remuneration is set out on pages 48 to 58.

Donald Emslie

Chair of the Remuneration Committee

Members' remuneration report

As far as is appropriate, Scottish Water adopts the same practice as quoted companies in the presentation of this Remuneration Report, even though it is not a quoted company.

1. Statement of Executive Remuneration Policy

a. General Policy

Scottish Water's vision is to be trusted to care for the water on which Scotland depends. Scottish Water will build on its past success by seeking to provide levels of service, performance and efficiency which exceed the expectation of its customers, regulators and the Scottish Government.

Scottish Water will continue to provide a working environment that matches the expectations it places on its people to deliver best value outcomes in an empowered organisation. Scottish Water's remuneration and incentivisation policies are a major contributor to achieving Scottish Water's goals. This requires terms of employment for all employees that, taken together, ensure that Scottish Water is perceived as a fair employer that encourages excellence, rewards performance and empowers its people as well as providing scope for personal development.

Scottish Water's overall remuneration policy aims are to:

- Attract, develop, motivate and retain highly talented people at all levels of the organisation; and
- Incentivise and reward good individual and corporate performance.

b. Remuneration elements

- Scottish Water's Remuneration Policy for Executive Members consists of 5 principal elements:
 - Base salary;
 - Annual out-performance incentive plan (AOIP);
 - Long term incentive plan (LTIP);
 - Pension; and
 - Allowances (for business needs, car, relocation, etc.).

c. Relative importance of performance incentives

Scottish Water is a performance-orientated business, where Executive Members' remuneration should be closely related to corporate performance. The aim is to pay a base salary that is competitive, but appropriate for a public corporation, while providing for extra discretionary pay to be earned for out-performance of demanding targets.

d. Base Salary

Scottish Water is publicly owned and accountable to the Scottish Parliament and Scottish Ministers. Within the context of public sector ownership, Scottish Water seeks to attract, retain and motivate leadership talent in competition with private sector utilities and other organisations across the UK economy, as well as with employers in the public sector.

Scottish Water subscribes to the remuneration database of Hay Group Management Ltd and uses this as required to review the remuneration of comparator organisations and industry in general against its own. This is one of the largest remuneration databases in the UK with each job subjected to the same method of job sizing.

Scottish Water aims to pay in line with 95% of the median of an agreed industry benchmark group, reflecting remuneration levels in comparable organisations for similar work.

e. Annual Out-performance Incentive Plan

Scottish Water has an annual out-performance incentive plan (AOIP) designed to incentivise and reward the out-performance of targets agreed with regulators. Targets are set out in the Delivery Plan that has been approved by Scottish Ministers and reflect those set by the Water Industry Commission in its Final Determination of charges.

The potential maximum annual incentive attainable for out-performance by the Executive Members is 40% of base salary and is non-pensionable. The Delivery Plan targets, out-performance targets, and actual performance for each measure in 2014/15 are set out below.

Measure	Weighting	Delivery Plan target	Out-performance target	Actual performance
Profit before tax excluding depreciation (measured on a regulatory accounting basis)	40%	£390m	Up to £20m ahead of Delivery Plan, payment on a sliding scale 0% to 100%	£427m (+£37m) ⁽ⁱ⁾
Customer service OPA performance	40%	381 points	Score in the range 381 to 400 with payment on a sliding scale of 30% to 100% (zero for any score below 381)	400 points
Investment delivery: Q&S3b & Q&S4 early start overall measure of delivery (OMD) score ⁽ⁱⁱ⁾	20%	Q&S3b 242.6 points Q&S4 27.4 points	Exceed the combined targets for 50%; exceed each individually for 100%, no sliding scale	239.1 points 32.7 points

(i) Excluding benefit of a rates refund on the water undertaking of £15 million.

(ii) For any OMD related payment to be made, forecast capital programme cost at March 2015 must be inside the regulatory allowance (plus customer contributions).

The awards generated by this performance are detailed in the single figure table of the Members' Remuneration Report.

Non-executive Members are not eligible for annual incentive payments.

f. Long Term Incentive Plan to incentivise out-performance in the 5 years to March 2015

The Long Term Incentive Plan (LTIP) has been agreed with the Scottish Government and provides clear targets for out-performance of the Water Industry Commission's Final Determination for the 2010–15 period. Payments under the scheme will be made to Executive Members for their service during 2010 to 2015 in January 2016. The LTIP will only be payable if there is overall financial out-performance of the Final Determination.

The plan is structured as follows:

Measure	Weighting	Basis of calculation	Target
Growth in financial reserve, measured as debt less cash, relative to the Final Determination ⁽¹⁾	50%	Straight line sliding scale	£0 to £100m above Final Determination target
OPA – measured over the average performance in 2013–14 and 2014–15 ⁽²⁾	50%	Straight line sliding scale	380 to 400 points

(1) The financial target is the extent to which adjusted net debt is lower in March 2015 than was assumed in the Final Determination. Maximum LTIP would be payable for at least £100 million out-performance (after adjusting for 2010 rates revaluation and lower charge increases than allowed under the Final Determination).

(2) Out-performance of OPA targets above those set out in the Final Determination is measured as the average performance in 2013/14 and 2014/15. Maximum LTIP will be payable for an OPA score of at least 400, 20 points higher than the Final Determination target of 380.

The LTIP is funded by 12% of annual salary being accumulated each year during the 5 years to March 2015, ultimately vesting as determined by the above performance targets and being paid as a single sum in January 2016. Any LTIP payment is funded from financial out-performance after payment of any incentive awards to employees.

The Remuneration Committee maintains the right to vary LTIP payments (potentially to zero) should a major incident damage the financial stability or reputation of Scottish Water. Such reduction may be carried out at any time prior to LTIP payments being made.

Confirmation of awards under the LTIP will be made during 2015 following independent review of performance in the 2010–15 period by external auditors and our regulators. Consequently, no LTIP payment has been included within the single figure table of the Members' Remuneration Report. Any amount paid to Executive Members in January 2016 will be disclosed in the 2015/16 Members' Remuneration Report.

Non-executive Members are not eligible for long term incentive payments.

g. Pension

All employees, including Executive Members, are eligible to participate in the Local Government Pension Scheme (LGPS) (Scotland) which is a contributory, defined benefit scheme operating under regulations determined by the Scottish Parliament. These regulations require Scottish Water to offer this pension to all employees and in the case of the Executive Members participation is via the Lothian Pension Fund. All pension scheme members may request flexible retirement from age 55, reducing their hours or grade to receive all or part of their pension while continuing to work.

The value of pension provided through the LGPS is set out in section 2.c of the Members' Remuneration Report.

Non-executive Members are not eligible to receive pension benefits.

h. Benefits

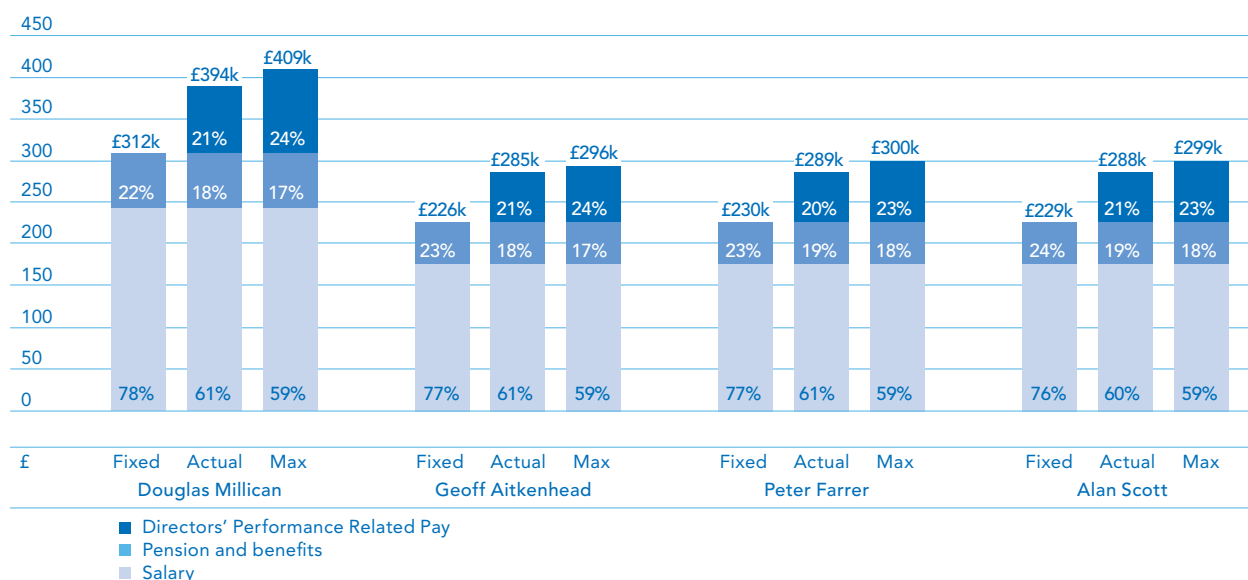
A car is provided to all Executive Members and the Chair for business needs. For those opting out of car provision, a car allowance is payable instead. Other non-executive members are not eligible for a car or car allowance.

Executive Members are covered by the Scottish Water Life Assurance Scheme that covers all employees.

The value of allowances received is set out in the benefits column of the single figure table in the Members' Remuneration Report.

i. Total pay potential for Executive Members – 2014/15

The following graphs set out minimum and maximum pay potentials for Executive Members. All figures are in £000s and are based on a full year of service with no change in base pay during the year; AOIP maximum assumes full out-performance of Delivery Plan targets. AOIP potential payments are linked to base salary; sums accruable in lieu of pension contributions may also vary in line with charges levied on Scottish Water by the Lothian Pension Fund.



j. Approach to Recruitment Remuneration

The remuneration of any new Executive Member will be agreed with the Scottish Government prior to appointment of that Member. The Remuneration Committee will put forward a recommended recruitment package, encompassing those elements that apply to other Executive Members and that are detailed elsewhere in this remuneration policy.

If recruitment of an Executive Member requires compensation for relocation this would normally be calculated as per Scottish Water's relocation policies and would be included in any recommendation made. Should recruitment of an Executive Member require compensation for forfeit of variable remuneration from a former employer, this would also be included in any recommendation made.

The appointment and remuneration of the Chair of Scottish Water and Non-executive Members is agreed by Scottish Ministers, with regard to the daily fee framework of the Scottish Government's Pay Policy for Senior Appointments. Fees paid reflect the time commitment required for each role and are detailed in the Members' Remuneration Report.

k. Payments on Loss of Office

Executive Members are expected to work the notice periods in their service contracts and will not normally be compensated in lieu of notice. In circumstances where it is in the operational interests of Scottish Water for an Executive Member to leave before the end of their notice period, the Remuneration Committee will consider options such as 'garden leave' or paying in lieu for all or part notice on a case-by-case basis.

If an Executive Member leaves the employ of Scottish Water before incentive payments under the AOIP or LTIP would be due, their payment will normally be forfeit. However, the Remuneration Committee may decide that a portion of the incentive payment is payable in certain circumstances such as departure due to redundancy and efficiency, ill health or normal retirement, or death in service. Any incentive payment so determined will be paid no earlier than would have been the case had the Member not left Scottish Water.

Where an Executive Member leaves for reasons of efficiency or redundancy, any severance payment that may apply will be on the same terms as for any other employee leaving under such circumstances and will be as set out under the approved redundancy scheme in operation at the time. Where the Executive Member is a member of the Local Government Pension Scheme (LGPS) (Scotland) then access to pension benefits on leaving will be determined by the regulations of that pension scheme, as for any other LGPS member.

No compensation is payable to any Non-executive Member if their appointment is terminated early.

l. Consideration of employment conditions elsewhere in the company

The Remuneration Committee requests and receives information as required on pay and terms and conditions for all employees in order to provide context for decisions on executive pay. This information includes comparison of the salary and total pay of the Chief Executive versus that of the median and average salary and total pay of other employees; as well as consideration of the ratio between the lowest and highest potential total pay in the organisation.

When considering payments to be made under the Annual Out-performance Incentive Plan (AOIP), the Remuneration Committee draws comparison between the proportion of potential payment resulting to Executive Members and that being made to other employees under their AOIP arrangements.

Any review of executive salaries includes consideration of the pay adjustment opportunities available to other employees.

In addition, for the 2015–21 period, Scottish Water discussed its incentive plans with the Customer Forum to ensure that those measures and targets which must be out-performed, align with customer expectations of what matters most within Scottish Water's delivered performance.

m. Service contracts

Details of Executive Members' permanent contracts are set out below.

Executive Member	Name	Date of Contract
Chief Executive	Douglas Millican	1 February 2013
Executive Director Capital Investment	Geoff Aitkenhead	20 April 2015*
Chief Operating Officer	Peter Farrer	1 April 2013
Finance Director	Alan Scott	24 September 2013

* Contract to be reviewed prior to March 2018.

All Members are required to give 6 months' notice of resignation. Scottish Water is required to give Members 12 months' notice of termination.

Non-executive Board Members

Non-executive Members do not have service contracts and are expected to work 4 days per month for Scottish Water with the exception of the Chairs of the Audit and Remuneration Committees, Lynne Peacock and Donald Emslie respectively, who work 5 days per month and the Chair, Ronnie Mercer, who works 2.5 days per week.

