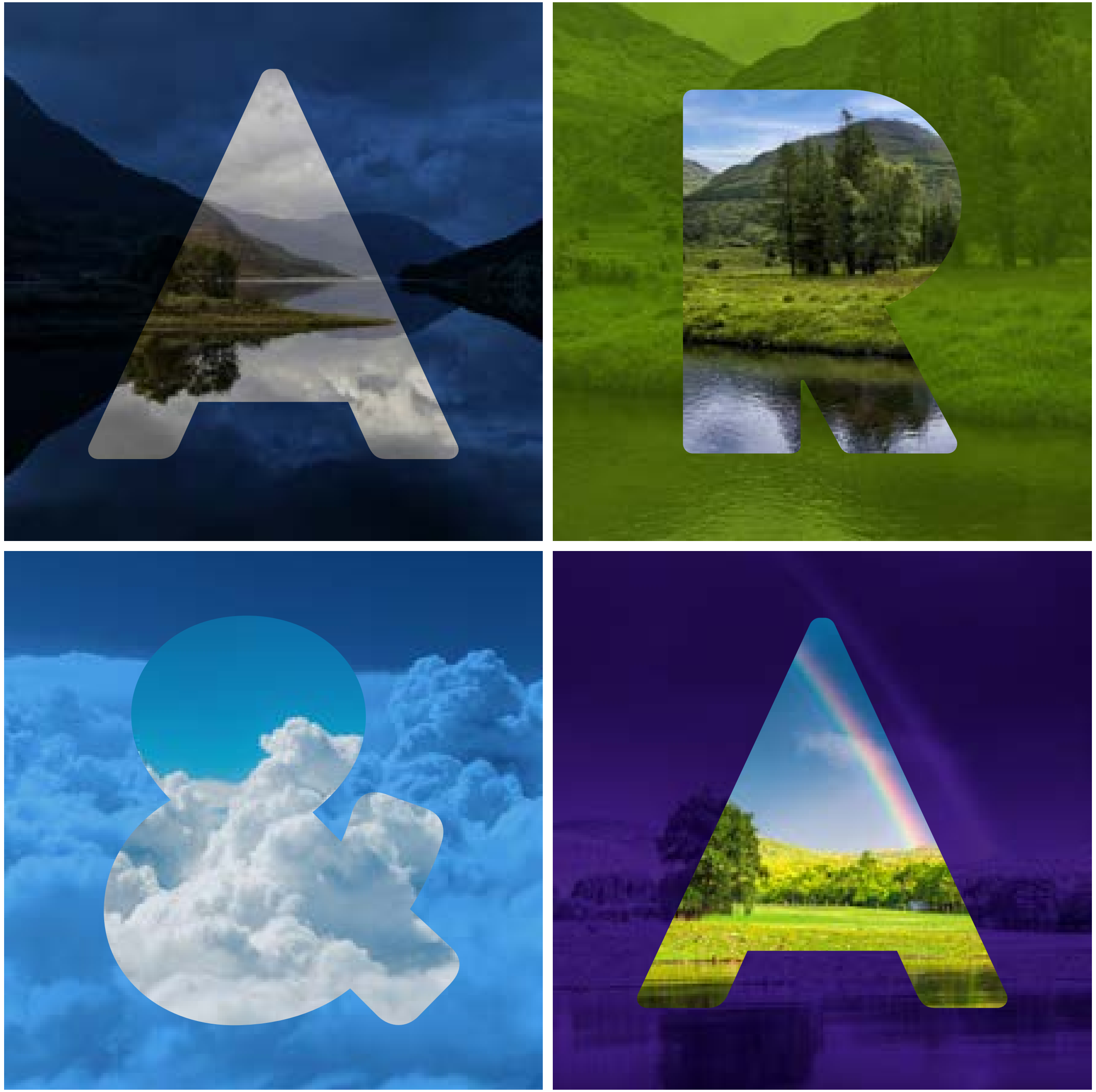


ANNUAL REPORT & ACCOUNTS 2019/20:

PERFORMANCE AND PROSPECTS

Scottish Water

Trusted to serve Scotland

CONTENTS

Please note: some photographs which appear within the Annual Report 2019/20: Performance & Prospects were taken before the Covid-19 pandemic.

OVERVIEW

OUR ANNUAL REPORT & ACCOUNTS 2019/20: PERFORMANCE AND PROSPECTS

This Annual Report & Accounts 2019/20: Performance and Prospects provides an open and transparent view of Scottish Water's performance in 2019/20. We explain what we have done well, where we fell short of what we planned to deliver and provide an overview of our future direction. Scottish Water seeks to learn from the past to drive improvements for the future. This report also sets out a clear view of the lessons we have learned and what we intend to do differently in future.

In February 2020, we published our strategic plan *Our Future Together*, which contains three new strategic ambitions: Service Excellence; going Beyond Net Zero Emissions; and delivering Great Value and Financial Sustainability. Although these ambitions relate primarily to the next regulatory period and beyond, this Report describes our performance and prospects in these three areas.

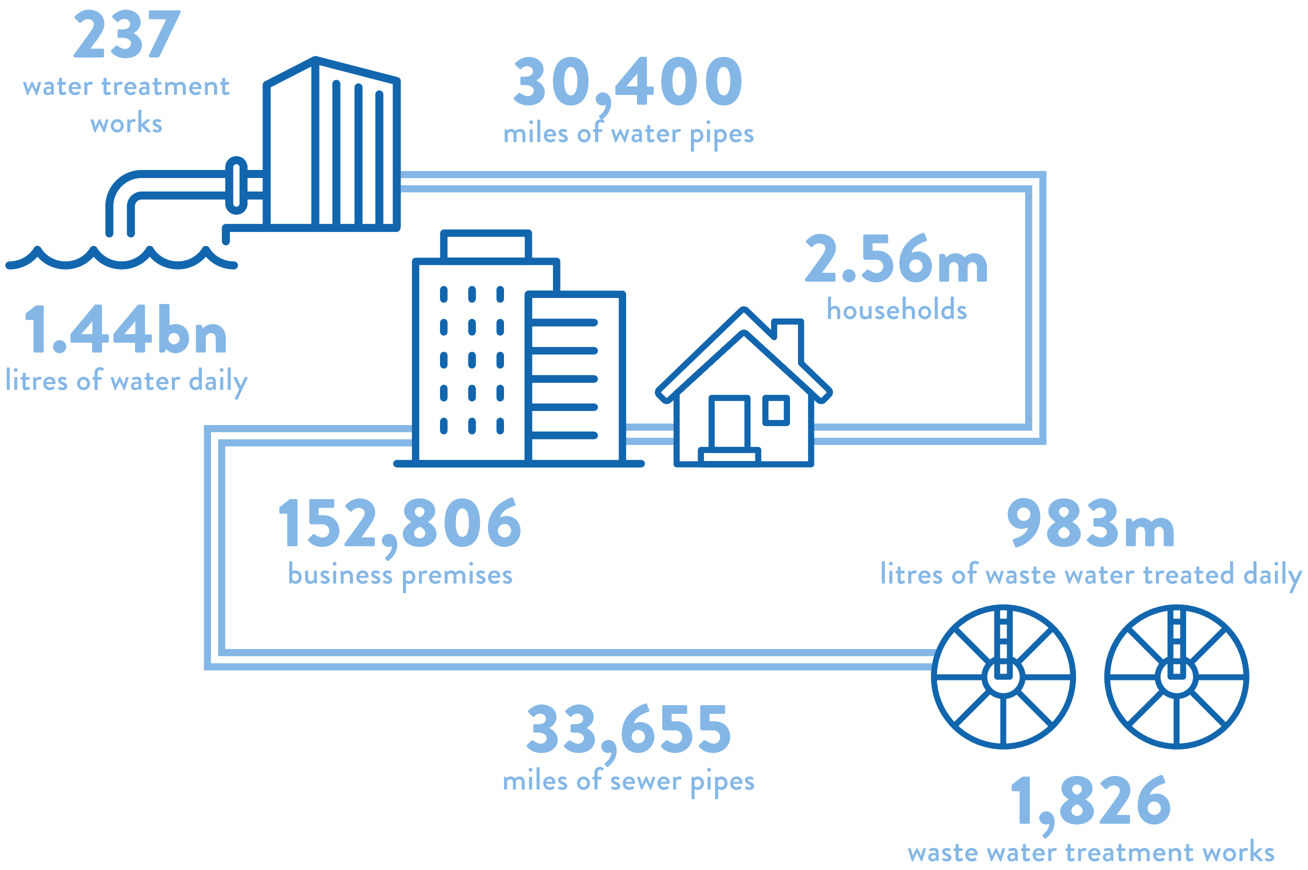
SCOTTISH WATER'S VITAL ROLE

Every day we:

- deliver 1.44 billion litres of clear, fresh drinking water; and
- remove 983 million litres of waste water which we treat, recover resources from and return safely to the environment.
- Our services support 2.56 million households and 152,806 business premises across Scotland.

Over the six-year period from 2015-21, we plan to invest £3.9 billion in managing our assets and making further improvements to drinking water quality, protecting the environment and contributing to the Scottish economy. In 2019/20, the fifth year of the regulatory programme, we invested £673 million.

OUR VITAL ROLE COVERS:



CHAIR'S STATEMENT
DAME SUSAN RICE

The world around us is changing at a dramatic pace. In the last 12 months we've seen the declaration of a climate emergency by the Scottish and United Kingdom Governments, the UK leave the European Union, a UK general election, and more recently, the Covid-19 pandemic and societal action on racial inequality.

Against such a turbulent backdrop, every organisation must adapt and plan for the future. And that is our position too. Scottish Water has a strong track record of delivering against the expectations set for each regulatory period, but we face significant changes as we look ahead to the next regulatory period starting in 2021. The expectations placed on us in the coming decades will require us to develop new capabilities, navigate an uncertain world, take the right decisions and build customers' and stakeholders' trust in the actions we are taking to achieve our long-term plans.

But before then, like everyone else, we are in the midst of dealing with the Covid-19 pandemic, the full impact of which is highly uncertain at this time. It will take many months and perhaps years before we fully understand the short and long-term consequences. However, there is a clear and renewed appreciation across the country of the essential services on which we all depend. In these challenging times, we are all reminded about the importance of good basic health care and hygiene.

We have now set a target to reach three times as much renewable energy generation as the electricity we use by 2030.

This reinforces the critical role we play in providing water and waste water services which are essential to public health. When society emerges from the pandemic we will continue to support the social and economic recovery to come.

While Business Stream's balance sheet was strong and debt free at 31 March 2020, Business Stream recognised that there would be a potentially significant financial impact on its business from the Covid-19 pandemic. Consequently, Business Stream has developed a number of financial scenarios to assess the potential range of financial impacts of the pandemic on its business. These have been used to secure new funding arrangements to meet the shorter-term liquidity impacts which will arise as a result of the pandemic.