Expiry dates of Non-executive appointments are as follows:

Alan Bryce	31 March 2018
Lynne Peacock	31 March 2018
Matt Smith	31 March 2017
James Spowart	31 March 2017
Andrew Wyllie	31 March 2017
Donald Emslie	31 March 2016
Ronnie Mercer, Chair	31 May 2015

2. Members' Remuneration Report

The auditors are required to report on information contained in sections 2.a to 2.e of the Remuneration Report.

a. Single Total Figure Table

		Salary / Fees	Benefits (i)	AOIP (ii)	Sub-total	Pension (iii)	Total
		£000	£000	£000	£000	£000	£000
Executive Members							
Douglas Millican	2015	242	12	82	336	58	394
	2014	237	12	92	341	57	398
Geoff Aitkenhead (iv)	2015	175	9	59	243	42	285
	2014	172	9	67	248	41	289
Peter Farrer	2015	176	12	59	247	42	289
	2014	172	11	67	250	41	291
Alan Scott (v)	2015	174	13	59	246	42	288
	2014	88	6	34	128	21	149
Non-executive Members (vi)							
Ronnie Mercer	2015	90	10	–	100	–	100
	2014	90	10	–	100	–	100
Alan Bryce	2015	20	–	–	20	–	20
	2014	20	–	–	20	–	20
Donald Emslie	2015	25	–	–	25	–	25
	2014	25	–	–	25	–	25
Lynne Peacock	2015	25	–	–	25	–	25
	2014	25	–	–	25	–	25
Matt Smith (viii)	2015	20	–	–	20	–	20
	2014	18	–	–	18	–	18
James Spowart	2015	20	–	–	20	–	20
	2014	20	–	–	20	–	20
Andrew Wyllie	2015	20	–	–	20	–	20
	2014	20	–	–	20	–	20
Former Members							
Douglas Reid (vii)	2015	15	–	–	15	–	15
	2014	18	–	–	18	–	18
Chris Banks	2014	159	11	62	232	38	270
Total remuneration	2015	1,002	56	259	1,317	184	1,501
	2014	1,064	59	322	1,445	198	1,643

- (i) Benefits include the value of a car or car allowance and annual life assurance premiums associated with the Scottish Water Life Assurance Scheme as described in the Executive Remuneration Policy; plus any holiday sale backs / purchases. The value of each benefit is described in a separate table below.
- (ii) Annual Out-performance Incentive Plan as described in the Executive Remuneration Policy.
- (iii) Pension amounts represent the amount of any Company pension contributions and / or cash in lieu. The increase in transfer values of the Members' interest in the defined benefit scheme are not included in this table but detailed in section 2.c.
- (iv) Mr. Aitkenhead's remuneration reflects his service as Asset Management Director to 27 March 2015.
- (v) Payments made to Mr. Scott in 2014 reflect his appointment as Finance Director on 24 September 2013.
- (vi) Non-executive Members are expected to work 4 days per month for Scottish Water with the exception of the Chairs of the Audit and Remuneration Committees, Lynne Peacock and Donald Emslie respectively, who work 5 days per month and the Chair, Ronnie Mercer, who worked 2.5 days per week. Fees are agreed by Scottish Ministers with regard to the daily fee framework of the Scottish Government's Pay Policy for Senior Appointments and payments reflect the time commitment required for each role.
- (vii) Payments received by Douglas Reid reflect his appointment as a Non-executive Member on 1 May 2013 until his resignation on 31 December 2014.
- (viii) Payments received by Matt Smith reflect his appointment as a Non-executive Member on 1 May 2013.

The Committee approved a 1.8% increase in base salaries for 3 executive members with effect from 1 April 2015. Consequently, base salaries for 2015/16 are as follows: Peter Farrer £178,948; Douglas Millican £246,262; and Alan Scott £176,867. Geoff Aitkenhead's salary reflects his phased retirement and reduced to £140,636. Fee levels for non-executive members, excluding the Chair, for 2015/16 will increase by 1%, also with effect from 1 April 2015.

b. Details of benefits received 2014/15

	Car or allowance	Life assurance premium	Holiday purchase	Total
	£000	£000		£000
Executive Member				
Douglas Millican	10	2		12
Geoff Aitkenhead	11	2	-3	10
Peter Farrer	10	2		12
Alan Scott	12	1		13
Non-executive Member				
Ronnie Mercer (Chair)	10			10

c. Total pension entitlements to end of financial year 2014/15

The Executive Members Douglas Millican, Geoff Aitkenhead, Peter Farrer and Alan Scott are eligible to participate in the Lothian Pension Fund, a defined benefit scheme. The table below presents pension accruals under the regulations of the Local Government Pension Scheme (LGPS) (Scotland).

	Increase in accrued benefits during the year net of inflation			Accumulated total accrued benefits at 31 March 2015		Transfer Values ⁽⁴⁾		
	Years in Scheme	Pension £000	Lump sum £000	Pension £000	Lump sum £000	At 31 March 2015 £000	At 31 March 2014 £000	Increase in 2014/15 net of Members' own contributions and inflation £000
Douglas Millican	20.1	6	3	67	128	1,139	1,026	86
Geoff Aitkenhead ⁽⁵⁾	33.4	3	5	78	205	1,769	1,713	56
Peter Farrer	30.7	5	4	72	163	1,353	1,241	93
Alan Scott	1.5	3	–	4	–	64	21	25

Notes:

- (1) Members of the pension scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.
- (2) The normal retirement age of Executive Members is determined by the rules of the Local Government Pension Scheme. For pension accrued up to 31st March 2015 this is age 65. For pension benefits accrued after that date, normal retirement age is set equal to the individual's state pension age. Any pension benefits drawn before normal retirement age are usually reduced in value by actuarial factors reflecting the anticipated longer payment period.
- (3) The pension entitlement shown is that which would be paid annually on retirement along with the lump sum, based on service to the end of the year.
- (4) The transfer value of accrued pension is calculated in a manner consistent with Actuarial Guidance Note GN11.
- (5) On 27 March, Geoff Aitkenhead chose the opportunity to take phased retirement under terms available from the pension scheme. Consequently, the table above reflects his pension entitlement, which is fixed in real terms. The increase in his accrued benefits during the year reflects a 2.7% increase in CPI, as at September 2013. This is the rate applied to pension increases effective from 1 April 2014. The increase in the transfer value of his pension reflects the CPI increase and changes to age dependent actuarial factors only. Since 2012, Scottish Water no longer provided contributions to the Lothian Pension Fund in respect of Mr Aitkenhead. However, an equivalent cash in lieu value, equating to 24% of base salary, was charged and disclosed in the Remuneration Reports for the 2012/13, 2013/14 and 2014/15 periods and became payable to him on his phased retirement on 27 March 2015.

d. Change in Chief Executive single figure remuneration

	2014/15	2013/14	2012/13	2011/12	2010/11
CEO total single figure £000	394	398	458	472	444
AOIP as percentage of maximum	85%	97%	87.5%	100%	75%

The table above shows the prescribed remuneration data for the Member undertaking the role of Chief Executive during each of the last 5 financial years.

e. Percentage change in Chief Executive pay versus employees as a whole

The tables below compare the change in the Chief Executive's remuneration from 2013/14 to 2014/15 to employees within Scottish Water.

	Total ⁽ⁱ⁾ £000		Change %
	2014/15	2013/14	
Chief Executive	336.2	340.5	-1.3
Employees ⁽ⁱⁱ⁾	30.3	29.7	2.0

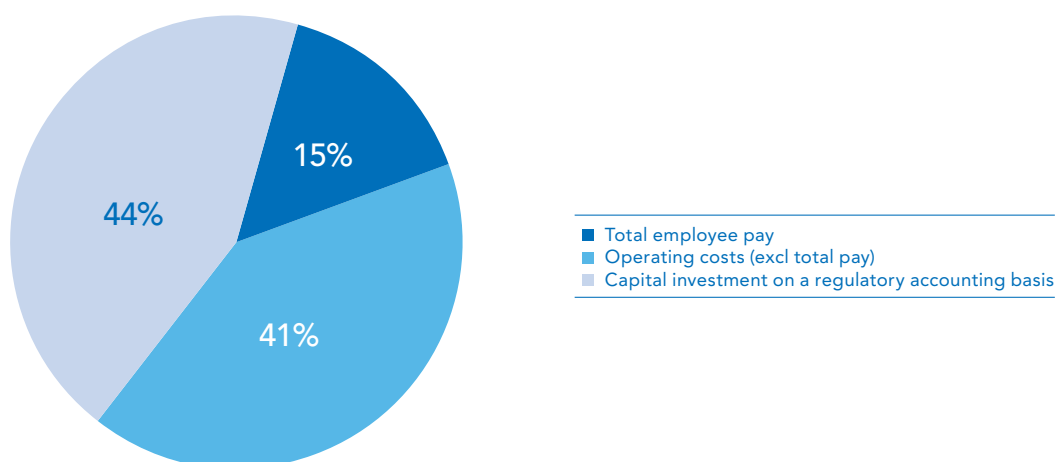
	% change of Chief Executive	% change of employees
Salary	2.2	2.2
Bonus	-10.4	-
Benefits	0	-
Total	-1.3	2.0

(i) The total excludes the calculation of change in pension as the value relies heavily on length of pensionable service and so has little meaning when comparing one person (the Chief Executive) against a group of employees with varying lengths of service, i.e. an individual with greater pensionable service could see a faster increase in calculated pension value than someone with shorter pensionable service, even if they are paid the same during a financial year.

(ii) Based on the average full time equivalent salary, AOIP and benefits of all employees other than Executive Members.

f. Relative importance of spend on pay

The importance of total annual spend on pay is shown in relation to other Operating costs and Capital investment during the year. As Scottish Water is a public sector organisation owned by the Scottish Government, there were no disbursements to shareholders.



g. Implementation of Remuneration Policy in 2015/16

As described in the Executive Remuneration Policy, Scottish Water operates an Annual Out-performance Incentive Plan (AOIP) designed to incentivise and reward the out-performance of targets agreed with regulators. To ensure that the AOIP targets remain suitably challenging they are reviewed each year and for 2015/16 the Remuneration Committee has determined the following out-performance targets.

Measure	Description	Weighting
Financial Out-performance	Profit Before Tax and Depreciation (PBTDA) to beat the delivery plan for 2015/16 by £0 to £20m. 0% payable at the delivery plan figure; 100% at +£20m.	40% on sliding scale ⁽¹⁾
Customer Service Provision	Overall Performance Assessment (OPA) – based on maintaining a score on a sliding scale between 380 and 400 points. 0% payable below 380; 30% payable at 380; 90% payable at 400; 100% payable for beating 400 points.	25% on a sliding scale
Customer Experience	Improvement in the Household Customer Experience Measure (hCEM) as developed and agreed with the Customer Forum. Beat the baseline hCEM for 2014/15 on a sliding scale so that: 0% payable below 82.6 points; 30% payable at 82.6 points; 100% payable for greater than or equal to 84.3 points.	25% on a sliding scale
Customer Benefit Delivery	Beat the delivery plan target Overall Measure of Delivery (OMD) of 73 points and ensure forecast capital programme cost is within the regulatory allowance (plus customer contributions). Requires that no more than 9 Q&S3a and Q&S3b projects are outstanding.	10% all or nothing payment

(1) PBTDA performance acts as a gateway and must be sufficient to fund AOIP payments; delivery plan baseline will be updated for inflation and regulatory out-turn assumptions.

h. Long Term Incentive Plan to incentivise out-performance in the 6 years to March 2021

The SR15 LTIP has been agreed with the Scottish Government and provides clear targets for out-performance of the Water Industry Commission’s Final Determination for the 2015–21 period. The LTIP is funded by 10% of annual salary being accumulated each year during the 6 years to March 2021, ultimately vesting as determined by the performance targets below and being paid as a single sum. Any LTIP payment is funded from financial out-performance after payment of any incentive awards to employees. The LTIP will only be payable if there is overall financial out-performance of the Final Determination.

The SR 15 LTIP structure is as follows:

Measure	Weighting	Basis of calculation	Target
Growth in cash, measured as debt less cash, relative to the Final Determination	50%	Straight line sliding scale	£0 to £200m above Final Determination (before any cash returned to customers) ⁽¹⁾
OPA – the average performance 2015–21 linked to leading company and best in class thresholds agreed with the Customer Forum	50%	Sliding scale	0% below an avg. 382.5 points 30% at an avg. 382.5 points 90% at an avg. 400 points 100% for an avg. >400 points

(1) Cash growth is before the impact of valid changes to external costs (e.g. rates) and any restrictions of customer price increases.

All other aspects of Executive and Non-executive Member remuneration will operate as described in the Executive Remuneration Policy.

i. Executive Members' Directorships of other companies

The Remuneration Committee supports active development of Executive Members including their involvement with other companies and public bodies where this is compatible with fulfilling their responsibilities to Scottish Water.

During the year, Geoff Aitkenhead has been a Non-executive Director of Scottish Canals and received fees of £5,664 (2014: £2,088).

This report was approved by the Board and signed on its behalf by:

Donald Emslie

Chair of the Remuneration Committee

19 May 2015

Members' report

The Members present their annual report together with the audited consolidated financial statements for the year ended 31 March 2015.

Strategic report

The Companies Act 2006 requires us to present a fair review of the business during the year to 31 March 2015 and of the position of the Group at the end of the financial year, together with a description of the principal risks and uncertainties faced. The Strategic Report is on pages 5 to 34.

Corporate governance statement

The Disclosure and Transparency Rules require certain information to be included in a corporate governance statement in the Members' report. Information that fulfils the requirements of the corporate governance statement can be found on pages 38 to 42.

Accounting requirements

The financial statements have been prepared in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002.

Members and their interests

All Members have declared that they had no material interests in any contracts awarded during the year by Scottish Water. A register of Members' interests is maintained at Scottish Water's head office and is open for inspection during normal office hours.

Results

The surplus for the year after taxation amounted to £91 million (2014: £165.5 million). Details of the financial results and associated accounting policies are set out on pages 70 to 104.

Going concern

Scottish Water operates under an annual external financing limit (EFL) set by the Scottish Government. The annual EFL controls the amount by which Scottish Water can increase its externally sourced finance, including borrowings. In addition, Scottish Water's charging structure is reviewed through a regulatory process and charges are approved annually by the Water Industry Commission for Scotland. Information regarding the agreed regulatory contract for the 2015–21 period is provided in the 'Looking ahead' section on page 34.

The Members, taking all relevant factors into account, consider that Scottish Water will have adequate resources to continue in operational existence for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Research and development

To ensure that Scottish Water derives benefit from the most up-to-date research being undertaken within the industry, research expenditure is targeted towards collaborative research with other water operators and regulators within the UK. This ensures that access is gained to high value, widely based research programmes in the Environmental, Quality, Engineering, Operational and Regulatory fields. Research into issues common to the UK water industry is procured through membership of the UK Water Industry Research Centre and the Foundation of Water Research.

Political contributions

No political contributions were made during the year (2014: nil).

Employee relations and involvement

The Scottish Water group of businesses employed an average of 3,683 (2014: 3,617) staff during the year. Details of the costs incurred in relation to these staff can be found in note 5 to the financial statements on page 81. Scottish Water is committed to a policy of equal opportunities for all employees irrespective of race, religion, gender, sexual orientation, disability or age and uses a number of forums to encourage employee involvement. Employees are kept involved through a process of regular team meetings, employee newsletters and representation on consultative forums.

Scottish Water is committed to continually improving its performance in relation to Health and Safety. Through an extensive safety awareness campaign, safety briefings and ongoing training, awareness of health and safety issues is being encouraged and increased among employees.

Public Services Reform (Scotland) Act 2010

Sections 31 and 32 of the Public Services Reform (Scotland) Act 2010 impose new duties on the Scottish Government and listed public bodies to publish information on expenditure and certain other matters as soon as is reasonably practicable after the end of each financial year.

In accordance with the Public Services Reform (Scotland) Act 2010, Scottish Water will publish the full information as required by the act on the Scottish Water website (www.scottishwater.co.uk) following the approval of the Scottish Water Annual Report and Accounts 2014/15. The report for this financial year will be available from August 2015.

Greenhouse gas emissions

All disclosures regarding the Group's greenhouse gas emissions are contained in the Strategic review – Environment report on page 28, with further information available on the Scottish Water website.

Financial risk management

Details of the Group's exposure to and management of liquidity/cash flow, credit, interest rate and foreign currency risk are provided in note 26 to the financial statements on pages 101 to 103.

Appointment and replacement of Members

Schedule 3 of the Water Industry (Scotland) Act 2002 specifies Scottish Water's Board must comprise between 5 and 8 Non-Executive Members and between 3 and 5 Executive Members. One Member must have special knowledge of the interests of the employees of Scottish Water. Non-Executive appointments are made by the Scottish Ministers for 3 or 5 years following an open and transparent public appointment process. Executive Members are appointed by Scottish Water with the consent of the Scottish Ministers for an unidentified period. The Members appointments can be terminated under procedures set out in Paragraph 1 of Schedule 3 of the Water Industry (Scotland) Act 2002.

Members' responsibilities

The following statement, which should be read in conjunction with the statement of auditors' responsibilities included in the Auditors' Report on pages 64 to 69, is made with a view to distinguishing the respective responsibilities of the Members and of the auditors in relation to the financial statements.

The Members are required by the Water Industry (Scotland) Act 2002 and directions made thereunder to prepare financial statements for each financial year which give a true and fair view of the state of affairs of Scottish Water and of its income and expenditure for that period. In preparing those financial statements, the Members are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to do so.

The Members are responsible for keeping proper accounting records, which disclose with reasonable accuracy, at any time, the financial position of Scottish Water and to enable them to ensure that the financial statements comply with statute and any financial reporting requirements. They are also responsible for taking reasonable steps to safeguard the assets of the business and to prevent and detect fraud and other irregularities.

Each of the persons who is a Member at the date of approval of this report confirms that:

- so far as the Member is aware, there is no relevant audit information of which the Company's auditors are unaware;
- each Member has taken all the steps that he/she ought to have taken as a Member in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The Members, as at the date of this report, consider that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess Scottish Water's performance, business model and strategy.

By order of the Board,

Tom Axford

Corporate Secretary

27 May 2015

Financials

Independent auditors' report	64
Consolidated income statement	70
Consolidated statement of comprehensive income	70
Consolidated statement of changes in equity	71
Company statement of changes in equity	71
Balance sheets	72
Statements of cash flow	73
Notes to the financial statements	74
Direction by the Scottish Ministers	105

Independent auditors' report

Independent auditors' report to the members of the Board of Scottish Water, the Auditor General for Scotland and the Scottish Parliament.

We have audited the financial statements of Scottish Water and its group for the year ended 31 March 2015 under the Water Industry (Scotland) Act 2002. The financial statements comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Statements of Changes in Equity, the Group and Company Balance Sheets, the Group and Company Statements of Cash Flow and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the 2014/15 Government Financial Reporting Manual (the 2014/15 FReM).

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Board Members and auditor

As explained more fully in the Statement of Members' Responsibilities, the Board Members are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and are also responsible for ensuring the regularity of expenditure and income. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We are also responsible for giving an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Board Members; and the overall presentation of the financial statements. It also involves obtaining evidence about the regularity of expenditure and income. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements, irregularities, or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers of the state of affairs of the group and of the company as at 31 March 2015 and of the surplus of the group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2014/15 FReM; and
- have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

Opinion on regularity

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Overview



- Overall group materiality: £10.8m which represents 1% of total expenses.
- We performed an audit of the complete financial information of the Scottish Water Group Company and Scottish Water Business Stream reporting units, and of Scottish Water Solutions 2 Limited, the jointly controlled operation.
- Our audit scope addressed 98% of the Group’s total expenses and 97% of the Group’s surplus before tax.
- Risk of fraud in expenditure and capital additions
- Household bad debt provision
- Pension obligations

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (“ISAs (UK & Ireland)”).

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as “areas of focus” in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
<p>Risk of fraud in expenditure and capital additions</p> <p>Refer to page 45 (Audit Committee Report), page 76 (significant accounting policies) and page 83 (notes)</p> <p>For the Scottish Water regulated business, the Directors are incentivised across a number of financial and other measures including profit and completion of capital investment programmes.</p> <p>We focused on the appropriateness of capital additions as the Directors may feel pressure to manipulate expenditure recognition by inappropriately capitalising maintenance costs to achieve planned targets on two of the incentive measures being profit and capital investment delivery.</p>	<p>We evaluated and tested the controls established by the Directors, checking that income statement expenditure and capital expenditure were correctly recorded and classified in the financial ledger. This included key authorisation controls.</p> <p>On a sample basis, we also selected items from the capitalised amounts and tested these by agreeing them to external completion certificates, invoices or employee timesheets as appropriate. We agreed that the amounts capitalised were appropriate.</p> <p>We tested material fixed assets transferred from assets under construction into asset categories for a period of one month before and one month after the balance sheet date. We tested that these transfers were appropriate by agreeing the assets to completion certificates and appropriate approval from within Scottish Water. We agreed that these capital programmes were complete and that the transfer of the assets was therefore appropriate.</p> <p>We also identified material manual journals being posted to reallocate costs to fixed assets from expenditure accounts, understood the rationale for the adjustments, and obtained appropriate evidence to check it was reasonable for the amounts in question to be reallocated to fixed assets.</p> <p>We agreed that the re-allocation journals posted between fixed assets and expenditure accounts were reasonable in the circumstances.</p>
<p>Household bad debt provision</p> <p>Refer to page 45 (Audit Committee Report), page 77 (significant accounting policies) and page 102 (notes)</p> <p>As at 31 March 2015, the Scottish Water regulated business reported a household revenue debtor of £439.4 million (2014: £432.3 million) and a corresponding bad debt provision of £418.6 million (2014: £398.8 million) on household billings from all years dating back to 1996/97. Household water debt is a statutory debt recoverable from the occupier. The household billing and cash collection is performed by local councils and Scottish Water cannot influence either of these areas.</p> <p>There are a number of key assumptions included in the calculation of the bad debt provision; the most sensitive of these is the forecast collection rate for 2013/14 and 2014/15 household debtors. We focused on this area as determining these assumptions is judgemental and changes to the assumptions could lead to a significant change in the closing bad debt provision amount.</p>	<p>We re-performed the bad debt provision calculation and reconciled the total billings, cash collected and closing debtor positions which form the basis of the provision calculation to the underlying ledger and prior year working papers.</p> <p>We agreed the closing debtor position and household revenue recorded in the year directly with the local councils which collect the household revenue and obtained 99% coverage.</p> <p>In challenging the Directors' underlying assumptions, we compared the provision to the previous years of operation, our understanding of developments in the business and external economic factors, and they appeared reasonable.</p> <p>We performed sensitivity analysis over the forecast collection rate and considered the impact of the historical cash collection rates, and other external factors. The expected range produced by the sensitivity analysis was within the overall materiality threshold.</p> <p>We also checked the sensitivities disclosed by the Directors associated with the household bad debt provision in note 26 to the financial statements.</p> <p>This is an area which requires significant judgement and has a range of possible outcomes. However, from the evidence we have obtained, and the sensitivity analysis performed we did not identify any material misstatement in the household bad debt provision.</p>

Area of focus	How our audit addressed the area of focus
<p>Pension obligations</p> <p>Refer to page 45 (Audit Committee Report), page 77 (significant accounting policies) and page 95 (notes)</p> <p>Employees of Scottish Water participate in 3 pension funds; North East Scotland pension fund, the Lothian pension fund and the Strathclyde pension fund which are all part of Local Government defined benefit pension schemes.</p> <p>We focused on this area because of the materiality of the obligations to the financial statements and the significant level of judgement required to be made by the Directors in determining the pension assumptions.</p> <p>The net pension liability at the year end was £161.1 million (2014: £109.8 million).</p> <p>The key assumptions involved in determining the net pension obligation include discount rates, inflation rates and mortality rates which are specific to Scottish Water’s industry. Unfavourable changes in a number of the key assumptions can have a material impact on the calculation of the liability.</p>	<p>We obtained and read the independent actuaries report commissioned by the Directors which reports on the assumptions and methodology used to calculate the pension liabilities and the compliance of these with relevant accounting standards. We also assessed the qualification and competence of the actuaries and found that they were suitably experienced in the sector.</p> <p>We tested the pension scheme census data information on a sample basis by agreeing the records held by the actuary to the company’s records, as this is a key input to the overall pension liability calculation. We agreed that the census data held by the actuary was accurate.</p> <p>We checked the proportion of pension scheme assets applied to the Scottish Water net calculation to confirmations received directly from the Local Authority pension funds. There were no differences identified between the amounts included in the financial statements and the confirmations received.</p> <p>We evaluated the Directors’ key judgements taking into account the specific characteristics of the pension schemes. We assessed the assumptions with respect to discount rate, inflation rates and mortality rates used by comparing them with our own independently formed expectations.</p> <p>In light of the above, we found the judgements made by the Directors to be reasonable and the pension assumptions to be within an acceptable range.</p>

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£10.8 million (2014: £10.8 million)
How we determined it	1% of total expenses
Rationale for benchmark applied	We believe that total expenses is an appropriate benchmark for materiality as the most significant part of the Scottish Water group is its regulated business which is a Scottish Government owned body where the level of expenditure is the most important measure.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £200,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons. There were no material unadjusted misstatements identified.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group has 4 main trading businesses located in Scotland which provide households, wholesale licensed providers and businesses with regulated water, waste water services and non-regulated services. The Group financial statements are a consolidation of 6 reporting units and one jointly controlled operation, comprising the Group's trading businesses and centralised functions.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, or component auditors within PwC UK operating under our instruction. Where the work was performed by component auditors we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Accordingly, of the Group's reporting units, we identified that Scottish Water Group Company and Scottish Water Business Stream, in our view, required an audit of their complete financial information due to their financially significant contribution to the Group's overall results. We also carried out an audit of the complete financial information of Scottish Water Solutions 2 Limited, the jointly controlled operation which we considered necessary to achieve sufficient audit evidence over the Group's activities. These entities accounted for 98% of the Group's total expenses. This, together with additional procedures performed at the Group level, gave us the evidence we needed for our opinion on the Group financial statements as a whole.

Opinion on other prescribed matters

In our opinion:

- the part of the Members' Remuneration Report to be audited has been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers; and
- the information given in the Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Under the ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of Scottish Water and its group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the boards' statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

We are also required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Members' Remuneration Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Corporate Governance Statement required by The Scottish Water Governance Directions 2009 does not address the 10 provisions of the UK Corporate Governance Code specified for auditor review by the Listing Rules.

We have nothing to report in respect of these matters.

Mark Hoskyns-Abrahall

For and on behalf of PricewaterhouseCoopers LLP
Edinburgh
29 May 2015

Consolidated income statement

For the year ended 31 March 2015

	Note	2015 £m	2014 £m
Revenue	3	1,187.4	1,179.7
Cost of sales		(754.6)	(742.6)
Gross surplus		432.8	437.1
Administrative expenses		(135.5)	(145.4)
Operating surplus	3, 4	297.3	291.7
Finance income	7	2.0	1.1
Finance costs	7	(188.6)	(191.8)
Surplus before taxation		110.7	101.0
Taxation	8	(19.7)	64.5
Surplus for the year	20	91.0	165.5

Consolidated statement of comprehensive income

For the year ended 31 March 2015

	Note	2015 £m	2014 £m
Surplus for the year	20	91.0	165.5
Other comprehensive income:			
Items which will not subsequently be reclassified to the income statement			
Actuarial (loss)/gain on post employment benefit obligations, net of deferred taxation	22	(62.6)	86.4
Total comprehensive income for the year		28.4	251.9

The surplus for the period and total comprehensive income for the period are attributable to the owners of Scottish Water.