Scottish Water has continually adapted, from the efficiency drive that was required to help finance investment in our early years, to the need to keep customer charges down since the 2008 financial crisis. We have repeatedly demonstrated an ability to adapt and transform, to do what our customers need us to do in the circumstances.

At this time our circumstances, even without Covid-19, are as challenging as any we have faced in the lifetime of Scottish Water. The declaration of the climate emergency and our commitment to achieve net zero emissions by 2040 mean that we must fundamentally transform how we work; reducing our emissions. That is an enormous challenge for an organisation with such a large number of long-life assets and a major programme of asset replacement.

But it also presents an opportunity for us to maximise our assets and land, our people and our ingenuity for the greater good of Scotland and the planet. If we can achieve this, reduce our emissions as far as possible, and maximise the potential of our land for natural carbon storage and renewable energy generation, we can significantly contribute to Scotland's efforts to tackle climate change.

In the last two years, we reached the milestone of generating or hosting over twice as much renewable energy as the electricity we use. We have now set a target to reach three times as much renewable energy generation as the electricity we use by 2030, maximising opportunities to host renewable energy on our land.

Another challenge we face is that of our ageing assets and their ability to sustain the service our customers rely on. In recent years we have become adept at managing the risk of asset failure to protect the overall service received by customers. Despite this success, our investment has not kept pace with the ageing of our assets, while we have been holding customer charge increases down.

Over the next 20 years, we will have to increase our levels of capital investment to around double the current level to achieve a stable overall state of our infrastructure, where the rate of investment in replacing life-expired assets matches the overall rate of decline in our other assets. This is essential to avoid exposing our customers to undue risk of increased service failure. Increasing our rate of asset replacement and dealing with the challenges of climate change will require real annual increases in customer charges over the long term. We are pleased that this imperative has been recognised by the Water Industry Commission for Scotland in their recently published draft determination of charges for 2021-27 but we are well aware that this may prove particularly challenging as our customers face economic uncertainty and challenges during, and beyond, the current Covid-19 pandemic.

But our asset challenge is also an opportunity, to find no-carbon or low carbon solutions, to maximise our potential for more renewable energy generation and natural carbon storage, and to start fixing the problem now, rather than passing it on to future generations.

The key to securing the support of customers for increased investment will be to become yet more efficient in everything we do, and to continually demonstrate that we deliver great value. The efficiency targets we are proposing, as we move into our next regulatory period, will be very challenging but entirely necessary if we are to maintain the confidence of those we serve.

Over the last year, a number of steps have been taken towards Scottish Water's long-term future. The most inspiring of these was the creation of a water sector Vision with the Scottish Government and key stakeholders. The first line of that Vision: *Scotland's water sector will be admired for excellence, secure a sustainable future and inspire a Hydro Nation*, summarises the level of ambition within the sector and sets a course for Scottish Water, our regulators and others.

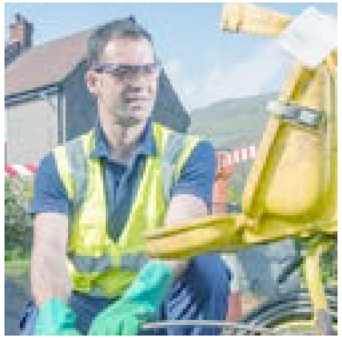
From the final line of the Vision: *We are a vital part of a flourishing Scotland*, we have drawn Scottish Water's new purpose: *To support a flourishing Scotland*. This new purpose is at the heart of our strategic plan, which describes how we will play a leading role in achieving Scotland's ambitious water sector Vision over the next 25 years.

The challenge ahead of us is to transform Scottish Water into an organisation that can go beyond net zero emissions, tackle our ageing assets and make progress towards the aspirations set out in the water sector Vision. Our Board recognises that this will be demanding, but we are confident that we will rise to the challenge.

During the last year, the Board and its committees have ensured Scottish Water has continued to deliver improvements in performance while also working on the strategy and plans needed for its long-term future. I would like to thank them all for their service during the year and their contribution towards securing our long-term future.

CHIEF EXECUTIVE'S STATEMENT
DOUGLAS MILLICAN

In the last year, we have started a significant transition from the Scottish Water that, over nearly two decades, has consistently delivered the expectations placed on us to the new organisation we must become to meet the challenges and opportunities over the next 25 years.



The catalyst for this transition has been the Strategic Review of Charges, a process we currently undertake every six years with regulators and stakeholders, to develop our plans to achieve the objectives set by Scottish Ministers. Unlike previous strategic reviews, which have focused on priorities for a defined period, of up to six years, we have agreed with our stakeholders that our future plans should focus on the next 25 years. This will help ensure we play a leading role in achieving Scotland's new water sector Vision.

That has led us to produce an ambitious and visionary strategic plan, *Our Future Together*, which sets Scottish Water on a different course for the future. At the heart of that plan is a new purpose for Scottish Water: to support a flourishing Scotland, and three new strategic ambitions: Service Excellence; going Beyond Net Zero Emissions; and delivering Great Value and Financial Sustainability. Achieving this strategic plan will require us to deliver a significant transformation in how we operate across Scottish Water.

For the last year, we have been working on twin tracks. Most of our people have continued to focus on delivering our commitments for the 2015-2021 period, including improving customer experience, protecting the environment and investing for the future. We have also been working on developing our strategic plan and how we will transform Scottish Water into the organisation that can deliver this plan over the coming decades.

We have had a successful year delivering our commitments for the 2015-21 period and serving our customers and communities. Thank you to all our people, and those in our alliance and supply chain partners, who have delivered this high performance.

I am especially proud of the work our people have been doing since the outbreak of Covid-19 to keep our water and waste water services running in support of the national effort to protect public health. We have been well served by strong business continuity plans developed for such an event and the commitment of our people in often difficult personal and family circumstances. The long-term impact of the pandemic will not be known for some time, but it is already clear that the national response to the outbreak has had significant consequences for our customers, impacting the level of business activity and current levels of employment.

‘Thank you to all our people, and those in our alliance and supply chain partners, who have delivered this high performance.’

During the year:

- Our drinking water quality in 2019 was broadly in line with our highest ever level previously achieved, and there was a reduction in reported drinking water quality events. This was in spite of challenges such as the deteriorating condition of our ageing assets and changes to our source waters caused by climatic factors. However, we experienced a rise in the number of more serious drinking water quality incidents and we recognise we have significant improvements to make over the coming years to deliver consistently excellent quality drinking water to all our customers; through investment in new assets and operational improvements.
- Our overall service, as measured by the regulatory Overall Performance Assessment (OPA) measure, achieved a score of 402; the third year in a row that we achieved a ‘best-in-class’ performance relative to the targets agreed for the 2015-21 period.
- Our customer experience has again shown year-on-year improvement, reaching record levels across household and non-household customers. We achieved this despite challenges during the year, such as the impact of the extreme weather in July and August 2019 which caused flooding in many parts of Scotland, and asset failures which caused an increase in short-term interruptions to customers’ water supply. Despite reaching record levels of customer experience overall, there were occasions when we failed to meet particular customers’ expectations, for which I apologise. We use insights from any service failing to drive improvements in future service delivery.
- We invested £673 million in water and waste water assets, through our capital investment programme, which makes us one of the biggest infrastructure investors in Scotland. This investment has delivered improvements in drinking water quality and protection of the environment. Although this investment was slightly lower than planned, we are overall ahead of plan in delivering our regulatory investment commitments for the 2015-21 period.

- Safety, health and wellbeing remain one of our highest priorities. The number of RIDDOR incidents (Reportable Injuries Diseases Dangerous Occurrences Regulations) increased from 11 to 15, although over a three-year period the number remains stable.
- We have been awarded the Fair Tax Mark for 2019/20, which is the world's first independent accreditation for fair responsible tax. Our published tax strategy provides a firm commitment to be fair and transparent on tax, not to take an aggressive interpretation of tax legislation and not to use tax havens to secure a tax benefit.

The headline group surplus before taxation at £85.7 million was £0.4 million lower than last year. Scottish Water surplus before taxation increased by £11.6 million to £97.2 million, and this will be fully reinvested in supporting future service delivery. However, Business Stream incurred a loss before taxation of £12.9 million, having generated a profit of £1.3 million in 2018/19, as a result of recognising a £13.2 million charge for doubtful debt provisions in relation to the Covid-19 pandemic.

The Covid-19 pandemic will have a significant adverse impact on our 2020/21 financial performance as we experience lower customer revenue and additional costs, particularly associated with our capital investment programme. As a result of government measures imposed to limit the spread of Covid-19, we closed all our construction sites in late March 2020. We have since reopened sites, in line with government guidance. In terms of income, undoubtedly our customer revenue base in this and subsequent years will be lower than previously anticipated, increasing pressure on future customer charges to deliver the services our customers expect.

I will now turn to the work we have done to develop our strategic plan for the future, the second track of our twin track approach.

The water sector in Scotland is adopting a new approach to how it fulfils its responsibilities that is very different from the past, and from other utility sectors. There are several core features of this, including: a long-term approach to investment planning; a highly constructive and collaborative engagement with our regulators and water sector stakeholders; and greater focus on social and environmental challenges and opportunities. Gone will be the days of a clear regulatory contract with fixed regulatory commitments and investment levels. Instead we will take a rolling, more flexible and long-term approach to investment planning and prioritisation, to help deliver what customers, communities and stakeholders want and need. A key feature of this new approach is our commitment to openness and transparency of reporting.

The most obvious driver of this change is the impact of climate change and the declaration of the climate emergency by the Scottish Government. We have responded to that with a commitment to reach net zero emissions by 2040, five years ahead of the national target.

The importance of the climate emergency is reflected in our strategic ambition to go Beyond Net Zero Emissions.

The importance of the climate emergency is reflected in our strategic ambition to go Beyond Net Zero Emissions. But our other strategic ambitions - Service Excellence, and Great Value and Financial Sustainability - are as significant and will be just as stretching for us to achieve, given our ageing asset base and the impact of extreme weather and changing weather patterns on our assets. Over the next 20 years we will need to increase capital investment to reach a level that is around double our investment level today, an unprecedented challenge in the UK water sector, while delivering year-on-year efficiency improvements.

This will require annual increases in customer charges above the rate of CPI inflation, and this has been recognised in the recently published draft determination of charges for 2021-27 by the Water Industry Commission for Scotland. We are however mindful of the impact of Covid-19 on household and business finances and will continue to consider carefully with our stakeholders how best to balance the need for investment with the immediate economic pressures on many of our customers.

To deliver our ambitions requires nothing short of a transformation of Scottish Water. Over the past year, we have introduced a new agile approach to delivering transformation projects, for example, increasing productivity during capital investment projects and using digital technology to streamline processes. But there is much more to do over the next year and beyond to set Scottish Water on course to be the organisation it must become. Over the next year, we will develop a transformation plan, which will set out how we maximise the involvement of customers and communities in our decision making, improve how we manage our assets, reach net zero emissions, and harness the full scope of new technology.

Transformation of this type and scale is never easy. There will doubtless be many challenges ahead as we transform the way we work while sustaining the improvements we have already made in the services we deliver for customers. We have no choice; the status quo is not an option. It is our responsibility and duty to look to the future challenges we will face, play our full part in tackling the climate crisis and replacing our ageing assets, while effectively and sustainably responding to the current pandemic.

I am confident that, with the continued support of our customers, communities, employees, partners and stakeholders, we will navigate the uncertainties we currently face with Covid-19 and make a successful transition into the new regulatory period, transform our business, and create a sustainable future together.


STRATEGIC
REPORT

OUR BUSINESS MODEL

Who We Are

Scottish Water is a public sector body, classified as a public corporation of a trading nature, answerable to the Scottish Parliament through Scottish Ministers. Consequently, Scottish Water does not have shareholders. This ownership model allows the surplus generated to be reinvested in the provision of services to our customers.

Scottish Water's core services are covered by the Water Industry (Scotland) Act 2002. Under that, the charges for these services have to be approved annually by the Water Industry Commission for Scotland (WICS). In delivering these services effectively, Scottish Water has to make use of its resources to achieve the ministerial objectives at the lowest reasonable overall cost.

As the economic regulator for the Scottish water industry, the WICS' mission is to manage an effective regulatory framework that encourages the water industry in Scotland to provide a high quality service and value for money to customers. The role of the Scottish Government is as policy maker, owner and banker.

What We Do

Scottish Water's purpose is to support *a flourishing Scotland through being trusted to care for the water on which Scotland depends.*

Scottish Water supplies water and waste water services to households and is also the wholesaler to the 30 retailers (Licensed Providers (LPs)) who operate in the water retail market for businesses in Scotland.

Using Scotland's natural resources and the skills of our people, Scottish Water is committed to improving our services for customers and communities while protecting and enhancing the environment of Scotland.

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

Details of the Scottish Water group structure, strategic frameworks and financial frameworks are provided in the following sections: Scottish Water Group (pages 96 to 99), Scottish Water – regulated services (pages 100 to 106), Business Stream (pages 106 to 108) and Non-regulated businesses (pages 108 to 109).

A CHANGING WORLD: EXTERNAL PERSPECTIVE

Delivering 'Our Future Together' will require us to transform our business to ensure we are able to tackle the impact of unpredictable factors including a changing climate, and political and economic uncertainties. Over the past year several external events have significantly impacted us, and may continue to impact us in the coming months and years. We actively work to mitigate the risks posed by environmental, societal, political and economic shifts.

Covid-19 Pandemic

The Covid-19 pandemic has had a profound effect on our everyday lives since the first case was recorded in the UK on 31 January 2020.

On 23 March 2020 the UK Government announced a lockdown, where people had to remain within their homes except for essentials and exercise, in an attempt to control the spread of the virus. As part of that lockdown many millions of people who previously worked from an office or other workplace switched to working from home, schools were closed and non-essential businesses shut down as slowing the spread of the virus and protecting the capacity of the national health service became governments' priority. During March, April and May, around 40,000 people died as a result of the virus.

As the lockdown was gradually lifted through the summer months, some aspects of life returned to something near normal, including schools reopening and industries restarting. Despite the restart and government attempts to support the economy, the economic impact of the Covid-19 pandemic and the lockdown is potentially the deepest in modern history and it is uncertain what the medium and long-term impacts will be for the economy and society.

Scottish Water committed to reaching net zero emissions by 2040, five years ahead of the target for Scotland.

The increase in cases of infection through the autumn is likely to mean that some restrictions will probably remain in place during the winter months. Work on effective vaccines against Covid-19 is progressing around the world.

The Climate Emergency

In May 2019, the Scottish Government announced a climate emergency in response to continued heating of the planet and a scientific consensus that this would lead to potentially catastrophic consequences on a global scale.

As part of the Programme for Government announced in September 2019, Scottish Water committed to reaching net zero emissions by 2040, five years ahead of the target for Scotland. We also committed to host or generate three times as much renewable energy generation as the electricity we use by 2030, maximising opportunities to host renewable energy on our land.

Achieving net zero by 2040, and going beyond this, poses a challenge as big as any we have previously faced. Our activities, by their very nature, are energy intensive and we are currently one of the biggest users of electricity in Scotland. Likewise, some of our waste water treatment processes produce emissions that cannot simply be turned off.

However, our biggest challenge to achieving net zero is the age and condition of many of our assets, which were never designed to achieve zero emissions. Some will need to be replaced and many others significantly transformed. The costs of doing this while replacing ageing assets at the end of their lives will, we estimate, require a near-doubling of our annual level of capital investment over the next 20 years.

The Impact of Climate Change

Climate change is having an impact on all the services we provide, from changing the quality of the source waters we treat to provide drinking water, to dealing with increasing extremes in flooding and dry spells.

These are serious, uncertain and costly challenges that will only increase as the planet heats further. We are committed to dealing with these by finding innovative solutions and transforming how we deliver our services.

Managing the risk of failing assets has been a key factor in providing our services in recent years. To deal with the impact of climate change and achieve service excellence, we will significantly increase investment in replacing our ageing infrastructure and transform our operational effectiveness.

Exit from the European Union

On 31 January 2020, the United Kingdom left the European Union. The protracted discussions over a withdrawal agreement created risk and uncertainty in many areas of the economy and public services.

We will continue to plan for continuity of services in the event of a disorderly exit from EU trading arrangements.

For the UK water sector, including Scottish Water, the largest risk is to the supply of chemicals required for the safe treatment of water and waste water. The water sector, through Water UK, has formed an Incident Management Group to coordinate the planning for a no-deal Brexit, sharing information about stocks and availability of essential chemicals and establishing mutual aid arrangements in advance of them being required.

The UK will continue to follow EU rules during a transition period to December 2020. At the time of writing the UK Government and European Union negotiators remain in discussion about a post-Brexit agreement. We will continue to plan for continuity of services in the event of a disorderly exit from EU trading arrangements after 31 December 2020.

England and Wales

The water sector in England and Wales has faced significant challenges in recent times. Political criticism following major flooding incidents and media scrutiny of companies' financial performance, led to questions about the legitimacy of privately-owned and listed companies owning and managing monopoly water and waste water services.

In December 2019, Ofwat announced an average charge reduction for customers in England and Wales of 12% before inflation over the next five years. Ofwat rejected cases put forward by many of the companies that its draft determinations were not financeable and that investment would have to be scaled back to unsustainable levels. Four companies in England have appealed their determinations to the Competition and Markets Authority.

There is a related risk to Scottish Water that the poor standing of some water and waste water companies in England could lead to criticism of our operations or performance. However, our ownership model, separate economic regulator and overall improving performance have all helped offset that risk.

Scottish Political Landscape

We will continue to monitor political developments associated with the planned Scottish Parliament elections in May 2021 for any potential impacts on our operations or planning.

OUR VISION AND STRATEGY

For the last three years we have been working with the Scottish Government, our economic regulator, the WICS, and other water sector stakeholders on our plans for the future; for the regulatory period starting in April 2021.

In January 2017, the Scottish Government commissioned the WICS to undertake the Strategic Review of Charges (SRC) for the period from 2021. They invited them to ensure the processes of the SRC gave customers an enhanced voice in the consideration of levels of charges and service priorities. The Scottish Government recognised that the coming period will present some important challenges, such as capital maintenance, resilience and strategic capacity and invited us to work with the WICS to ensure these are properly addressed. Scottish Ministers also requested that the WICS indicate longer-term price profiles based on their understanding of longer term investment requirements.

The WICS responded with their methodology for the SRC, 'Innovation and Collaboration: future proofing the water industry for customers'. The methodology adopted the principles of Ethical Based Regulation to ensure a fully transparent and collaborative process, and required Scottish Water to take ownership of its strategy. The WICS have also published 22 Decision Papers, setting out emerging thinking on key areas of the SRC including investment and long-term prospects for prices.

Work undertaken by the water sector identified:

- In an industry reliant on assets that can last 50 or even 100 years, we must take a longer-term view of our investment decisions.
- The condition of some of those assets is deteriorating and there is a need to replace them at a rate that is both achievable and affordable.
- The declaration of the climate emergency and our commitment to achieve net zero emissions by 2040 requires us to plan over the next 20 years.

With this long-term outlook came an opportunity to work in a different way as a water sector. The regulation of utilities has often been characterised by an adversarial relationship between the regulator and the regulated company. Adopting a long-term approach within Scotland's water sector, considering sustainability and fairness between generations, has created an opportunity to forge a new way of working.

As an organisation we have committed to Ethical Business Practice, a way of operating based on trust and transparency, rather than a traditional strict regulatory contract. This change has helped create a new relationship between Scottish Water and its economic regulator. It has also created the opportunity for the water sector[1] to work together on future plans that are in the best interests of customers and communities.

We have worked very closely with water sector stakeholders on these plans, co-creating ideas for the future with them. This has brought greater diversity of thought on what needs to be done over the next 25 years and how we should get there. The outcome of this way of working has been a strong consensus about the future direction for the sector, as reflected in the water sector Vision.

[1] The water sector includes: the WICS; the Scottish Government; our quality regulators, the Scottish Environmental Protection Agency (SEPA) and the Drinking Water Quality Regulator (DWQR); and customer representatives, Citizen's Advice Scotland (CAS) and the Customer Forum.

Water Sector Vision

SCOTLAND'S WATER SECTOR WILL BE ADMIRED FOR EXCELLENCE, SECURE A SUSTAINABLE FUTURE AND INSPIRE A HYDRO NATION.

Together we will support the health and wellbeing of the nation. We will ensure that all of Scotland gets excellent quality drinking water that people can enjoy all of the time. Scotland's waste water will be collected, treated and recycled in ways that generate value and protect the environment. We will enable the economy to prosper.

We will transform how we work to live within the means of one planet's resources, enhance the natural environment and maximise our positive contribution to Scotland achieving Net Zero emissions.

We will involve and inspire Scotland's people to love their water and only use what they need. We will promote access to the natural environment and encourage communities to enjoy and protect it.

We will be agile and collaborate within the sector and with others to be resilient to the challenges which will face us. We will keep services affordable by innovating and delivering the greatest possible value from our resources, helping those who need it most. We will serve all customers and communities in a way that is fair and equitable to present and future generations.

We are a part of a flourishing Scotland.

We have created a new corporate purpose for Scottish Water

TO SUPPORT A FLOURISHING SCOTLAND THROUGH BEING TRUSTED TO CARE FOR THE WATER ON WHICH SCOTLAND DEPENDS.

The Vision, created jointly by all water sector stakeholders, describes the future industry we are working together to build to meet the needs of customers and society. It is a vision for the whole sector that will require Scottish Water, government, regulators, our supply chain, customers and communities to work together.