Consolidated statement of changes in equity

	Note	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2013		903.0	133.4	1,036.4
Surplus for the year		165.5	–	165.5
Other comprehensive income:				
Actuarial gain on post employment benefit obligations, net of tax	22	86.4	–	86.4
Total comprehensive income for the year		251.9	–	251.9
Balance at 31 March 2014		1,154.9	133.4	1,288.3
Surplus for the year		91.0	–	91.0
Other comprehensive loss:				
Actuarial loss on post employment benefit obligations, net of tax	22	(62.6)	–	(62.6)
Total comprehensive income for the year		28.4	–	28.4
Balance at 31 March 2015	20	1,183.3	133.4	1,316.7

Company statement of changes in equity

	Note	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2013		806.4	133.4	939.8
Surplus for the year	20	132.3	–	132.3
Other comprehensive loss:				
Actuarial gain on post employment benefit obligations, net of tax	22	86.0	–	86.0
Total comprehensive income for the year		218.3	–	218.3
Balance at 31 March 2014		1,024.7	133.4	1,158.1
Surplus for the year	20	64.6	–	64.6
Other comprehensive loss:				
Actuarial loss on post employment benefit obligations, net of tax	22	(60.7)	–	(60.7)
Total comprehensive income for the year		3.9	–	3.9
Balance at 31 March 2015	20	1,028.6	133.4	1,162.0

The 'Statement of changes in equity' above excludes Government loans which, in accordance with the Corporate Governance Direction, are recorded on the balance sheet under Equity. Full details of Government loans are provided in note 18.

Balance sheets

As at 31 March 2015

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Assets					
Non-current assets					
Property, plant and equipment	9	5,483.8	5,430.6	5,469.6	5,407.9
Investments	10	–	–	37.6	37.6
Deferred tax asset	15	0.5	0.1	–	–
		5,484.3	5,430.7	5,507.2	5,445.5
Current assets					
Inventories	11	2.5	2.4	2.3	2.1
Trade and other receivables	12	154.1	163.2	83.5	70.3
Current tax asset		3.7	5.6	0.8	0.9
Cash and cash equivalents	13	491.4	416.6	345.4	270.3
		651.7	587.8	432.0	343.6
Total assets		6,136.0	6,018.5	5,939.2	5,789.1
Liabilities					
Current liabilities					
Trade and other payables	14	(385.5)	(389.8)	(338.1)	(281.1)
Other loans and borrowings	17	(18.3)	(17.8)	(18.3)	(17.8)
Current tax liabilities		–	–	–	–
Provisions for liabilities	16	(1.8)	(2.9)	(12.7)	(13.8)
		(405.6)	(410.5)	(369.1)	(312.7)
Non-current liabilities					
Trade and other payables	14	(68.3)	(95.3)	(61.6)	(89.8)
Other loans and borrowings	17	(364.6)	(382.9)	(364.6)	(382.9)
Deferred tax liabilities	15	(354.5)	(351.3)	(354.1)	(350.8)
Retirement benefit obligations	22	(201.4)	(137.2)	(201.4)	(139.3)
Provisions for liabilities	16	(1.6)	(0.2)	(3.1)	(2.7)
		(990.4)	(966.9)	(984.8)	(965.5)
Total liabilities		(1,396.0)	(1,377.4)	(1,353.9)	(1,278.2)
Net assets		4,740.0	4,641.1	4,585.3	4,510.9
Equity					
Government loans	18	3,423.3	3,352.8	3,423.3	3,352.8
Retained earnings	20	1,183.3	1,154.9	1,028.6	1,024.7
Other reserves		133.4	133.4	133.4	133.4
		4,740.0	4,641.1	4,585.3	4,510.9

The financial statements on pages 70 to 104 were approved by the Board of Members on 27 May 2015 and signed on its behalf by:

Douglas Millican
Chief Executive

Statements of cash flow

For the year ended 31 March 2015

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Surplus before taxation		110.7	101.0	77.4	60.2
Depreciation charges		258.1	254.1	255.4	251.8
Amortisation of grants		(1.0)	(1.1)	(1.0)	(1.0)
Surplus on disposal of property, plant and equipment		(10.7)	(10.3)	(10.7)	(10.3)
Non cash adjustment for retirement benefit obligations		(13.3)	0.1	(13.1)	0.2
Finance costs – net		186.6	190.7	187.8	191.4
Operating cashflow before changes in working capital and provisions		530.4	534.5	495.8	492.3
Changes in working capital and provisions:					
Decrease/(increase) in receivables		7.4	6.2	(9.2)	5.7
(Increase)/decrease in inventories		(0.1)	–	(0.2)	0.1
(Decrease)/increase in payables		(62.0)	4.7	(0.3)	2.4
Decrease in provisions		(7.9)	(6.3)	(8.9)	(8.3)
Cash flows from operating activities		467.8	539.1	477.2	492.2
Taxation received/(paid)		0.7	(6.5)	–	–
Net cash generated from operating activities		468.5	532.6	477.2	492.2
Cash flows from investing activities					
Purchase of property, plant and equipment		(289.5)	(381.5)	(295.1)	(375.5)
Sale of property, plant and equipment		11.3	11.9	11.3	11.9
Government grants and other contributions		1.6	–	–	–
Infrastructure income receipts		10.3	7.6	10.3	7.6
Net cash used in investing activities		(266.3)	(362.0)	(273.5)	(356.0)
Cash flows from financing activities					
Repayments of loans		(224.4)	(347.4)	(224.4)	(288.9)
Proceeds from borrowings		294.4	373.9	294.4	373.9
Interest received		2.0	1.1	1.0	0.5
Interest paid		(182.1)	(180.9)	(182.3)	(180.6)
Payment of finance lease liabilities		(17.3)	(16.3)	(17.3)	(16.3)
Net cash used in financing activities		(127.4)	(169.6)	(128.6)	(111.4)
Net increase in cash and cash equivalents		74.8	1.0	75.1	24.8
Cash and cash equivalents at beginning of year	13	416.6	415.6	270.3	245.5
Cash and cash equivalents at end of year	13	491.4	416.6	345.4	270.3

Notes to the financial statements

For the year ended 31 March 2015

1. Accounting policies

1.1 General information

Scottish Water is a public sector body, classified as a public corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers.

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below.

1.2 Basis of preparation

The financial statements of Scottish Water for the year ended 31 March 2015 have been prepared in accordance with EU adopted and endorsed International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations, as interpreted by the International Government Financial Reporting Manual (FRoM). The FRoM is published by HM Treasury and is available from their website.

The consolidated financial statements have been prepared on the going concern basis under the historical cost convention, as modified by the revaluation of derivative financial instruments at fair value through the profit and loss. The financial statements are prepared in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002. The Company's financial statements have been prepared on the same basis and, as permitted by Section 408 of the Companies Act 2006, no income statement or statement of comprehensive income is presented for the Company.

Scottish Water's accounting policies, as set out below, have been consistently applied to all the years presented, unless otherwise stated.

Scottish Water's financial statements have been prepared in accordance with IFRS since 1 April 2008. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies (note 2).

The consolidated financial statements are presented in Pounds Sterling which is the functional and presentational currency of Scottish Water and its subsidiaries.

1.3 Changes in accounting policy

Scottish Water has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with effect from 1 April 2014.

- IFRS 10 'Consolidated Financial Statements';
- IFRS 11 'Joint Arrangements'; and
- IFRS 12 'Disclosure of Interests in Other Entities'.

The adoption of IFRS 10 and IFRS 11 has not required the Group to change the accounting treatment of any of its subsidiaries or entities subject to joint control and therefore there has been no impact on the overall results and financial position of Scottish Water.

1.4 Accounting standards not yet adopted by Scottish Water

As at the date of authorisation of these financial statements, the following key standards and interpretations were in issue but not yet effective (and in some cases had not yet been adopted by the EU). Consequently, Scottish Water has not applied these new IFRSs and IFRICs in the preparation of the financial statements.

- IFRS 9 'Financial Instruments';
- IFRS 14 'Regulatory Deferral Accounts';
- IFRS 15 'Revenue from Contracts with Customers';
- Annual improvements 2014; and
- Amendments to IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 1 'Presentation of Financial Statements', IAS 16 'Property, Plant and Equipment', IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures'.

The impact on Scottish Water's financial statements of the future adoption of these new and amended standards is currently under review, but Scottish Water does not expect any of these changes to have a material impact on the results or financial position of Scottish Water.

1.5 Basis of consolidation

a. Subsidiaries

The consolidated financial information incorporates the results of Scottish Water (the Company) and its trading subsidiaries. The consolidated financial information does not include the non trading subsidiaries as permitted under section 405 of the Companies Act 2006. Subsidiaries are all entities over which Scottish Water has the power to direct the relevant activities of the entities, the rights to variable returns and the ability to use its power to influence the returns. Scottish Water Business Stream Limited (Business Stream) is treated as a subsidiary although there are special governance arrangements which were established in conjunction with the Water Industry Commission for Scotland and associated with the conditions attached to Business

Stream's licence for the supply of water and waste water services. Scottish Water is, however, satisfied that the controls and governance in place are such that consolidation is appropriate. Subsidiaries are fully consolidated from the date on which control is transferred to Scottish Water; they are de-consolidated from the date when control ceases.

Intercompany transactions, balances and any unrealised gains on transactions between Scottish Water related companies have been eliminated within the consolidated financial statements. Uniform accounting policies have been adopted across the Group.

b. Jointly controlled operations

The nature of the contractual agreement between Scottish Water and the other shareholder in Scottish Water Solutions 2 Limited (SWS2) is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, SWS2 has been accounted for under IFRS 11 'Joint Arrangements', as a joint operation. On this basis Scottish Water accounts directly for its own gross assets, liabilities and cash flows in the joint operations.

1.6 Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board of Scottish Water.

1.7 Revenue recognition

Revenue is recognised to the extent that it is probable economic benefits will flow to the Group and that the revenue can be reliably measured. Revenue is not recognised until the service has been provided to the customer. Revenue is shown net of value added tax and after eliminating sales between the Scottish Water related companies. Where services have been provided, but for which no invoice has been raised at the year end, an estimate of the value is included in revenue.

Revenue comprises charges to customers for water and waste water services, and related services provided during the year in the normal course of business. For measured customers, revenue includes an estimate of the value of water and waste water services supplied to customers between the date of the last meter reading and the year end. For unmeasured customers billed in advance, income is deferred and released to the income statement throughout the year.

1.8 Research and development expenditure

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects which either do not meet the criteria defined in IAS 38 'Intangible assets' or are deemed to be not material, are recognised as an expense as incurred. Development costs which meet the relevant criteria are capitalised and written off over their expected useful lives. Development costs previously recognised as an expense are not recognised as an asset in subsequent periods.

1.9 Finance income and costs

Finance income comprises interest receivable on funds invested and recognised in the income statement. Finance costs comprise interest payable on borrowings and interest on pension scheme net liabilities. Interest income and costs are recognised in the income statement as they accrue, on an effective interest rate method.

Borrowing costs incurred by Scottish Water that are not directly attributable to the acquisition, construction or production of qualifying assets are expensed in the period in which they are accrued.

1.10 Taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, unless it relates to items recognised directly in reserves in which case it is recognised in reserves.

Current tax is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Notes to the financial statements

For the year ended 31 March 2015

continued

1. Accounting policies continued

1.11 Property, plant and equipment

Property, plant and equipment comprises water and waste water infrastructure assets and other assets, being overground assets including operational properties, plant, machinery and vehicles.

Property, plant and equipment are included at historical cost less accumulated depreciation and impairment. Cost includes the acquisition or construction cost together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs and, where material, borrowing costs. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that the future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. All items of property, plant and equipment, with the exception of land and assets under construction, are subject to depreciation.

Infrastructure assets

The infrastructure assets comprise a network of water and waste water systems including mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls. Expenditure on infrastructure assets, which relates to increases in capacity or enhancements of the network, is treated as additions. Expenditure incurred in maintaining and repairing the operating capability of the network is expensed in the year in which it is incurred. Depreciation is calculated for each component of the network with similar characteristics and asset lives.

Other assets

All other property, plant and equipment are depreciated on a straight-line basis over their estimated useful economic lives.

Depreciation

Depreciation is charged to the income statement to write-off cost, less residual values, on a straight-line basis over the estimated operational lives of the assets, from the date of beneficial use. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Freehold land and assets under construction are not depreciated. The estimated useful lives for assets depreciated are as follows:

Infrastructure assets	80 to 150 years
Non-specialised operational buildings and structures	60 years
Specialised operational buildings and structures	20 to 80 years
Plant, machinery and vehicles	1 to 20 years

1.12 Leased assets

Leases where Scottish Water control through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the service concession agreements are treated as finance leases. Private Finance Initiative (PFI) contracts are treated as finance leases, in accordance with IFRIC 12.

Assets held under finance leases are recognised as part of the property, plant and equipment of the Group at their fair value or, if lower, at the present value of the minimum lease payments, as determined at the inception of the PFI contract. The corresponding liability is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation. Finance charges are charged directly to the income statement. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

All other leases are categorised as operating leases. Payments made under operating leases are charged to the income statement over the term of the lease on a straight-line basis.

1.13 Impairment of assets

The carrying values of the Group's non-current assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be justified. An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

1.14 Capital grants and customer contributions

Capital grants and customer contributions in respect of infrastructure assets are deducted from the cost of the non-current asset. Grants and contributions received in respect of non-infrastructure assets are credited to deferred income and are released to the income statement over the expected useful lives of the relevant non-current assets.