The Vision explains what the sector should aim to achieve over the long term and sets out how the sector can do more for customers and communities, the environment and a flourishing Scotland. It was launched in October 2019 by Roseanna Cunningham MSP, the Cabinet Secretary for Environment, Climate Change and Land Reform.

From the sector Vision we have created a new corporate purpose for Scottish Water: *To support a flourishing Scotland through being trusted to care for the water on which Scotland depends.* This purpose aligns us with the Scottish Government's National Performance Framework and the United Nations' Global Goals. It underlines that Scottish Water has a vital part to play in the environmental, economic and social wellbeing of Scotland.

In February 2020, we launched our strategic plan *Our Future Together*. As well as our new purpose, our plan highlights the big challenges we will face in providing essential services to homes and businesses across Scotland: the impact of climate change, ageing assets, and reducing the emissions that contribute to the climate crisis.

Our Future Together also sets out three strategic ambitions for the next 25 years:

SERVICE EXCELLENCE

BEYOND NET ZERO EMISSIONS

GREAT VALUE AND FINANCIAL SUSTAINABILITY

Under *Service Excellence* we commit to investing in our people and adapting how we work so that we can provide excellent services in future, even as we face the increasing challenges of climate change and our ageing assets.

Under our second ambition, we commit to reaching net zero emissions by 2040 and going beyond that thereafter. We will do all we can to reduce emissions but may not be able to remove them entirely. We will also generate or host more renewable energy than we use, and maximise natural carbon solutions such as peatland and woodland, to capture and store emissions.

Under *Great Value and Financial Sustainability*, we commit to ensure that we keep services affordable and that customers continue to receive great value now and in the future.

Our plan expands each of these ambitions into ten strategic objectives covering our high-level plans for water and waste water services as well as many other areas, including how we will involve customers and communities in future investment decision making. A full version of Our Future Together can be found here.

Achieving our plan for the next 25 years will require a transformation of Scottish Water that will be at least as great as that carried out when Scottish Water was created nearly 20 years ago. No part of our activities will remain unchanged as we transform into the organisation that can fulfil our strategic ambitions.

We have already begun to transform key activities and work is progressing to produce a comprehensive transformation plan that will set us on course to achieve this. We expect to publish our transformation plan in 2021.

As part of this plan, we will work to better understand the capability and replacement needs of our assets. We are also working with industry experts on a long-term asset management improvement plan.

We are enhancing our approach to investment prioritisation and planning, moving to a dynamic process. This will allow us to incorporate the latest evidence and collaborate with stakeholders to ensure the costs and benefits of competing investment priorities are considered appropriately.

Part of our transformation will also include introducing a new 'Character' for Scottish Water which will set out the characteristics we will seek to display, and those that we will expect of our leaders and people. Our new Character will encapsulate how we will need to think and behave in future.

As with any organisation embarking on such large-scale transformation there are a number of risks to achieving it. We must manage the engagement and confidence of our people, stakeholders, customers and communities so that we can deliver our long-term transformation; and ensure this work does not negatively impact core service delivery. There is also an added risk from the delay to our detailed transformation planning due to the impact of the Covid-19 pandemic.

Achieving the strategic ambitions set out in *Our Future Together* will require around double the level of current investment with expected annual investment of over £1 billion by 2040. Financing this increased investment will require real increases in customer charges over the long term, which we will limit by pursuing stretching annual efficiency targets and accessing additional borrowing from the Scottish Government. While the broad trajectory of long-term charging requirements is clear, and we have now received the Water Industry Commission for Scotland's draft determination of charges for 2021-27, we await completion of the SRC process during 2020 to understand how this transition will begin, particularly in light of the current Covid-19 pandemic and subsequent economic downturn.

No part of our activities will remain unchanged as we transform Scottish Water into the organisation that can fulfil our strategic ambitions.

DELIVERING MINISTERIAL OBJECTIVES IN THE 2015-21 REGULATORY PERIOD

Scottish Ministers set objectives for Scottish Water for the period 2015-21. This report looks at our performance during the fifth year of that regulatory period as well as looking ahead to completion of these objectives in the final year and beyond. Ministers consulted with stakeholders in 2012 before making the following Directions:

- Helping to sustain better and more efficient public services by ensuring assets are maintained and improving services to customers.
- Helping people sustain and improve their health through the provision of continued, high quality drinking water and improving resilience.
- Contributing to improvements in Scotland's natural and built environment and the sustainable use and enjoyment of it.
- Supporting the delivery of the Government's priorities in rural communities with a view to improving water and waste water provision in rural areas.
- Servicing demand for new strategic capacity to meet all new housing development and the requirements of commercial and industrial customers.
- Improving Scotland's resilience to climate change by identifying possible impacts and, where appropriate, investing to manage these impacts.
- Contributing to Scotland meeting its climate change obligations of reduced greenhouse gas emissions.
- Taking all necessary steps to fulfil duties and obligations set out in the Flood Risk Management (Scotland) Act 2009.

Our Delivery Plan for 2015-21 is geared towards achieving these objectives. Our plan reflects the priorities and expectations of our customers following extensive research and consultation with them, discussion with the Customer Forum and other stakeholders in 2013/14 including the WICS, DWQR, SEPA, CAS and the Scottish Government. Our plan addresses our customers' highest priorities, including improvements to drinking water quality and reducing flooding from sewers. A major aspect of our plan for 2015-21 is to increase the resilience of the services we provide.

OUR APPROACH TO RISK MANAGEMENT

Principal Risks and Uncertainties

Overview

Strong and systematic risk management is integral to achieving Scottish Water's plans and the delivery of Ministerial objectives. Risks, both positive (opportunities) and negative (threats) exist and have the potential to impact the routine operations we undertake, services we provide to our customers, and ultimately affect the achievement of our business objectives, strategy and purpose.

Scottish Water's risk management framework encompasses subsidiaries; Scottish Water Horizons, Aberdeen Environmental Services and Scottish Water Services Grampian. In line with the Water Industry (Scotland) Act 2002: Scottish Water Governance Directions 2009, the framework excludes Business Stream's operational risk management. The Board of Scottish Water Business Stream Holdings Ltd oversees the financing risks associated with Business Stream, while Business Stream's Board is responsible for its own risk management.

Risk Control Assurance

Scottish Water operates a formal governance structure to manage risk. While everyone in the organisation has a responsibility to support the management of risk, the Scottish Water Board, supported by the Audit Committee and the Executive Leadership Team, has overall accountability for this risk management framework.

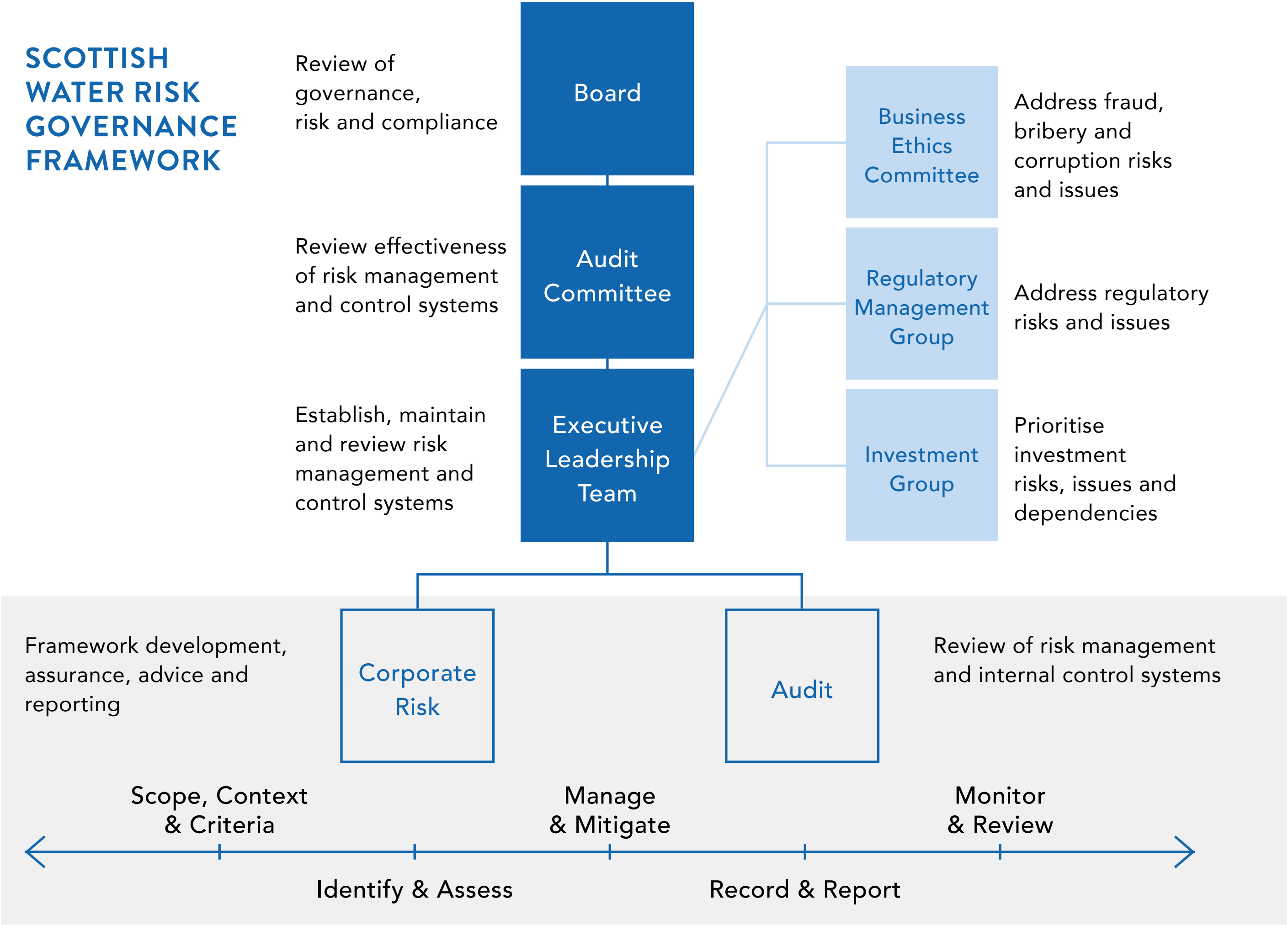
Regular reviews of the most significant risks are undertaken with appropriate mitigation strategies developed, implemented and monitored.

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

Our approach is designed to provide assurance that the opportunities and threats facing the business are understood; and that all necessary information is reported to senior managers and escalated to the Executive Leadership Team, Audit Committee and Board as appropriate.

The risk management framework was independently audited in March 2017.

SCOTTISH WATER RISK GOVERNANCE FRAMEWORK



Risk Management Approach

Scottish Water has an established Risk Management Policy which was refreshed in August 2017 and is subject to periodic reviews. The policy is due to be reviewed in 2020, but this has been deferred due to our current focus on managing Covid-19 related risks. This policy sets out a clear and consistent approach to the management of risk and defines our risk appetite. This is enabled by the Corporate Risk Register and a number of supporting risk management processes.