1.15 Investments

Investments in subsidiaries, held as non-current assets, are stated at cost less any provision for impairment. Any impairment is charged to the income statement as it arises.

1.16 Inventories

Inventories and work in progress are stated at the lower of cost or net realisable value. Cost is determined using the first-in, first-out

(FIFO) method. Cost includes all costs incurred in bringing each asset to its present location and condition. The valuation of work in progress is based on the cost of labour and materials plus appropriate overheads.

1.17 Financial instruments

Financial assets and liabilities are recognised in Scottish Water's balance sheet when an obligation is identified and released as that obligation is fulfilled. Scottish Water's financial instruments comprise trade and other receivables, cash and cash equivalents, borrowings, as well as trade and other payables that arise directly from operations. Scottish Water's policy is not to trade or speculate in financial instruments but under special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures. As such circumstances are rare, approval is required from Scottish Ministers. All treasury activities are undertaken in accordance with the permitted activities as set out in the Scottish Water Governance Directions 2009.

a. Trade receivables

Trade receivables are recorded at net realisable value after deducting a provision where there is evidence that Scottish Water will not be able to collect all amounts due. The provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile of the outstanding debt. Trade receivable balances, with the exception of statutory debt, are written off when Scottish Water determines that it is unlikely that future remittances will be received. Trade receivables do not carry any interest.

b. Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits with banks, which have a maturity of 3 months or less from the date of acquisition and which are subject to an insignificant risk of change in value.

c. Trade and other payables

Trade and other payables are stated at cost.

d. Interest-bearing loans and borrowings

Borrowings are recognised initially at fair value and are subsequently stated at amortised cost. Overdrafts and non Government loans are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

e. Derivative financial instruments

In special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures such as foreign exchange fluctuations. As such circumstances are rare, in addition to the approval of the Scottish Water Board, approval is required from Scottish Ministers under the terms of section 42(3)(b) Water Industry (Scotland) Act 2002.

Financial derivative instruments are recognised at fair value and are re-measured to fair value each reporting period. Scottish Water has not applied hedge accounting and all derivatives are measured at fair value through the income statement. The fair values of foreign exchange contracts are calculated by reference to market forward rates at the balance sheet date.

1.18 Employee benefit obligations

Employees of Scottish Water participate in the Local Government Pension Scheme administered by Aberdeen, Glasgow and Edinburgh City Councils, all of which are defined benefit schemes. Pension scheme assets are measured using the bid market values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

Any increase in the present value of liabilities within the defined benefit pension schemes expected to arise from employee service in the period is charged to operating surplus. The net interest cost for the period, calculated by applying the discount rate to the net pension scheme liabilities, is included in the finance costs. Actuarial gains and losses are recognised in full as an item of 'other comprehensive income' in the consolidated statement of comprehensive income. Pension scheme deficits and surpluses, to the extent that the surplus is considered recoverable, are recognised in full and presented on the face of the balance sheet.

1.19 Provisions

Provisions are recognised when there is a present obligation for a past event, for which it is probable that a transfer of economic benefits will be required and a reliable estimate can be made of the amount of the obligation. Provisions currently relate to onerous property rental costs, income uncertainty and redundancy costs associated with employees who will leave Scottish Water under voluntary redundancy and early retirement. Pension related liabilities associated with employees who have left Scottish Water under the voluntary severance scheme are recognised in the pension liability.

1.20 Foreign currency transactions

Transaction in foreign currencies are translated at the exchange rate ruling at the date of the transactions. Foreign exchange gains and losses resulting from (i) the settlement of such transactions and (ii) the retranslation to exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

1.21 Indebtedness to the Scottish Ministers

Loans from the National Loans Fund, the Scottish Consolidated Fund and other Government borrowings are treated as part of equity, including loan repayments due within one year, in accordance with the Scottish Water Governance Directions 2009.

Notes to the financial statements

For the year ended 31 March 2015

continued

2. Accounting estimates and judgements

The preparation of financial statements to conform to IFRS requires the use of estimates, assumptions and judgements that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts for revenue and expenses during the reporting period. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Although based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from these estimates, the effect of which is recognised in the period in which the facts giving rise to the revision arise.

The most critical of these accounting judgement and estimation areas are noted below.

a. Revenue recognition

Revenue relating to metered customers includes an estimate of the value of water or waste water services supplied between the date of the last meter reading and the year end. At the balance sheet date, the estimated consumption by customers will either have been billed (estimated billed revenue) or accrued (unbilled revenue). Using historical consumption patterns, management apply judgement to the measurement of the quantum of the estimated consumption and to the valuation of that consumption. The judgements applied, and the assumptions underpinning these judgements, are considered to be appropriate. However, a change in these assumptions would have no material impact upon the amount of revenue recognised.

b. Impairment of trade and other receivables

Scottish Water and each of its subsidiaries evaluate the recoverability of their trade receivables as at the reporting date and assess the allowances for doubtful receivables based on experience. These allowances are based on, amongst other factors, actual collection history, forecast rates and customer category. The actual level of receivables collected may differ from those estimated, due to factors such as changes in customer behaviour, potential impact of government policy initiatives and the economic outlook, which could impact positively or negatively on operating results (see sensitivity analysis in note 26).

c. Carrying value of property, plant and equipment

Property, plant and equipment (PPE) represents the majority of the Group's asset base and a significant proportion of the Group's annual expenditure (see funding chart on page 8). Therefore the estimates and assumptions made in determining the carrying values and related depreciation are critical to the Group's financial performance and position.

The estimated useful economic lives and residual values of PPE are based on management's judgement and experience. Due to the significance of PPE investment, variations between actual and estimated economic lives could impact on operating results both positively and negatively. When management identifies that actual useful economic lives differ materially from the estimates used, the relevant depreciation charge is adjusted prospectively. However, historically, any changes to estimated useful lives and residual values have not resulted in material changes to the Group's depreciation charges.

Each financial year, in accordance with IAS 23 'Borrowing costs', Scottish Water calculates the amount of borrowing which would be attributable to the PPE acquired or under construction. To date these amounts have been immaterial and therefore not capitalised.

d. Provisions

The assessments undertaken in recognising provisions and contingencies have been made in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The evaluation of the likelihood of the contingent events has required the best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseen developments, this likelihood could alter.

e. Retirement benefits

Scottish Water and its subsidiaries are participating employers in 3 Local Government Pension Schemes (LGPS) which are defined benefit schemes. Actuarial valuations of the schemes are carried out by the administering authorities triennially in line with LGPS regulations. The assumptions in relation to the cost of providing post-retirement benefits during the period are set after consultation with qualified actuaries. These assumptions include discount rates, returns on the schemes' assets, pay growth and increases to pension payments (see note 22) and, while these assumptions are believed to be appropriate, a change to the assumptions would impact the surplus of the Group and the carrying amount of pension obligations. These assumptions may differ from the actual results due to changes in market and economic conditions and longer or shorter lives of participants.

3. Segmental analysis

The principal activities of the Scottish Water Group are the supply of water and waste water services to household and business customers across Scotland. In view of the integrated nature of Scottish Water's operational activities, the financial statements include all of the costs of water and waste water collection, treatment and distribution within cost of sales.

Scottish Water's reportable segments are the provision of regulated water and waste water services, Business Stream (a Licensed Provider in the supply of water and waste water services to non-household customers) and other trading activities. The other trading activities include the results of Horizons, Scottish Water International and Scottish Water's non-regulated activities. These operating segments reflect the internal management reporting that are reviewed regularly by the Board in order to allocate resources to and assess the performance of the segments.

	2015 £m	2014 £m
Revenue		
Regulated water and waste water services	1,096.9	1,078.2
Business Stream	320.0	364.2
Other trading activities	22.5	18.6
	1,439.4	1,461.0
Intercompany elimination	(252.0)	(281.3)
	1,187.4	1,179.7

During the year Business Stream generated £12.1 million (2014: £12.7 million) of non-licensed trading revenue bringing the total revenue from other trading activities for the Group to £34.6 million (2014: £31.3 million).

	2015 £m	2014 £m
Operating surplus		
Regulated water and waste water services	264.9	251.4
Business Stream	30.4	38.3
Other trading activities	2.7	1.0
	298.0	290.7
Intercompany elimination	(0.7)	1.0
	297.3	291.7

Business Stream's operating surplus from non-licensed trading activities during the year was £2.5 million (2014: £1.8 million) bringing the total operating surplus from other trading activities for the Group to £4.2 million (2014: £2.8 million).

Notes to the financial statements

For the year ended 31 March 2015

continued

3. Segmental analysis continued

	2015 £m	2014 £m
Total assets		
Regulated water and waste water services	5,895.5	5,743.1
Business Stream	191.2	236.6
Other trading activities	49.3	38.8
	6,136.0	6,018.5

	Capital additions to property, plant and equipment		Depreciation on property, plant and equipment	
	2015 £m	2014 £m	2015 £m	2014 £m
Regulated water and waste water services	317.7	354.8	255.4	251.8
Business Stream	0.9	2.1	2.0	1.8
Other trading activities	2.3	3.9	0.7	0.5
Less: intercompany transfer	(9.0)	–	–	–
	311.9	360.8	258.1	254.1

Revenue and operating surplus by geographical location of customers is as follows:

	Revenue		Operating surplus	
	2015 £m	2014 £m	2015 £m	2014 £m
United Kingdom	1,185.0	1,178.5	296.9	291.9
Rest of the World	2.4	1.2	0.4	(0.2)
	1,187.4	1,179.7	297.3	291.7

4. Operating surplus

Operating surplus is arrived at after charging/(crediting):

	Note	2015 £m	2014 £m
PFI operating costs		112.1	109.3
Depreciation of property, plant and equipment	9	258.1	254.1
Surplus on sale of property, plant and equipment		(10.7)	(10.3)
Release of deferred income in relation to capital grants		(1.0)	(1.1)
Operating lease rentals		2.9	2.4
Auditors' remuneration – audit fee for audit of the company and consolidated financial statements (including £30,000 (2014: £31,000) in respect of the audit of subsidiary companies)		0.2	0.2
– other services		–	–
Research and development expenditure		1.3	0.7

5. Staff costs

	2015 £m	2014 £m
Wages and salaries	123.7	118.9
Social security costs	9.9	9.6
IAS 19 current service costs relating to current period	20.2	22.4
Employee benefit expense	153.8	150.9
Less: charged as capital expenditure	(45.2)	(45.4)
Less: seconded staff charged to Scottish Water Solutions 2 Limited	(0.5)	(0.6)
	108.1	104.9

The average monthly number of people (including Executive and Non-executive Members) employed by Scottish Water, split by activity, during the year was:

	2015	2014
Regulated water and waste water services	3,315	3,257
Business Stream	294	290
Other trading activities	65	58
Scottish Water Solutions Limited and Scottish Water Solutions 2 Limited secondees	9	12
	3,683	3,617

6. Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 48 to 58. No Member or Director had, during the year or at the end of the year, any material interest in any contract of significance in relation to Scottish Water's business.

7. Finance income and costs

	Note	2015 £m	2014 £m
Interest income:			
Short-term deposits		2.0	1.1
Finance income		2.0	1.1
Interest expense:			
Government loans		(157.3)	(156.1)
Other loans		(0.2)	(0.2)
Finance lease liabilities		(23.6)	(24.6)
Interest on pension scheme net liabilities	22	(6.1)	(10.9)
Net foreign exchange losses		(0.1)	–
Fair value losses on financial instruments: forward currency contracts	26	(1.3)	–
Finance costs		(188.6)	(191.8)
Net finance costs		(186.6)	(190.7)

Notes to the financial statements

For the year ended 31 March 2015

continued

8. Taxation

	Note	2015 £m	2014 £m
Analysis of tax/(credit) charge recognised in the income statement			
Current tax: UK corporation tax		6.8	7.4
Current tax: Adjustment in respect of prior years		(5.6)	(7.4)
		1.2	–
Deferred tax: Origination and reversal of timing differences		18.5	(10.9)
Deferred tax: Effect of rate change		–	(53.6)
	15	18.5	(64.5)
Total taxation charge/(credit)		19.7	(64.5)
The charge/(credit) for the year can be reconciled to the surplus per the income statement as follows:			
Group surplus before tax		110.7	101.0
Tax on surplus on ordinary activities at standard UK corporation tax rate of 21% (2014: 23%)		23.2	23.2
Adjustment in respect of prior years		(2.5)	(31.5)
Remeasurement of deferred tax due to change in UK corporation tax rate		(0.8)	(55.6)
Accounting gain with no capital gain		(1.7)	(0.7)
Depreciation on non qualifying additions		1.4	1.7
Other permanent differences		0.1	(1.6)
Total tax charge/(credit) for the year		19.7	(64.5)

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Tax (credit)/charge recognised directly in reserves					
Deferred tax relating to:					
Pension scheme actuarial movements	15	(15.7)	29.7	(15.2)	29.6

During the year, as a result of the change in the UK corporation tax rate from 21% to 20% that will be effective from 1 April 2015, deferred tax balances have been remeasured.