Our systematic and structured risk management framework enables the identification, assessment and effective management of business risks. The consequence and likelihood of risks are determined and ranked using a scoring matrix which is aligned to our risk appetite. This ensures a consistent approach is taken when assessing the overall impact to Scottish Water and our customers.

When forming this assessment, we consider risks aligned to four risk perspectives. These are 'Managing our Assets', 'Working with People', 'Managing External Influences' and 'Developing the Business'.

The current, or projected, level of risk is compared to the Board's risk appetite to ascertain whether further action is required to ensure the achievement of service delivery and business objectives in line with our ambitions and risk appetite.

Culture

The Board recognise that the effectiveness of risk management is dependent on Scottish Water's culture, which encompasses the knowledge, beliefs and attitudes of our people. We aim to foster a risk-aware culture throughout the business. We seek to do this by promoting a consistent tone from the top, outlining clear responsibilities and accountabilities for those managing risk and recognising individuals who manage risk effectively and who share and report risk information in a timely manner.

Risk Appetite

The level of risk we are willing to accept in the pursuit of our business objectives is reviewed and approved by the Board in advance of, and during, each regulatory period, or where there is a material change to the operating environment.

We have established Risk Appetite Statements for key business areas. Beneath each statement is a series of measurable Risk Appetite Definitions which assist in providing a view as to whether we are operating within our appetite or whether additional risk mitigation may be required.

These metrics are routinely reviewed by the Corporate Risk Team and individual risk owners, and are incorporated into bi-annual reports to the Executive Leadership Team, Audit Committee and the Board. The appropriateness of the mitigating actions is determined in accordance with the risk appetite for the relevant business areas.

Board

The Board has overall responsibility for reviewing governance, risk and compliance. The Board receives two risk reports per year, supplemented by a further two summary updates, which review the principal risks and uncertainties, including the mitigating actions being undertaken and their effectiveness.

Audit Committee

The Audit Committee has responsibility for the risk management framework on behalf of the Board, reviewing the effectiveness of risk management and supporting control systems. The Committee receives two risk reports per year, supplemented by a further two summary updates.

Executive Leadership Team

The Executive Leadership Team is responsible for establishing, maintaining and reviewing risk management and supporting control systems. The Executive Leadership Team receives regular risk reporting. A number of executive sub-committees assist with oversight of specific risk areas - the Business Ethics Committee which meets quarterly to address fraud and corruption risks and issues; the Regulatory Management Group which meets monthly to address regulatory risks and issues; and the Investment Group which also meets monthly to address investment risks, issues and dependencies.

Corporate Risk

Scottish Water has a Corporate Risk Function. This is headed by a General Manager, reporting to the Finance Director, who leads and manages the risk management framework and processes and is responsible for risk reporting and advice to the Executive Leadership Team, Audit Committee and the Board.

Audit

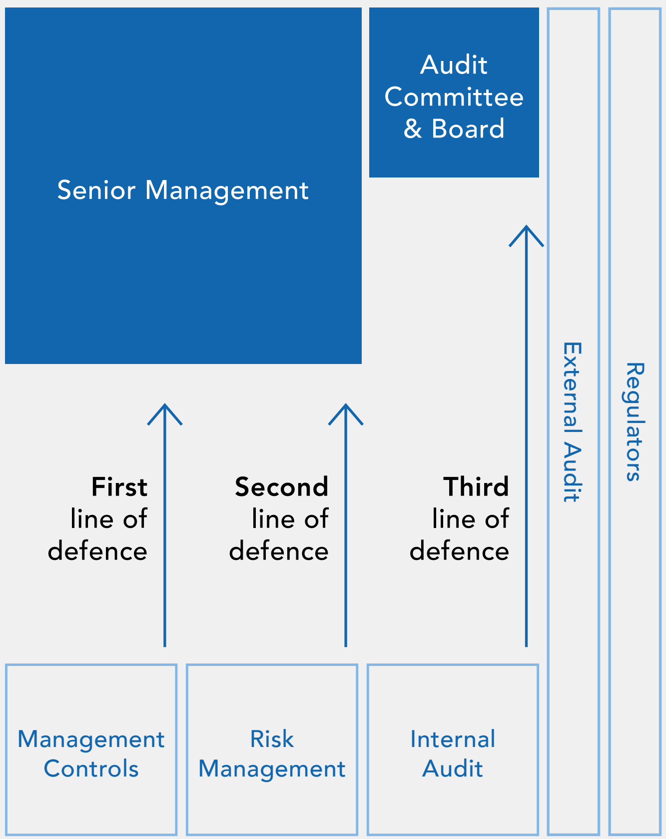
In the context of risk management, a range of audit activity is undertaken by teams across the business to provide assurance on risk controls. This is supplemented by internal and external audits and escalation processes, including an externally supported whistleblowing facility. The three lines of defence model further illustrates this process.

Three Lines of Defence

Scottish Water operates a three lines of defence model with clearly defined roles and responsibilities. This model ensures the effectiveness of the risk management framework by providing key governance groups with appropriate assessment, monitoring and assurance at three different points.

1. **First line of defence**. Each business area is responsible for the identification and assessment of risks, understanding and adopting appropriate controls.
2. **Second line of defence**. Risk management provides challenge on the completeness and accuracy of risk assessments, considers the adequacy of mitigation plans and enables risk reporting.
3. **Third line of defence**. Internal audit, through a risk-based approach to its work, provides an independent assurance of the effectiveness of risk management across the organisation, including the first and second lines of defence.

THREE LINES OF DEFENCE MODEL



Principal Risks and Uncertainties

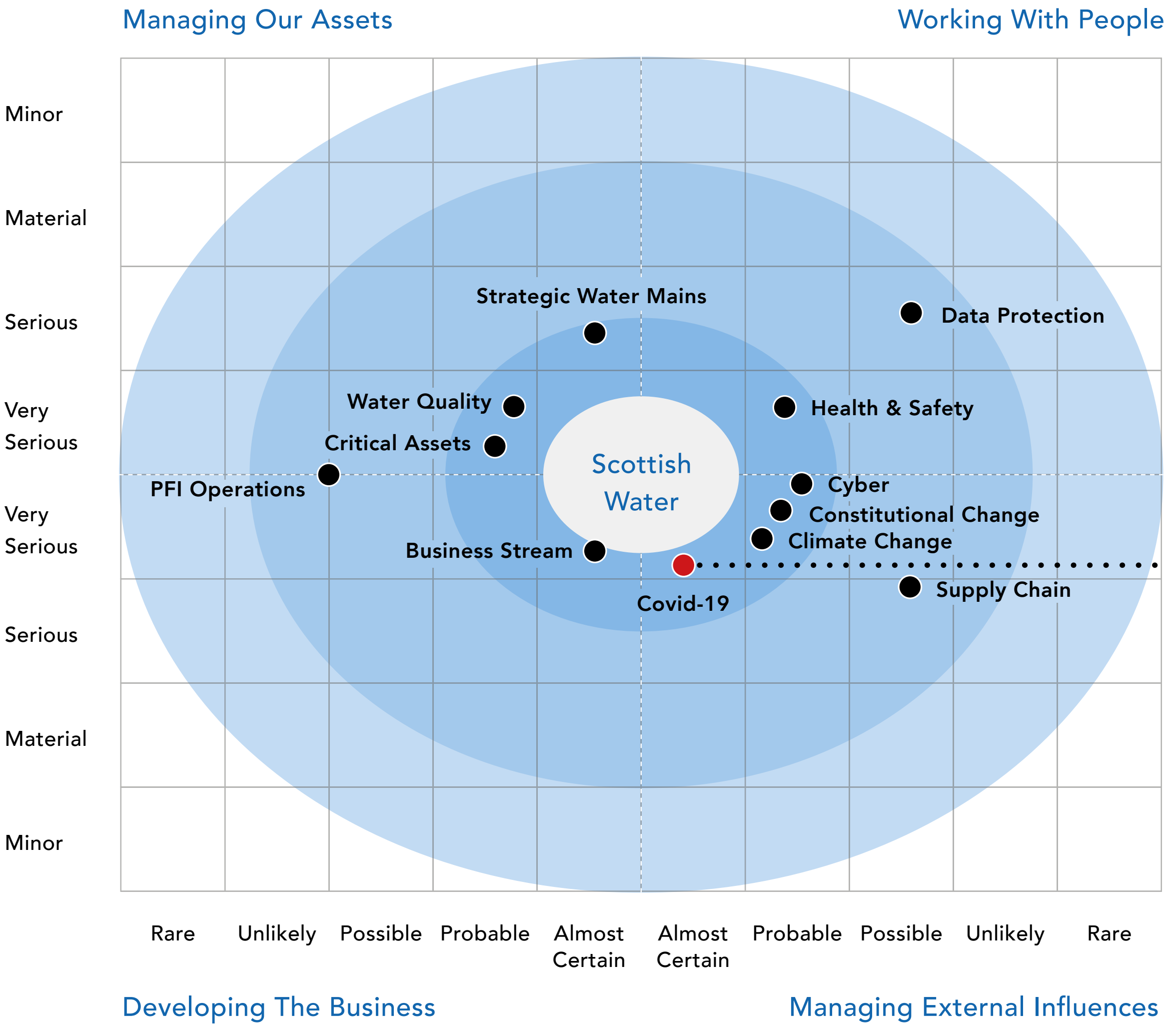
At the time of this report, the Board has carried out a robust assessment of the principal risks and uncertainties facing Scottish Water and its subsidiaries. This is set out over the following pages. These are the risks that we consider to be the most material to our business and our performance, including those that would threaten the business model, future performance within our regulatory settlement, and short and long-term financing of Scottish Water.

This list does not comprise all of the risks that the Group may face and is not provided in order of priority. With the exception of the evolving impacts from Covid-19, the nature of these risks has remained largely unchanged over the year. We have outlined our current view of potential future risks in the Emerging Risks section.

We have also commented on key mitigating actions that are employed to manage these risks as well as our risk appetite in each of the risk areas.

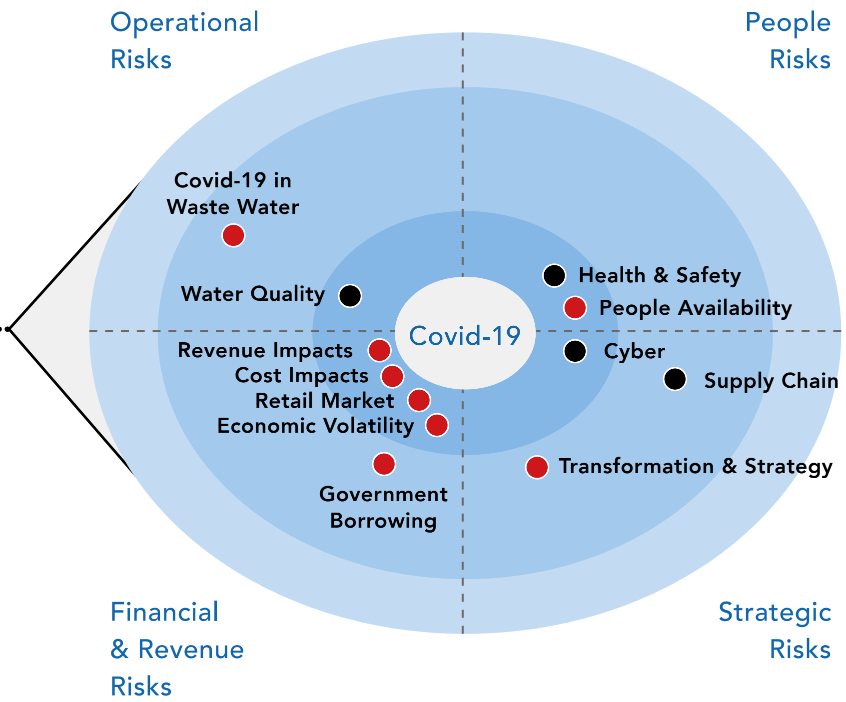
A visual representation of the relative likelihood and consequence of each of the principal risks, grouped by our risk appetite headers, is provided on page 29. This diagram illustrates, in relative terms, the greater the likelihood and consequence of the risk, the closer the risk is to the centre of the diagram.

The larger radar illustrates the principal risks faced by Scottish Water under normal operating conditions; while the smaller diagram radar details the risks influenced by Covid-19. Within the smaller diagram, the risks illustrated by the red dots highlight those risks primarily driven by Covid-19 impacts; while those denoted in black are existing risks further compounded by Covid-19.



Legend

- Business as usual principal risks, some of which are compounded by aspects of the Covid-19 pandemic.
- Specific Covid-19 risks that are currently under focus.



Emerging Risks

We define emerging risks as future events which present uncertainty, but are difficult to fully assess at the current time due to lack of information, a changing or unpredictable environment and/or limited understanding of the speed at which the risk may materialise.

Emerging risks have the potential to increase in significance and affect the performance of Scottish Water and, as such, are continually monitored and reported through our existing risk processes.

We undertake regular horizon scanning including PESTLE analysis[2] to monitor both the internal and external business environment, to help identify and review new and emerging risks in the short to medium term.

Scottish Water will also be exposed to additional emerging risks arising in the medium-long term from Covid-19 challenges. The emerging key risks identified at this time, are outlined in the following table.

An overarching principal risk related to Covid-19 is also outlined on page 32. This considers the broader pandemic risk-taking account of Covid-19. This risk will likely be influenced by these emerging aspects in the future.

[2] PESTLE is the framework to analyse Political, Economic, Sociological, Technological, Legal and Environmental factors

Covid-19 Emerging Risk	Description
People Risks	
People Availability	Risk that effective delivery of essential business activities is severely impacted due to lack of availability of people and/or key skills.
Financial & Revenue Risks	
Revenue Impacts	Financial risk arising from reduction in revenue from household and business customers, in the short and longer term.
Cost Impacts	Financial risk arising from costs associated with the close-down of the capital programme and reduced productivity when capital project sites reopen because of the need for new safe working arrangements.
Retail Market	Risk of Licensed Provider (LP) failure in the retail market in light of impacts on both business customers and Licensed Providers.
Economic Volatility	Financial risk due to the global macroeconomic impacts arising in the short and longer term.
Government Borrowing	Access to government borrowing may be impacted by economic conditions and the need for greater and sustained investment in other areas of government policy.

Covid-19 Emerging Risk	Description
Operational Risks	
Covid-19 in Waste Water	Research is ongoing to more fully understand Covid-19 transmission routes. While this is currently deemed low risk, we continue to monitor and manage our activities and controls appropriately.
Strategic Risks	
Transformation & Strategy	Transition from pandemic management back into 'new business as usual' activities is likely to provide challenges and opportunities to sustain new ways of working beyond the Covid-19 period.

In addition to Covid-19, a list of further key emerging risks of relevance to Scottish Water is set out below:

Emerging Risks	Description
Water Availability	Monitoring and planning for changing weather patterns, especially drier, hotter summers which could lead to a reduction in available water resources.
Power Interruptions	Developing specific plans to respond to total or partial shutdown of the national electricity transmission system, which could impact the running of our core services.
Micro Plastics	Understanding and addressing the impact of micro plastics, both on natural resources and customers.
Biosolids[3]	Monitoring discussions and planning for impact of a potential loss of key disposal route due to regulatory change.

[3] Biosolids are solid organic matter recovered from the waste water treatment process and used as fertiliser.

Scottish Water – Principal Risks and Uncertainties

Managing External Influences

Risk	Trend	Risk Description	Risk Appetite
Covid-19	↑	Operational, service and financial risk arising from the impact of Covid-19 on Scottish Water and the wider population.	Delivering a continuous service to our customers is paramount. We will ensure a sufficient capacity of engaged, enabled and energised people to the required areas of the business at the appropriate times, with effective skills and competency. We will ensure financial contingency planning remains robust, with appropriate scenario modelling in place.

Key Mitigations

- Established Business Continuity Plans to cater for low likelihood high impact events.
- Incident Command Structure to identify areas of concern and direct targeted people resource to support critical activities.
- Essential skills, roles and business activities identified with clear successions plans for key roles.
- Working with and applying government and regulatory guidance.
- Understanding the financial exposures (economic, revenue and borrowing).
- Understanding and managing operational changes, developing appropriate measures to support or address.
- Developing recovery and transition plans to support activities as the lockdown restrictions begin to ease.

This risk continues to be closely managed and mitigated at this time given the essential nature of Scottish Water's core services to the general population alongside protecting our people and finances.

Managing External Influences (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Cyber Security	⟷	Operational risk from loss of key IT service arising from a deliberate external or internal attack (physical/virtual).	Scottish Water seeks to ensure the integrity and security of its IT estate.

Key Mitigations

- Organisation-wide education and awareness programme in place.
- External Expert Vulnerability and Threat Management service in place.
- Security gap analysis undertaken. Plans and funding in place to further increase security level.
- Regular application of updates to software and security products.
- Detailed disaster recovery plans.
- Participation in UK & Scottish Government and industry cyber incident exercises.
- Achieving and retaining ISO 27001 certification for Scottish Water Data Centres.
- Planning to meet the requirements of the Network and Information Systems Directive (NIS) and the Scottish Government Public Sector Action Plan.

While the water industry has not been subject to a notable attack in 2019/20, we note that the number of attempted cyber-attacks continues to increase in the UK and globally. As an "operator of an essential service", Scottish Water is required under the Network and Information Systems Directive (NIS) to take appropriate and proportionate security measures to manage risks to our network and information systems, and report serious incidents to the relevant national authority.

The National Cyber Security Centre has issued warnings for increased vigilance as there is a growing number of malicious phishing and fake websites being set up under the guise of Covid-19 support. This risk could be exacerbated by the marked increase in agile working.

Managing External Influences (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Climate Change	⟷	Risk of failure to deal with the impact of extreme and unpredictable weather events on our assets, infrastructure and services. Risk of changes to future water resource supply and demand due to climate change.	As a water utility company, provision of safe drinking water remains our highest priority. Delivering a continuous service to our customers is paramount. Scottish Water seeks to treat and return waste water in a way that does not harm the environment.

Key Mitigations

- Undertaking a Scottish Water climate change risk assessment.
- Undertaking climate change vulnerability assessments.
- Delivering investment in our water and waste water assets.
- Participation in projects and studies of which the outputs inform our strategic plans.
- Carbon costing will be included in future appraisals.

Climate change and more variable and extreme weather patterns are anticipated to present a challenge across the water industry.

There is an expectancy that Scottish Water will contribute to both the mitigation of climate change and adaptation to a changing climate. Considerable work is underway to support challenging objectives including our target to achieve net zero emissions by 2040.

Managing External Influences (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Supply Chain	↑	Reputational and financial risk from the failure of key suppliers, partners, contractors or consultants.	We should always endeavour to have a sustainable and resilient supply chain to meet our investment needs.

Key Mitigations

- Develop and enhance productive relationships with key existing partners and suppliers.
- Ensure Supplier Risk Assessments are complete and up to date.
- Routinely review supplier Risk Profiles to monitor financial viability.
- Business Continuity Plans in place, should they be required.

While this is the first time the supply chain risk has been reported, it continues to be closely managed and mitigated given our reliance on other organisations to support the delivery of our core services.

Close engagement and monitoring of our key suppliers ability to provide goods and services due to impacts from Covid-19 and Brexit is key to ensuring continuity of our core services. The long-term sustainability of key suppliers will also continue to be reviewed in light of these impacts and wider macro-economic pressures.

Managing External Influences (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Constitutional Change	↑	Operational and financial risk and opportunity arising from constitutional change.	We will seek to maximise any opportunities and minimise any risks arising from constitutional change.

Key Mitigations

- Ongoing review of potential risks and opportunities arising from the UK departure from the EU.
- Involvement in external workshops to ascertain areas of concern for water industry.
- Engagement with government and regulators, to shape priorities in both EU and domestic context.
- Supply chain analysis undertaken to understand potential impacts; with ongoing discussions with the supply chain regarding contingency arrangements and contractual relationships.
- Established a Brexit Strategic Command Team and a Brexit Co-ordination Group.
- Contingency planning including the advance purchase of chemicals and strategic/critical spares.
- Review and update of Business Continuity Plans.

Monitoring of the political landscape continues with UK-EU negotiations underway on the future relationship and trade deal agreements. Scottish Water is maintaining the availability of chemicals and critical spares to enable the continuity of core services in the event of a potential 'No deal' in December 2020.

We are cognisant of the potential impact to negotiations during the Covid-19 pandemic.

Developing the Business

Risk	Trend	Risk Description	Risk Appetite
Business Stream	↑	Risk of reducing value of Business Stream and increased demand on Scottish Water Group resources due to the impact of Covid-19 on Business Stream's revenue and cash collection, competitive market conditions, and the complex operating environment in the English market.	Business Stream will maintain a financially viable retail business.

Key Mitigations

- Continued transformation of customer service and cost base, and focus on cash management.
- Improvements to English market customer data sets and payment arrangements.
- Utilisation of available support including wholesale payment deferral and additional supports for Covid-19.
- Working with Regulators and stakeholders to implement further market changes to improve liquidity and solutions to expected increase in bad debt exposure due to Covid-19.
- Ensure appropriate funding facilities for financial sustainability.

The Scottish market remains very competitive. The retail market in England provides access to £2.5 billion of revenue opportunity. However, the English market environment is currently complex, with low margins available, data quality issues and complex wholesale tariff arrangements.

Like all Licensed Providers, Business Stream is facing cash collection challenges and reduced revenue due to a considerable reduction in business sector consumption due to Covid-19.