9. Property, plant and equipment

Group	Specialised operational properties and structures £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant, machinery and vehicles £m	Assets under construction £m	Total £m
Cost						
At 1 April 2013	2,837.3	69.2	1,924.0	2,487.9	822.0	8,140.4
Additions	4.7	–	–	2.1	354.0	360.8
Disposals	(10.4)	(0.7)	–	(4.3)	–	(15.4)
Reclassifications	55.7	15.6	50.3	126.2	(247.8)	–
At 31 March 2014	2,887.3	84.1	1,974.3	2,611.9	928.2	8,485.8
Additions	11.1	–	–	0.9	299.9	311.9
Disposals	(2.3)	(3.6)	–	(7.2)	–	(13.1)
Reclassifications	93.9	2.1	77.6	224.1	(397.7)	–
At 31 March 2015	2,990.0	82.6	2,051.9	2,829.7	830.4	8,784.6
Accumulated depreciation						
At 1 April 2013	932.9	29.8	442.7	1,409.5	–	2,814.9
Charge for the year	65.0	1.2	14.3	173.6	–	254.1
Disposals	(9.4)	(0.3)	–	(4.1)	–	(13.8)
At 31 March 2014	988.5	30.7	457.0	1,579.0	–	3,055.2
Charge for the year	66.9	1.7	14.8	174.7	–	258.1
Disposals	(1.7)	(3.6)	–	(7.2)	–	(12.5)
At 31 March 2015	1,053.7	28.8	471.8	1,746.5	–	3,300.8
Net book value						
At 31 March 2015	1,936.3	53.8	1,580.1	1,083.2	830.4	5,483.8
At 31 March 2014	1,898.8	53.4	1,517.3	1,032.9	928.2	5,430.6

All capital investment is recognised initially within assets under construction. When assets are capable of performing the function for which they were constructed and come into beneficial use, they are reclassified and transferred from assets under construction to the appropriate property, plant and equipment category.

Capital grants received during the year and credited to deferred income were £1.6 million (2014: £nil). No capital grants were received during the year in respect of infrastructure assets.

Notes to the financial statements

For the year ended 31 March 2015

continued

9. Property, plant and equipment continued

Company	Specialised operational properties and structures £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant, machinery and vehicles £m	Assets under construction £m	Total £m
Cost						
At 1 April 2013	2,823.9	69.2	1,924.0	2,473.2	815.5	8,105.8
Additions	4.7	–	–	–	350.1	354.8
Disposals	(10.4)	(0.7)	–	(4.2)	–	(15.3)
Reclassifications	52.8	15.6	50.3	126.1	(244.8)	–
At 31 March 2014	2,871.0	84.1	1,974.3	2,595.1	920.8	8,445.3
Additions	11.1	–	–	–	306.6	317.7
Disposals	(2.3)	(3.6)	–	(7.1)	–	(13.0)
Reclassifications	92.3	2.1	77.6	224.0	(396.0)	–
At 31 March 2015	2,972.1	82.6	2,051.9	2,812.0	831.4	8,750.0
Accumulated depreciation						
At 1 April 2013	927.7	29.8	442.7	1,399.1	–	2,799.3
Charge for the year	64.6	1.2	14.3	171.7	–	251.8
Disposals	(9.4)	(0.3)	–	(4.0)	–	(13.7)
At 31 March 2014	982.9	30.7	457.0	1,566.8	–	3,037.4
Charge for the year	66.3	1.7	14.8	172.6	–	255.4
Disposals	(1.7)	(3.6)	–	(7.1)	–	(12.4)
At 31 March 2015	1,047.5	28.8	471.8	1,732.3	–	3,280.4
Net book value						
At 31 March 2015	1,924.6	53.8	1,580.1	1,079.7	831.4	5,469.6
At 31 March 2014	1,888.1	53.4	1,517.3	1,028.3	920.8	5,407.9

9. Property, plant and equipment continued

Included within specialised operational properties and structures and plant, machinery and vehicles are the following PFI assets which are held under finance leases. These assets are included within the previous tables for both the Group and the Company.

	Specialised operational properties and structures £m	Plant, machinery and vehicles £m	Total £m
Group and Company			
Cost			
At 1 April 2013, 31 March 2014 and 31 March 2015	221.7	347.1	568.8
Accumulated depreciation			
At 1 April 2013	51.3	157.2	208.5
Charge for the year	3.7	11.6	15.3
At 31 March 2014	55.0	168.8	223.8
Charge for the year	3.7	11.6	15.3
At 31 March 2015	58.7	180.4	239.1
Net book value			
At 31 March 2015	163.0	166.7	329.7
At 31 March 2014	166.7	178.3	345.0

10. Investments

	Company	
	2015 £m	2014 £m
Cost and net book value		
At 31 March	37.6	37.6

Investment in subsidiaries

Principal subsidiary undertakings	Country of incorporation	% of Ordinary shares and votes held	Principal activity
Scottish Water Horizons Holdings Limited	Scotland	100.0	Holding company
Scottish Water Business Stream Holdings Limited*	Scotland	100.0	Holding company
Scottish Water Business Stream Limited**	Scotland	100.0	Licensed water and waste water services
Scottish Water Horizons Limited*	Scotland	100.0	Commercial non- regulated water and waste water services
Scottish Water International Limited*	Scotland	100.0	Overseas consultancy

* owned by Scottish Water Horizons Holdings Limited

** owned by Scottish Water Business Stream Holdings Limited

Scottish Water owns shares in a further 8 companies, which did not trade during the year ended 31 March 2015. The companies' financial statements have not been consolidated as permitted by Section 405 of the Companies Act 2006, as they did not trade during the year and the issued share capital is immaterial.

Notes to the financial statements

For the year ended 31 March 2015

continued

10. Investments continued

Group

Investment in Jointly Controlled Operations

On 6 April 2010 Scottish Water Solutions 2 Limited (SWS2) commenced trading. This company is jointly owned with Thistle Water Limited and is delivering part of Scottish Water's capital investment programme for the 2010 to 2015 regulatory period. The nature of the contractual agreement between Scottish Water and the other shareholder in SWS2 is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, SWS2 is accounted for, under IFRS 11 'Joint Arrangements', as a Joint Operation. Details of the investment are as follows:

	Country of incorporation	% of Ordinary shares and votes held	Principal activity
Scottish Water Solutions 2 Limited	Scotland	51.0	Contracting services

Summary aggregated financial information on jointly controlled entities – 51%:

	2015 £m	2014 £m
Current assets	9.7	11.9
Current liabilities	9.7	11.9
Income	37.4	37.8
Expenses	37.4	37.8

The information detailed above for 2015 was extracted from the financial statements for SWS2. SWS2 themselves have no contingent liabilities and there are no contingent liabilities relating to Scottish Water's interest in SWS2.

11. Inventories

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Raw materials and consumables	2.7	2.5	2.5	2.2
Less provision held	(0.2)	(0.1)	(0.2)	(0.1)
	2.5	2.4	2.3	2.1

All inventories will be recovered within 12 months.

12. Trade and other receivables

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Trade receivables	26	513.7	511.2	449.7	438.0
Less provision for impairment of trade receivables	26	(437.3)	(417.8)	(422.0)	(402.4)
Net trade receivables		76.4	93.4	27.7	35.6
Other receivables		39.8	21.9	36.5	19.6
Prepayments and accrued income		32.9	47.9	8.4	7.1
Amounts due from subsidiaries		–	–	5.9	8.0
Amounts due from jointly owned operations		5.0	–	5.0	–
		154.1	163.2	83.5	70.3

The following table shows the development of the provision for impairment of trade receivables:

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Balance at 1 April	417.8	389.4	402.4	376.5
Charge for the year	23.2	35.7	19.8	25.9
Amounts written down during the year	(3.7)	(7.3)	(0.2)	–
Balance at 31 March	437.3	417.8	422.0	402.4

Management considers the carrying value of trade and other receivables are equal to the fair value.

13. Cash and cash equivalents

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Cash at bank and in hand	247.4	192.6	151.4	126.3
Short-term bank deposits	244.0	224.0	194.0	144.0
Cash and cash equivalents per the statement of cash flows	491.4	416.6	345.4	270.3

The fair values of cash and cash equivalents are not different from those disclosed above.

Notes to the financial statements

For the year ended 31 March 2015

continued

14. Trade and other payables

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Current					
Trade payables		20.3	12.9	18.6	11.4
Non trade payables and accruals		119.7	85.2	119.1	84.4
Accruals		157.3	172.2	135.7	151.7
Payments received in advance		66.3	95.1	37.8	3.3
Other payables		13.3	17.9	0.7	1.9
Deferred income		4.6	2.9	1.3	1.4
Derivative financial liabilities	26	1.0	–	1.0	–
Other taxes and social security		3.0	2.8	2.7	2.6
Amounts due to subsidiaries		–	–	21.2	23.6
Amounts due to jointly owned operations		–	0.8	–	0.8
		385.5	389.8	338.1	281.1
Non-current					
Payments received in advance		47.8	75.3	47.8	75.3
Deferred income		20.2	20.0	13.5	14.5
Derivative financial liabilities	26	0.3	–	0.3	–
		68.3	95.3	61.6	89.8

The fair values of trade and other payables are not different from those disclosed above.

15. Deferred taxation

The following are the deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting periods:

	Note	Accelerated capital allowances £m	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
Group						
At 1 April 2013		521.8	(56.6)	(69.1)	(10.1)	386.0
Charge/(credit) to income statement	8	(86.1)	(0.5)	20.2	1.9	(64.5)
Charge to reserves	22	–	29.7	–	–	29.7
At 31 March 2014		435.7	(27.4)	(48.9)	(8.2)	351.2
Charge/(credit) to income statement	8	16.9	2.8	(0.4)	(0.8)	18.5
Charge to reserves	22	–	(15.7)	–	–	(15.7)
At 31 March 2015		452.6	(40.3)	(49.3)	(9.0)	354.0
Company						
At 1 April 2013		521.5	(56.9)	(68.4)	(9.9)	386.3
Charge/(credit) to income statement		(86.2)	(0.5)	19.9	1.7	(65.1)
Charge to reserves	22	–	29.6	–	–	29.6
At 31 March 2014		435.3	(27.8)	(48.5)	(8.2)	350.8
Charge/(credit) to income statement		17.1	2.7	(0.8)	(0.5)	18.5
Charge to reserves	22	–	(15.2)	–	–	(15.2)
At 31 March 2015		452.4	(40.3)	(49.3)	(8.7)	354.1

Certain deferred tax assets and liabilities have been offset, including the asset balances analysed in the tables above. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Deferred tax assets	(0.5)	(0.1)	–	–
Deferred tax liabilities	354.5	351.3	354.1	350.8
At 31 March	354.0	351.2	354.1	350.8

The Members believe that the deferred tax assets will be recoverable against projected taxable profits over the foreseeable future in the companies to which they relate.

No deferred tax is provided on temporary differences arising on investments in subsidiaries because, in each case, the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of temporary differences associated with investments in subsidiaries for which a deferred tax liability has not been recognised is £155 million (2014: £127 million) for both the Company and the Group. No tax is expected to be payable in this regard.

Notes to the financial statements

For the year ended 31 March 2015

continued

16. Provisions for liabilities

	Restructure provision £m	Income uncertainty provision £m	Other £m	Total £m
Group				
At 1 April 2013	2.6	–	0.8	3.4
Charged/(released) to the income statement	0.6	–	(0.1)	0.5
Utilised during the year	(0.8)	–	–	(0.8)
At 31 March 2014	2.4	–	0.7	3.1
Charged/(released) to the income statement	–	1.7	0.7	2.4
Utilised during the year	(1.9)	(0.1)	(0.1)	(2.1)
At 31 March 2015	0.5	1.6	1.3	3.4

Company

At 1 April 2013	2.5	15.5	0.8	18.8
Charged/(released) to the income statement	0.5	6.1	(0.1)	6.5
Utilised during the year	(0.6)	(8.2)	–	(8.8)
At 31 March 2014	2.4	13.4	0.7	16.5
Charged/(released) to the income statement	–	2.7	0.7	3.4
Utilised during the year	(1.9)	(2.1)	(0.1)	(4.1)
At 31 March 2015	0.5	14.0	1.3	15.8

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Analysis of total provisions				
Current	1.8	2.9	12.7	13.8
Non-current	1.6	0.2	3.1	2.7
	3.4	3.1	15.8	16.5

The restructuring provision relates to redundancy costs associated with employees who will leave Scottish Water under voluntary redundancy and early retirement. It is expected that the provision will be utilised within the next year. Pension related liabilities associated with employees who have left Scottish Water under the voluntary severance scheme are recognised in the pension liability (note 22).

The income uncertainty provision relates to non-household revenues. The reconciliation process, through the Central Market Agency, relating to each financial year would normally be finalised 18 months after the end of the relevant financial year. However, at 31 March 2015, the settlement reports for the financial years 2010/11 through to 2013/14 had not yet been finalised. The provision in the company represents the agreed intercompany settlement positions forecast for the relevant financial years. It is expected that the provision will be utilised during 2016.

The other provision of £1.3 million relates primarily to onerous property rental costs.

17. Other loans and borrowings

	2015 £m	2014 £m
Group and Company		
Current		
Non-government loans	–	0.5
Obligations under finance leases	18.3	17.3
	18.3	17.8
Non current		
Non-government loans	1.0	1.0
Obligations under finance leases	363.6	381.9
	364.6	382.9
Total		
Non-government loans	1.0	1.5
Obligations under finance leases	381.9	399.2
	382.9	400.7

(i) Non-government loans

Other loans are repayable as follows:

	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Total £m
At 31 March 2015	–	–	1.0	–	1.0
At 31 March 2014	0.5	–	–	1.0	1.5

The carrying amounts and fair value of the non-government borrowings are as follows:

	Book value 2015 £m	Book value 2014 £m	Fair value 2015 £m	Fair value 2014 £m
Non-government loans	1.0	1.5	1.4	2.0

Notes to the financial statements

For the year ended 31 March 2015

continued

17. Other loans and borrowings continued

(ii) Finance lease liabilities – PFI liabilities

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2015 £m	2014 £m	2015 £m	2014 £m
Amounts payable:				
Within one year	40.9	40.9	18.3	17.3
Between one and 5 years	163.4	163.5	107.1	102.7
After 5 years	385.4	426.2	256.5	279.2
Present value of minimum lease payments including finance charges	589.7	630.6		
Less future finance charges	(207.8)	(231.4)		
Present value of minimum lease payments	381.9	399.2	381.9	399.2

PFI – Service concession arrangements

Upon its creation in April 2002 Scottish Water inherited 9 concession contracts which had been entered into with 9 private sector consortia (PFI Cos) by its 3 predecessor authorities (i.e. East of Scotland Water Authority, North of Scotland Water Authority and West of Scotland Water Authority). Scottish Water acts as the client body to the 9 private sector consortia that provide waste water and sludge treatment and disposal services to Scottish Water.

These contracts are based over a wide geographic area including the Aberdeen, Dundee, Edinburgh, Glasgow and Inverness conurbations as well as the Ayrshire, Fife and Moray coasts.

Characteristics of the arrangements

Description

The length of these contracts varies between 25 and 40 years with expiry dates ranging from December 2021 through to October 2040. Under the terms of these contracts the private sector have either upgraded or built new waste water and sludge treatment assets, and, in certain circumstances, network assets (e.g. sewers and pumping stations) in order to meet Scottish Water's legal obligations in respect of the treatment and disposal of these products. These consortia are also responsible for the operation and maintenance of these assets over the lifetime of each contract.

Significant terms

The key terms relate to the basis upon which Scottish Water pays the services provided by the PFI Cos. The levels of such payments are predominantly dependent upon the volume of waste water and sludge treated, although in a minority of contracts there is either a partial availability payment element or some part of the payment is linked to the strength of the waste water. Scottish Water also has the power to levy payment deductions where the level of service falls below pre-determined standards, primarily linked to the quality of the treated waste water.

The contracts are structured such that either party may seek to amend the basis upon which the service is provided, primarily where driven by a change in law. This is subject to a formal variation procedure and is ultimately dependent upon the parties reaching agreement on the contractual changes required to give effect to the specific variation.

Nature and extent of rights and obligations

Scottish Water's primary obligations are to deliver waste water to the PFI Cos and thereafter pay for the treatment services provided, making the appropriate deduction where the PFI Cos fail to meet the appropriate performance standards. The PFI Cos provided the initial construction services through a sub-contract and also entered into a separate sub-contract for the operation and maintenance of these assets once satisfactorily commissioned. All such projects are now in their operational phase.

A majority of the contracts have limited extension options. However, termination during the contractual period can arise for a number of reasons including default (by either the PFI Co or Scottish Water), force majeure, uninsurable events or voluntary termination by Scottish Water. Each contract contains a formula from which termination compensation payable by Scottish Water is derived.

Other than each party's unilateral right to propose an amendment to a contract, the most likely circumstance which would give rise to the re-negotiation of a contract is as a result of a change in law which requires the manner in which the treatment and disposal service is delivered to be changed, in order to ensure it meets the requirements of such legislative changes.

The contracts also stipulate a range of handback conditions linked to the remaining life of certain assets.

18. Government loans

	Group and Company	
	2015 £m	2014 £m
Government loans	3,423.3	3,352.8

Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002. The limit at 31 March 2015 on these powers was that total net new borrowings for the year ended 31 March 2015 should not exceed £70 million. Net new borrowings were £70 million in the year.

Government loans, both short and long-term, are recorded on the balance sheet under Capital and Reserves in accordance with the Scottish Water Governance Directions 2009. Other debt is recorded under short and long-term payables following best practice.

a. Analysis of borrowings by type and maturity

	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Over 10 years £m	Total £m
Scottish Consolidated Fund – SW Company	271.4	80.0	243.5	381.4	1,640.9	2,617.2
Scottish Consolidated Fund – subsidiaries	–	–	–	–	–	–
Scottish Consolidated Fund – SW Group	271.4	80.0	243.5	381.4	1,640.9	2,617.2
National Loans Fund	14.0	24.0	88.0	291.4	272.5	689.9
Public Works Loan Board	38.5	14.9	38.7	14.4	9.7	116.2
At 31 March 2015	323.9	118.9	370.2	687.2	1,923.1	3,423.3
At 31 March 2014	223.9	119.5	364.5	643.2	2,001.7	3,352.8

b. Fair values

The carrying amounts and fair value of the Government borrowings are as follows:

	Book value 2015 £m	Book value 2014 £m	Fair value 2015 £m	Fair value 2014 £m
Scottish Consolidated Fund	2,617.2	2,512.2	3,297.4	2,755.0
National Loans Fund	689.9	694.9	964.4	903.6
Public Works Loan Board	116.2	145.7	143.8	178.1
	3,423.3	3,352.8	4,405.6	3,836.7

Notes to the financial statements

For the year ended 31 March 2015

continued

19. Analysis of net debt

	Note	As at 1 April 2014 £m	Increase in cash £m	(Increase)/ decrease in debt £m	As at 31 March 2015 £m
Group					
Cash and cash equivalents	13	416.6	74.8	–	491.4
Government loans	18	(3,352.8)	–	(70.5)	(3,423.3)
Other loans	17	(1.5)	–	0.5	(1.0)
Net debt		(2,937.7)	74.8	(70.0)	(2,932.9)
Company					
Cash and cash equivalents	13	270.3	75.1	–	345.4
Government loans	18	(3,352.8)	–	(70.5)	(3,423.3)
Other loans	17	(1.5)	–	0.5	(1.0)
Net debt		(3,084.0)	75.1	(70.0)	(3,078.9)

20. Reserves

	Note	Retained earnings excluding actuarial gains £m	Actuarial gains on pension obligations £m	Retained earnings including actuarial gains £m
Group				
At 1 April 2013		1,099.5	(196.5)	903.0
Retained surplus for the year		165.5	–	165.5
Actuarial gain, net of deferred taxation	22	–	86.4	86.4
At 31 March 2014		1,265.0	(110.1)	1,154.9
Retained surplus for the year		91.0	–	91.0
Actuarial loss, net of deferred taxation	22	–	(62.6)	(62.6)
At 31 March 2015		1,356.0	(172.7)	1,183.3
Company				
At 1 April 2013		1,003.3	(196.9)	806.4
Retained surplus for the year		132.3	–	132.3
Actuarial gain, net of deferred taxation	22	–	86.0	86.0
At 31 March 2014		1,135.6	(110.9)	1,024.7
Retained surplus for the year		64.6	–	64.6
Actuarial loss, net of deferred taxation	22	–	(60.7)	(60.7)
At 31 March 2015		1,200.2	(171.6)	1,028.6

21. Results of Scottish Water (the Company)

Of the results for the financial year, a retained surplus of £64.6 million (2014: £132.3 million) is dealt with in the consolidated financial statements of Scottish Water. The Members have taken advantage of the exemption available under section 408 of the Companies Act 2006 and do not present an income statement or a statement of comprehensive income for Scottish Water alone.

22. Pensions

Employees of Scottish Water participate in the North East Scotland Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund, which are part of the Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively. The schemes provide defined benefits based on final pensionable pay. Actual pension costs for the year for each fund, as a % of pensionable pay, were 19.3% (2014: 19.3%), 24.0% (2014: 24.0%) and 19.3% (2014: 19.3%) respectively.

Employee pension contributions are determined according to the level of an employee's full-time equivalent pensionable pay. A key feature of the pension arrangements is that contribution rates are applied in tiers ranging from 5.5% to 12% depending on the employee's rate of pensionable pay on 31 March. It is anticipated that this approach to employees' contribution rates will ultimately result in a 2:1 ratio between Scottish Water's contributions and employees' contributions in a fully funded scheme.

A full actuarial valuation was carried out at 31 March 2014 for all 3 funds and updated at 31 March 2015 by a qualified independent actuary, to take account of the requirements of IAS 19.

The major assumptions used by the actuaries were:

	2015 %	2014 %
Rate of increase in pensionable salaries	2.3	2.3
Rate of increase in pensions payment	2.3	2.6
Discount rate	3.3	4.3
Inflation rate	2.3	2.6

Longevity assumptions on retiring at age 65 adopted for each fund:

	North East Scotland Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2015			
Male	22.0	22.2	22.3
Female	24.6	23.8	23.7
Retiring at 31 March 2035			
Male	24.2	24.3	24.9
Female	27.5	26.4	26.3

The sensitivities regarding the principal assumptions used to measure the liability in the Funds are:

Assumption	Change in assumption	Approximate Impact on IAS 19 liability %	Approximate Impact on IAS 19 liability £m
Rate of increase in pensionable salaries	+/- 0.5% per annum	Increase/decrease by c. 3.0%	Increase/decrease by c. £45 million
Discount rate	+/- 0.5% per annum	Decrease/increase by c. 10.0%	Decrease/increase by c. £149 million
CPI Inflation rate	+/- 0.5% per annum	Increase/decrease by c. 7.0%	Increase/decrease by c. £104 million
Longevity	Increase life expectancy by 1 year	Increase by c. 3.0%	Increase by c. £45 million

Notes to the financial statements

For the year ended 31 March 2015

continued

22. Pensions continued

Scottish Water's share of the assets in the schemes and the expected rate of return were:

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Total fair value of assets	1,284.0	1,162.0	1,263.3	1,145.7
Present value of scheme liabilities	(1,485.4)	(1,299.2)	(1,464.7)	(1,285.0)
Gross pension liability	(201.4)	(137.2)	(201.4)	(139.3)
Related deferred tax asset	40.3	27.4	40.3	27.8
Net pension liability	(161.1)	(109.8)	(161.1)	(111.5)

Scheme assets are stated at their bid values.

Reconciliation of opening and closing retirement benefit liabilities and assets

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Movements in liabilities during the year:				
Opening value of total liabilities	(1,299.2)	(1,333.6)	(1,285.0)	(1,321.4)
Total service cost	(20.6)	(22.8)	(19.3)	(21.6)
Interest on pension scheme liabilities	(55.5)	(57.2)	(54.9)	(56.6)
Contributions by members	(7.3)	(7.0)	(6.8)	(6.5)
Actuarial (loss)/gain	(144.5)	83.9	(140.4)	83.7
Benefits paid	41.7	37.5	41.7	37.4
Closing value of total liabilities	(1,485.4)	(1,299.2)	(1,464.7)	(1,285.0)
Movement in assets during the year:				
Opening fair value of total assets	1,162.0	1,087.4	1,145.7	1,073.8
Interest on pension scheme assets	49.4	46.3	48.7	45.7
Contributions by members	7.3	7.0	6.8	6.5
Contributions by the employer	40.8	26.6	39.3	25.2
Actuarial gain	66.2	32.2	64.5	31.9
Benefits paid	(41.7)	(37.5)	(41.7)	(37.4)
Closing fair value of assets	1,284.0	1,162.0	1,263.3	1,145.7
Gross deficit in the schemes at 31 March	(201.4)	(137.2)	(201.4)	(139.3)

22. Pensions continued

Return on assets

As required by IAS 19R, the expected return on assets for all asset categories is equal to the discount rate. Assets with higher volatility will no longer generate higher returns.

	Note	Group		Company	
		2015 £m	2014 £m	2015 £m	2014 £m
Actual return on pension scheme assets		115.6	78.5	113.2	77.6
Actuarial (loss)/gain in other comprehensive income in the consolidated statement of comprehensive income					
Gross actuarial (loss)/gain recognised in the pension fund		(78.3)	116.1	(75.9)	115.6
Deferred tax movement	15	15.7	(29.7)	15.2	(29.6)
Net actuarial (loss)/gain recognised in other comprehensive income in the consolidated statement of comprehensive income		(62.6)	86.4	(60.7)	86.0

Amounts recognised in the consolidated income statement

	Note	2015 £m	2014 £m
Total service cost		20.6	22.8
Interest cost on pension scheme net liabilities	7	6.1	10.9
		26.7	33.7

The unpaid contributions outstanding at the year end included in other payables (note 14) was £0.6 million (2014: £0.7 million). It is estimated that Scottish Water will make contributions of £20.6 million to the pension funds in financial year 2015/16.

Notes to the financial statements

For the year ended 31 March 2015

continued

22. Pensions continued

History of experienced gains and losses

Group	2015 £m	2014 £m
Difference between the expected and actual return on scheme assets:		
Amount	66.2	32.2
Fair value of assets	1,284.0	1,162.0
Experienced gains/(losses) on scheme liabilities:		
Amount	58.1	(0.1)
Present value of liabilities	1,485.4	1,299.2
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	(202.6)	84.0
Total variance between pension fund actuarial assumptions and actual experience	(78.3)	116.1
Gross deficit in the schemes at 31 March	(201.4)	(137.2)
Company		
Difference between the expected and actual return on scheme assets:		
Amount	64.5	31.9
Fair value of assets	1,263.3	1,145.7
Experienced gains/(losses) on scheme liabilities:		
Amount	57.5	(0.1)
Present value of liabilities	1,464.7	1,285.0
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	(197.9)	83.8
Total variance between pension fund actuarial assumptions and actual experience	(75.9)	115.6
Gross deficit in the schemes at 31 March	(201.4)	(139.3)

23. Commitments

a. Capital commitments

The Group has contracted capital commitments of £138.9 million (2014: £175.6 million) relating to property, plant and equipment at the balance sheet date. These commitments are expected to be settled within the following 2 financial years.

b. Operating lease commitments

The Group leases various operational properties and offices under non-cancellable operating lease agreements. The lease terms are between 1 and 99 years, with the majority of lease agreements being renewable at the end of the lease period at market rates.