Managing Our Assets

Risk	Trend	Risk Description	Risk Appetite
Water Quality	↔	Risk of provision of water to customers which has the potential to have an immediate impact on health.	As a water utility, provision of safe drinking water remains our highest priority.

Key Mitigations

- Skilled and trained employees operate our water assets.
- Routine monitoring of the water in our catchments, and in our treatment and distribution activities.
- Routine testing on water quality (beyond regulatory requirements) to manage drinking water quality and minimise associated risks.
- Delivering significant investment to further improve water quality.
- Detailed emergency response and Business Continuity Plans.
- Our Water Quality Improvement Group actively manages emerging water quality problems or issues and implements actions to address.
- Investigation of all incidents and tracking of necessary remedial actions, including learnings for continuous improvement.

The most recent DWQR Annual Report (2019 report year) reported compliance with water quality standards at 99.92% demonstrating the continuing high quality of drinking water that consumers in Scotland receive.

Significant investment has continued across 2019/20 to further improve water quality and is planned in the next investment period.

We continue to ensure the continuous supply of high quality drinking water to our customers, particularly in light of the potential challenges from Covid-19.

Managing Our Assets (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Critical Assets	⟷	Risk to service to customers arising from failure of a critical asset or assets.	Delivering a continuous service to our customers is paramount.

Key Mitigations

- Developing detailed knowledge and understanding of our critical assets.
- Undertaking operational inspections, maintenance and emergency planning activities to minimise the risk and consequences of failure.
- Identifying investment to reduce this risk for promotion in our future investment programmes.
- Meeting the requirements of the Network and Information Systems Directive (NIS) and the Scottish Government Public Sector Action Plan.

Investigations have continued to identify critical assets and better inform our short and long-term strategies. As this work continues, our understanding of what assets are truly critical and our awareness of our risk exposure will increase.

Over the long term, and with sustained investment in inspections, maintenance, and network connectivity, our risk exposure will reduce. Until all key mitigations are in place however, we will remain exposed to service impacts.

We remain aware that our ability to respond to interruptions to supply during the Covid-19 pandemic may be challenging and could have the potential to impact on customer's ability to practice good personal hygiene measures. As such considerable focus and effort is on maintaining essential service at this difficult time.

Managing Our Assets (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Strategic Water Mains	↔	Risk arising from failure of key/strategic water mains resulting in loss of service and significant water damage to surrounding properties and/or infrastructure.	Delivering a continuous service to our customers is paramount. Scottish Water seeks to minimise adverse impacts to our customers.

Key Mitigations

- Identify locations where previous bursts have caused flooding and develop options to mitigate risk exposures.
- Delivering mitigations at known historic flooding locations.
- Developing policy on management of flooding risk from current infrastructure for new developments.
- Securing further investment via the investment planning and prioritisation framework for the next regulatory period.

Historic high-profile flooding locations are being reviewed and addressed, with further work to identify wider flooding risks. This work remains at an early stage in developing methodology, with assessments still to be carried out. Appropriate investment will be necessary to address and identify action required.

We remain aware that our ability to respond to interruptions to supply during the Covid-19 pandemic may be challenging and could have the potential to impact on customers' ability to practice good personal hygiene measures. As such considerable focus and effort is on maintaining essential service at this difficult time.

Risk	Trend	Risk Description	Risk Appetite
PFI Operations	↔	Financial and operational risk should a PFI plant or operations fail to deliver in accordance with the contract terms.	Scottish Water seeks to deliver services in an efficient and cost-effective manner including via a number of PFI waste water contracts.

Key Mitigations

- Maintaining ongoing strong relationships with the PFI companies.
- Monitoring and management of PFI company performance.
- Undertaking deep dive PFI plant audits.
- Developing contingency plans for both the financing and operation of these contracts as they enter their final stages.

While there were no material changes to the level of PFI project risk faced in 2019/20, we are continuing to closely monitor in light of the Covid-19 pandemic.

Working with People

Risk	Trend	Risk Description	Risk Appetite
Health & Safety	↔	Risk arising from our assets, activities and actions resulting in an impact on the health and safety of our people, contractors, supply chain, customers and the public.	We will ensure the health and safety of our people, contractors, supply chain, customers and the public remains paramount. Our behaviours, activities and assets should therefore not place at risk the health, safety or wellbeing of Scottish Water people, contractors, supply chain, customers and the public.

Key Mitigations

- Detailed Health and Safety Management System and supporting processes.
- Strategic Health & Safety Improvement Plan in progress.
- Embedment of health and safety in our culture and processes via training and awareness raising.
- Completion of risk assessments and regular inspections.
- Investigation of all accidents and incidents and tracking of necessary remedial actions, including learnings for continuous improvement.
- Regular health and safety reporting to key governance groups.

Health and safety risk continues to be closely managed and mitigated given the inherent risks faced by our business. Health and Safety will be a continuing area of strong focus in 2020/21.

In response to Covid-19 we have developed and implemented guidance around areas such as social distancing, provision of Personal Protective Equipment and working with Covid-19 in waste water. Work is also underway to ensure close monitoring and reporting of absence levels, with consideration being given to the physical and physiological impacts of different methods of working during the lockdown period.

Working with People (Cont...)

Risk	Trend	Risk Description	Risk Appetite
Data Protection	↔	Risk of failure to maintain a suitable and sufficient framework to manage data protection legislative obligations.	Scottish Water seeks to safeguard any personal data by complying with relevant standards.

Key Mitigations

- Reviewing and launching of policies, processes and guidelines.
- Raising awareness of data protection and General Data Protection Regulation (GDPR) requirements.
- Producing and publishing corporate privacy notices.
- Developing and communicating a process to ensure breaches are identified and reported in a timely manner.

As the data security landscape has continued to mature, significant work to improve data protection practices to ensure compliance with the new and changing standards has continued. For example, the introduction of the EU General Data Protection Regulation and Data Protection Act 2018, introduced additional obligations.

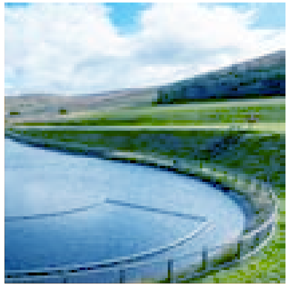
We continue to adapt and embed our policies, processes and guidelines in support of these, learning from external breaches and the ramifications of these where appropriate.

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

These include reputational and financial risks arising from damage to third party assets, e.g. oil/gas transmission pipes and/or railway networks; non-compliance with the EU Urban Waste Water Treatment Directive; risks to revenue, risk of water shortage, evolving regulatory processes and a service and financial risk arising from contractors not fulfilling their obligations/liabilities.

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 a risk materialises, then service to customers could be affected. In this situation, we will enact our contingency and emergency plans, mobilising resources to minimise the impact and restore service promptly to customers.

GOING CONCERN AND VIABILITY STATEMENTS



The Members of Scottish Water's Board have concluded that it is appropriate to adopt a going concern basis in preparing the financial statements. The going concern basis confirms that there are adequate resources to remain in operation for at least one year from the date that the financial statements are signed.

The viability statement, required under the 2016 UK Corporate Governance Code, takes a longer-term perspective of the group's operational sustainability. The two statements are set out on pages 43 to 44.

Going Concern

Scottish Water's business model, activities and the factors that could impact on its future development and performance are described in the strategic report on pages 14 to 111. The principal risks and uncertainties are described on pages 24 to 42.

Scottish Water operates under an annual borrowing limit set by the Scottish Government. The annual borrowing limit controls the amount by which Scottish Water can increase its externally sourced finance. In addition, Scottish Water's charging structure is reviewed through a regulatory process and charges are approved annually by the WICS.

As at 31 March 2020, Government loans totalled £3.9 billion and Scottish Water group held cash and cash equivalents of £531.6 million.

In considering the basis of accounting, cash flow forecasts have been prepared for a period of at least 12 months from the date of approval of these financial statements which consider various scenarios taking into consideration severe but plausible downsides impact of the Covid-19 pandemic. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. They also consider the risks associated with the Covid-19 pandemic including the impacts in relation to reduced cash collection levels (up to a maximum of 10%) and the reduction of water consumption by business customers (up to a maximum volumetric impact of 40%) over the period of review.

Under all of the scenarios, Scottish Water will be able to operate within its available facilities and is well placed to withstand the challenges presented by the Covid-19 pandemic.

The Members, taking all relevant factors into account, consider that Scottish Water will have adequate resources to continue in operational existence for the next 12 months. Accordingly, the accounts continue to be prepared on a going concern basis.

Viability Statement

In accordance with provision C.2.2 of the UK Corporate Governance Code, the Members have assessed the prospects of the group over a longer period than the 12 months required by the "Going Concern" provision. The Members consider that the 3-year period is appropriate because it is consistent with the business planning process, providing greater certainty over the forecasting assumptions used. Consequently, Members confirm that they have a reasonable expectation that the group will be able to continue in operation and meet its financial obligations as they fall due over the next 3 years to March 2023.

In making their assessment, the Members considered the resilience of the group, taking account of its strategic and financial frameworks, including the borrowing limit, operational positions, risks associated with the Covid-19 pandemic and the level of the capital investment programme. They considered the potential impacts, in severe but reasonable scenarios, of the principal risks, set out on pages 24 to 42, and the probable degree of effectiveness of current and available mitigating actions.

The key processes used by Members for their assessment are summarised below:

The business and strategic planning processes cover the regulatory period to March 2021, based on key assumptions in respect of the funding of the business. Planning for the next regulatory period is also progressing well with the WICS scheduled to publish its Final Determination later in 2020. Business planning is an annual process which forecasts the performance and liquidity of the group over the regulatory period with a detailed focus on the first 3 years of any planning period. The plan considers base, downside and severe downside financial and economic scenarios.

Quantitative stress and scenario testing which consider the primary individual and combined quantitative risks relating to liquidity and regulatory financial ratios.

Qualitative scenario testing which gives a qualitative understanding of plausible but severe risk scenarios which could threaten the viability of the group, and informs related management actions. The scenarios tested are based on the principal risks and include widespread contamination of water supply giving rise to emergency response and recovery, a critical infrastructure breakdown and cyber-attack.

In conclusion for this assessment, Members have assessed the prospects and viability of the group over a 3-year period to March 2023.

SERVICE EXCELLENCE

Overall Performance Assessment

Evaluating how we deliver water and waste water services to our customers is critical to understanding how we're performing as a business and is measured through the OPA. For the 2015-21 period we agreed ambitious targets with the Scottish Government, the WICS and the Customer Forum that encourage and drive us to continuously improve.

In our 2015 Delivery Plan we set out our plan to achieve an OPA score at, or above, the 2010/11 threshold for leading water and waste water companies, of 380 points in 2015/16 rising to 385 points by 2020/21. Our aspiration is to achieve an OPA score at, or above, 400 points.