The Group also leases vehicles under cancellable operating lease agreements. The Group is able to give notice at any time within the lease period for the termination of these agreements. Termination costs are incurred on early termination. The lease expenditure charged to the consolidated income statement during the year is disclosed in note 4.

The total minimum lease payments under non-cancellable operating leases are as follows:

	2015 £m	2014 £m
Within one year	2.0	1.8
Between one and 5 years	8.2	8.2
After 5 years	17.2	18.7
	27.4	28.7

24. Contingent liabilities

Scottish Water has the following contingent liabilities in respect of companies limited by guarantees:

Central Market Agency

The Central Market Agency (CMA), a company limited by guarantee, co-ordinates the non household retail market for business customers in Scotland. As a market participant, Scottish Water is liable to pay charges to the CMA to cover part of the operating, financing and any other capital costs of the organisation. These charges are set annually in advance and approved by the CMA Board. Scottish Water's liability, as a member, for the debts and liabilities of the CMA is limited to £1.

Water Regulatory Advisory Service

Water Regulatory Advisory Service Limited (WRAS) is a company established by all UK water companies as a company limited by guarantee to provide guidance on the development and application of the Water Regulations (England and Wales) and the Water Byelaws (Scotland). WRAS operates on a subscription basis. Scottish Water's liability, as a member, in the event of the company going into default, is limited to £1. Scottish Water may withdraw from the company by giving one year's notice.

Notes to the financial statements

For the year ended 31 March 2015

continued

25. Related party transactions

The Group has related party relationships with the Scottish Government, with its subsidiaries and jointly controlled operations (note 10), and with its Members and Executive Management. Details of transactions between the Group and other related parties are disclosed below.

Scottish Government

Scottish Water is a public corporation of a trading nature sponsored by the Scottish Government. During the year Scottish Water had various material transactions with the Scottish Government, namely the drawdown and repayment of loans and associated interest charges. Details of the loans from the Scottish Government are shown in note 18.

During the year Scottish Water had various material transactions with entities for which the Scottish Government is regarded as the parent. The main entities which fall into this category are the Local Authorities, the Scottish Environment Protection Agency, the Drinking Water Quality Regulator, the Water Industry Commission for Scotland and the Central Market Agency. However, as permitted under IAS 24 'Related Party Disclosures' paragraph 25, Scottish Water is exempt from the disclosure requirements of IAS 24, paragraph 18 in respect of these government related entities.

Jointly controlled operations

In the course of normal operations, Scottish Water contracted on an arms-length basis with Scottish Water Solutions 2 Limited (a Joint Arrangement between Scottish Water and Thistle Water Limited). The aggregate transactions which are considered to be material and which have not been disclosed elsewhere in the financial statements are summarised below:

	2015 £m	2014 £m
Sales and costs charged to Scottish Water Solutions 2 Limited	10.0	10.8
Purchases from Scottish Water Solutions 2 Limited	(91.7)	(91.4)
Amounts due from Scottish Water Solutions 2 Limited (note 12)	5.0	–
Amounts due to Scottish Water Solutions 2 Limited (note 14)	–	0.8

Subsidiaries

During the year the Company entered into the following transactions with its subsidiaries (note 10):

	2015 £m	2014 £m
Wholesale water and waste water services to Business Stream	252.0	281.3
Sale of waste water services to other subsidiaries	2.3	0.8
Seconded staff costs charged to subsidiaries	2.8	2.4
Other operating costs charged to subsidiaries	3.7	3.6
Purchase of property, plant and equipment from subsidiaries (note 3)	9.0	–

Key management personnel

The key management under IAS 24 'Related Party Disclosure' is defined as those persons who have authority and responsibility for planning, directing and controlling the entity's activities, directly or indirectly. The Group's key management comprises the Executive Members and Non-executive Members. The remuneration of the Members is determined by Scottish Water's Remuneration Committee in accordance with its stated policy. Further information about the remuneration and pension details of individual Members is provided in the Members' Remuneration Report on pages 48 to 58.

26. Financial instruments and risks

The management of Scottish Water and the execution of strategy are subject to a number of risks as detailed below. All risks are reviewed by the Board and appropriate processes are in place to monitor and mitigate them. See the Strategic report on pages 9 to 11 and Corporate Governance report on pages 38 to 42.

a. Qualitative risk disclosures

Operational and business risk

This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes losses due to external factors such as the market situation or government regulations. Reputational risk is included in this category. The risk register and risk management processes identify key operational and other risks and are reviewed on a regular basis.

Credit risk

Credit risk is the risk that Scottish Water is exposed to loss if another party fails to perform its financial obligation to Scottish Water. Credit risk arises from cash, cash equivalents and deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions. Scottish Water monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its exposure to any one party to ensure that they are within Board approved limits and that there are no significant concentrations of credit risk. The maximum exposure to credit risk for receivables and other financial assets is represented by their carrying amount.

Liquidity risk

Liquidity risk is the risk that Scottish Water will have insufficient funds to meet its liabilities. Scottish Water's policy is to ensure that it has adequate financial resources to enable it to finance its day-to-day operations and capital investment programme, based on cash flow projections, while adhering to the annual limits set by the Scottish Government for new borrowings. Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002.

Interest rate risk

All of Scottish Water's borrowings are at fixed interest rates. Therefore Scottish Water is not deemed to bear any interest rate risk.

Currency risk

In special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures such as foreign exchange fluctuations. As such circumstances are rare, in addition to the approval of the Scottish Water Board, approval is required from Scottish Ministers under the terms of section 42(3)(b) Water Industry (Scotland) Act 2002.

To manage the foreign exchange risk exposure relating to part of Scottish Water's capital investment programme, Scottish Water entered into forward Euro currency contracts.

b. Categories of financial assets and liabilities and fair values

Scottish Water's financial assets and liabilities comprise trade and other receivables (note 12), cash and cash equivalents (note 13), borrowings (notes 17 and 18) and trade and other payables (note 14). No trading in derivative financial instruments was undertaken.

Basis of determining fair value

The financial assets of the Group and the Company fall into the 'loans and receivables' category. The financial liabilities of the Group and the Company fall into the category of 'financial liabilities measured at amortised cost'.

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing partners, other than in a forced or liquidation sale, and excludes accrued interest.

The carrying amounts of financial assets and liabilities, excluding borrowings, are equal to their fair values. Borrowings are held at cost in the balance sheet but the fair value is disclosed in notes 17 and 18.

Credit risk

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to cash. These are subject to insignificant risk of change in value or credit risk.

Notes to the financial statements

For the year ended 31 March 2015

continued

26. Financial instruments and risks continued

The trade receivables total includes an allowance for impairment. Trade receivables comprise receivables from business customers and receivables from domestic household customers.

	Group		Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Trade receivables per note 12:				
Trade receivables	513.7	511.2	449.7	438.0
Less provision for impairment of trade receivables	(437.3)	(417.8)	(422.0)	(402.4)
Net trade receivables	76.4	93.4	27.7	35.6
Analysed between:				
Household receivables	439.4	432.3	439.4	432.3
Less provision for impairment	(418.6)	(398.8)	(418.6)	(398.8)
Net household receivables	20.8	33.5	20.8	33.5
Business customer receivables	74.3	78.9	10.3	5.7
Less provision for impairment	(18.7)	(19.0)	(3.4)	(3.6)
Net business customer receivables	55.6	59.9	6.9	2.1

Household water and waste water services are billed to customers by Local Authorities as an element of the annual Council Tax bills. The Local Authorities are responsible for the collection and transfer to Scottish Water of the amounts due in accordance with the statutory regulations. Household charges are billed by individual financial year and are payable within the same year. Provision is made against outstanding debt, in respect of prior years, based primarily on historical collection rates and the near-term business outlook. Household water and waste water debt is a statutory debt recoverable from the occupier. Debt since the establishment of the former Water Authorities in 1996 continues to be collected. As at 31 March 2015 trade receivables in respect of household customers totalled £439.4 million with a provision of £418.6 million (2014: £432.3 million and £398.8 million respectively).

The sensitivities regarding the principal assumptions used to measure the level of the household bad debt provision are:

Assumption	Change in assumption %	Approximate Impact on bad debt charge £
Overall household collection rate	+/- 0.01%	Increase/decrease by c. £1.0m
In-year household bad debt provision charge	+/- 0.10%	Increase/decrease by c. £0.8m

As at 31 March 2015 trade receivables from business customers totalled £74.3 million (2014: £78.9 million). The ageing analysis of trade receivables from business customers and the related provisioning is as follows:

Group	Total £m	Current £m	<3 months overdue £m	3-12 months overdue £m	>12 months overdue £m
Gross receivable	74.3	48.8	5.8	9.1	10.6
Provision	(18.7)	(0.2)	(2.0)	(5.9)	(10.6)
Net trade receivable as at 31 March 2015	55.6	48.6	3.8	3.2	–
Gross receivable	78.9	48.9	9.1	12.4	8.5
Provision	(19.0)	–	(1.8)	(8.7)	(8.5)
Net trade receivable as at 31 March 2014	59.9	48.9	7.3	3.7	–

26. Financial instruments and risks continued

Company	Total £m	Current £m	<3 months overdue £m	3-12 months overdue £m	>12 months overdue £m
Gross receivable	10.3	7.1	1.0	0.8	1.4
Provision	(3.4)	(0.2)	(1.0)	(0.8)	(1.4)
Net trade receivable as at 31 March 2015	6.9	6.9	–	–	–
Gross receivable	5.7	0.2	2.9	1.6	1.0
Provision	(3.6)	–	(1.0)	(1.6)	(1.0)
Net trade receivable as at 31 March 2014	2.1	0.2	1.9	–	–

Forward foreign exchange contracts

During the financial year, Scottish Water entered into forward foreign currency contracts, specifically a commitment to buy Euro currency. The notional principal amounts of the outstanding contracts at 31 March 2015 were £13.0 million (2014: nil). The maturity dates of the outstanding contracts are between April 2015 and May 2017.

	Note	2015 £m	2014 £m
Derivative financial liabilities			
Foreign exchange contracts Total		1.3	–
Less non-current portion	14	0.3	–
Current portion	14	1.0	–

The forward currency contracts are measured, subsequent to initial recognition, at fair value. The fair value is determined using valuation techniques that utilise observable inputs, with the key assumption being the exchange rate for GBP:Euro. Based on the degree to which the fair value is observable, this valuation method is classified as Level 2. The fair value level definitions are summarised below.

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative financial liabilities				
Foreign exchange contracts	–	1.3	–	1.3

27. Ultimate controlling body

Scottish Water is a public sector body, classified as a public corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers.

28. Regulatory information

The Water Industry Commission for Scotland (the 'Commission') has the general function of promoting interests of customers in relation to the provision of core services. The Commission determines Scottish Water's price limits and approves Scottish Water's annual charges scheme.

The Commission monitors Scottish Water's performance on efficiency and customer service and approves the code of practice. Each year the Commission publishes reports on the exercise of its functions. In preparing these reports, the Commission assesses the performance by using information supplied by Scottish Water and by making comparisons with information obtained on other regulated water companies. In carrying out this performance monitoring, the Commission may make regulatory amendments to figures published in Scottish Water's audited financial statements to ensure like for like comparisons with other companies.

Direction by the Scottish Ministers

In accordance with section 45(2) of the Water Industry (Scotland) Act 2002

Under the Scottish Water Governance Directions 2009, which are available on the Scottish Government website, Scottish Water is required to disclose details of certain types of expenditure which exceed given thresholds and which are not disclosed elsewhere in the Annual Report and Accounts. The required information is presented in the following table:

Project expenditure	Threshold	Project	Cost
Capital expenditure on major works including improvements to existing assets	£10 million	Shieldhall tunnel project	£16.5m
Purchase of individual capital items, including land, with a life of more than one year	£1 million	None	–
Advertising	£1 million	None	–
Sponsorship	£10,000	None	–
Gifts	£100	None	–

The water industry in Scotland

Regulators provide assurance that Scottish Water meets the interests of our customers, protects the quality of drinking water and the environment, and is accountable for our performance.

The water industry in Scotland is regulated as shown in the diagram on this page.

The Scottish Parliament

Holds Scottish Water and Scottish Ministers to account and regularly calls executives to its committees to give progress updates.

The Scottish Government

Scottish Ministers set the objectives for Scottish Water and appoint the Chair and Non-executive Members.

Scottish Water

Responsible for providing water and waste water services to household customers and wholesale Licensed Providers. Delivers the investment priorities of Scottish Ministers within the funding allowed by the Water Industry Commission for Scotland.

Water Industry Commission for Scotland (WICS)

Economic regulator. Sets charges and reports on costs and performance.

Drinking Water Quality Regulator (DWQR)

Responsible for protecting public health by ensuring compliance with drinking water quality regulations.

Scottish Environment Protection Agency (SEPA)

Responsible for environmental protection and improvement.

Scottish Public Services Ombudsman (SPSO)

Responsible for investigating complaints about public services in Scotland, including Scottish Water, once the services' complaints procedure has been completed and sharing lessons from complaints to improve the delivery of public services.

Citizens Advice Scotland (CAS)

Represents the interests of consumers within Scotland's water industry.

Customer Forum

Responsible for ensuring that customers have a clear voice in the business planning and price setting processes and at the heart of key decisions that affect the services Scottish Water customers pay for.

Other regulators

Like other companies and utilities, Scottish Water is also regulated by a variety of other bodies such as the Health and Safety Executive (HSE), Environmental Health Officers and the Scottish Road Works Commissioner.



For more information on Scottish Water and our services contact our Customer Helpline on **0800 0778778*** or visit **www.scottishwater.co.uk**. Alternative formats of this document can be made available free of charge. For information on Braille, large print, audio and a variety of languages, please call our Customer Helpline.

* We record all calls for quality and training purposes.