In 2019/20, we exceeded our 2015 Delivery Plan target with an OPA score of 402 points, down one point from the previous year. This is the third year in a row in which we achieved an OPA score of above 400 points. While we are pleased with this continuing high overall performance, we also faced some challenges last year, including intense storms over the summer period which resulted in almost 13,000 sewer flooding incidents in 2019/20.

CUSTOMERS AND COMMUNITIES

We recognise the importance of our essential services for the daily lives of customers and communities across Scotland and we aim to continually improve how we engage, listen and work with them to deliver services which meet their needs. As customer expectations evolve, our service will need to continue to adapt to retain the confidence and trust of the people we serve.

Our customers almost always receive a continuous supply of high-quality drinking water and have their waste water taken away and treated satisfactorily. However, occasionally, problems do occur, which can have a significant negative impact on our customers. When that happens, we want to ensure our customers receive a rapid and personal resolution. We measure the experience of our customers through household and non-household Customer Experience Measures.

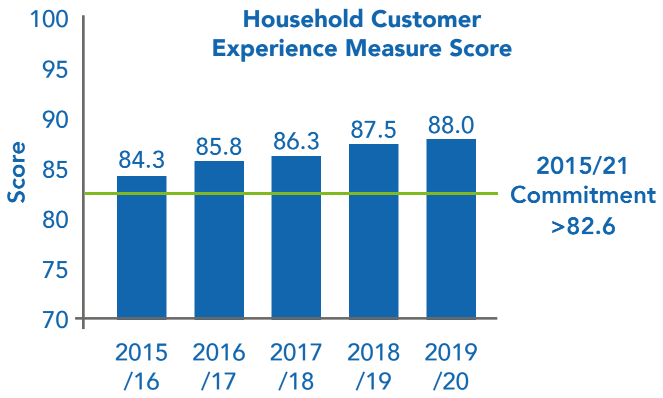
Throughout the 2015-21 period we have delivered significant year-on-year improvements in customer experience although there is more to do to deliver service excellence for our customers. We plan to continue adopting new technology and to further enhance our support to household and non-household customers, particularly those who may be in vulnerable circumstances and those who are looking to build new houses and business premises and connect to our networks. We are also working to create stronger links with the communities we serve, recognising the need to give communities a greater say in what we do.

In April 2019, we launched our new customer website offering interactive and personalised information, improving our service to household and non-household customers. Since launch, the site has achieved more than 3.3 million unique page views and over 2 million users.

In November 2019, Scottish Water took part in Business in the Community's Responsible Business Tracker. This benchmarking and improvement tool, underpinned by the UN's Global Goals, enabled us to evaluate our responsible business performance against 10 peers within the Utility and Energy sector and 94 organisations in total across the UK. The results position Scottish Water as a leader within our benchmarking peer group while also scoring higher than the total cohort average. Feedback from the survey is helping support our ongoing commitment to responsible business culture, processes and practices.

Household Customer Experience

Our Household Customer Experience Measure (hCEM) is a basket of measures which allows us to understand the experience of our customers. Last year, we recorded our highest ever hCEM score of 88.0 points, an increase of 0.48, securing our fifth consecutive year of improved performance. Insights gained from customer feedback show how we can continue to improve the service we provide when a problem occurs, particularly how we keep customers updated.



Service Issue Contacts

While the hCEM score demonstrates that we have delivered further improvements in 2019/20, there were some issues that had a negative impact on the service experienced by our customers.

In 2019/20, we received over 340,000 contacts across our main communication channels with the highest number of service issue contacts during August 2019 due to the high number of localised flooding incidents.

Over the past 5 years we have invested over £30 million in our digital services for customers in a bid to improve their experience of us. We are seeing a continuous upward trend in the number of contacts we receive via social media channels year-on-year, and in 2020 we anticipate reaching over 100,000 social media followers.

CASE STUDY
GLASGOW WATER SUPPLY INTERRUPTIONS

On 7 December and 17 December 2019, the failure of a valve near Milngavie Water Treatment Works resulted in a loss of supply to around 20,000 properties in parts of Glasgow. On each occasion customers' supplies were impacted for several hours and the result was a significant level of inconvenience for customers. These incidents impacted the largest number of customers in several years, with the risk that around 100,000 more properties could have been impacted.

To compound the issue, on 7 December our corporate website suffered an outage at the same time, so customers were unable to access information immediately. We received over 4,000 customer contacts and a high number of complaints on social media about a lack of up-to-date information.

In response, we have developed a plan to tackle the underlying issue, and have deployed an operative to watch the critical valve at key times of the day, when there is a risk of it malfunctioning. We continue to work at resolving the asset capacity to ensure ongoing resilience without the need for operational oversight. We have also worked with our digital partners to make improvements to the resilience of our corporate website at times of peak demand.

Complaints

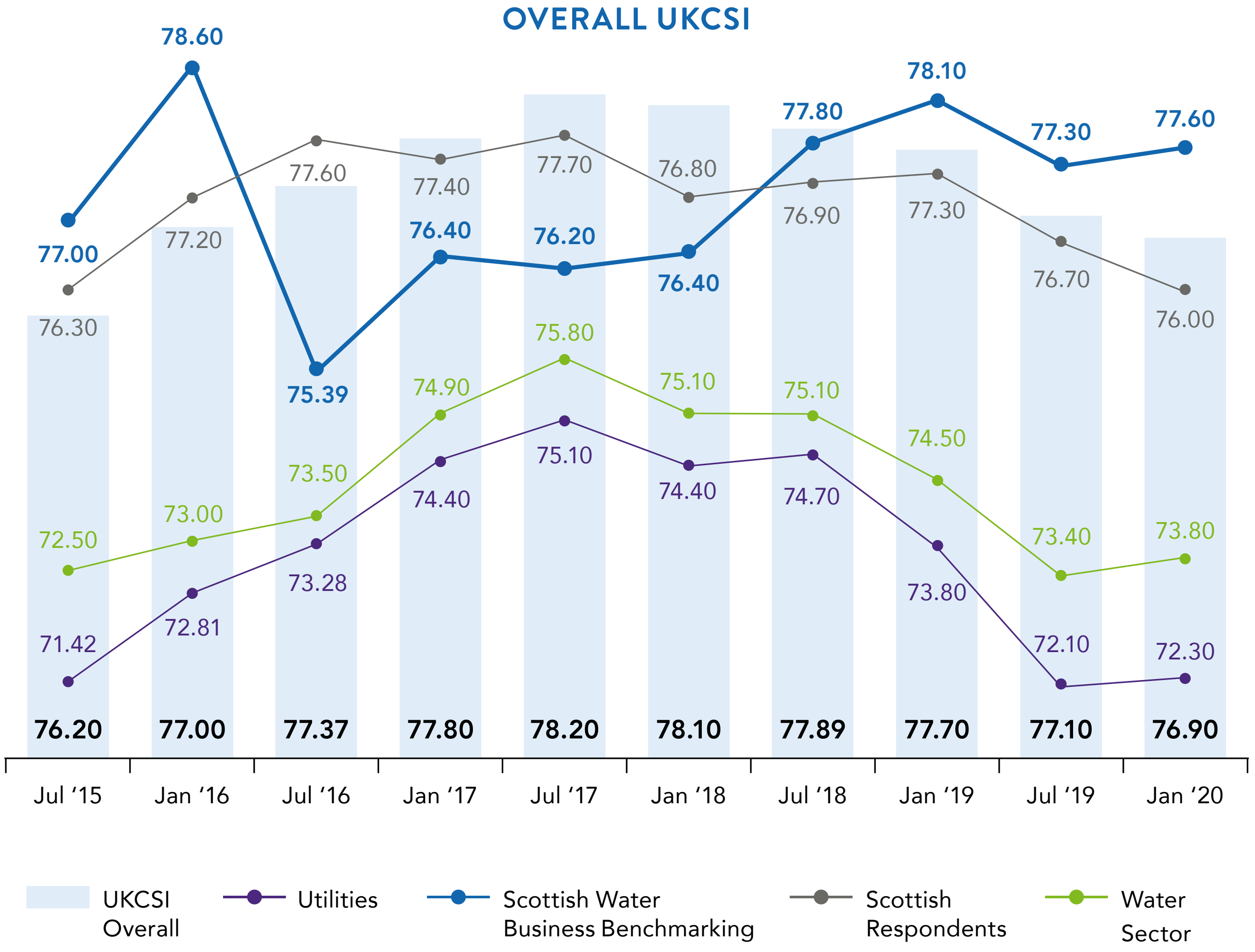
By seeking to understand and resolve customer dissatisfaction promptly we have continued to reduce the number of complaints that follow our formal process. However, we still receive just under 50 formal complaints each month due largely to interruptions to water supplies and sewer flooding, often where these issues have had a repeated impact. We carry out root cause analysis on each complaint to establish what went wrong and where we need to improve our service or target investment.

During the year, we have worked proactively with customers to support them through our compensation claims processes and to reduce the number of complaints associated with any damage or injuries.

Industry Benchmarking

According to the UK Customer Satisfaction Index (UKCSI), a national benchmark survey run by the Institute of Customer Service, Scottish Water is the third top water company and utility company in the UK. This is an improvement on our previous position of fifth.

Overall UKCSI in 2019/20 has seen a decrease of 0.2 to 76.9. In the same period, Scottish Water's score increased by 0.3 to 77.6. While this is positive, it is worth noting that overall, the UKCSI is on a downwards trajectory, experiencing its longest ever sequence of decline. This may be due to increasing customer expectations which means we need to work harder to maintain levels of satisfaction in the future.



Priority Services Register

Last year we commissioned independent research on the service provision to customers who may find themselves in vulnerable circumstances. This helped us review how we proactively support, consult and engage with these customers.

As a result of feedback and to align with best practice, we have renamed our register the Priority Services Register (PSR) and updated the categories we use.

In 2019/20, we also started to develop and deliver training packages for customer-facing employees, working in partnership with Age Scotland and others in dementia and mental health awareness.

Non-Household Customer Experience

We provide wholesale water and waste water services to 30 Licensed Providers (LPs) who in turn supply business customers. We also handle requests from LPs relating to the physical supply to their customers (such as meter repairs) and the record of services provided which is essential to accurate customer bills. The quality of the service we provide is critical to the ability of LPs to carry out their business and to the quality of the experience that the ultimate business customer (Business End User) receives.

In 2019/20, the non-household Customer Experience Measure (nhCEM) improved to 85.19 from 81.74 in the previous year. There has also been an increase in LP satisfaction levels to 95.44% from 90.82% and Business End User satisfaction which has improved to 90.08% from 87.64%. Listening to customer feedback, we continue to gain a better understanding of how to deliver further service improvements.

Further information on how we are working with developers can be found in the Enabling Sustainable and Inclusive Economic Growth section on pages 69 to 74.

Working closely with the Customer Forum, we have developed an ambition for our wholesale service to enable the best possible retail environment and customer experience to LPs and businesses. Our aim is to drive up service quality across all the relationships we have with LPs and businesses, while lowering both wholesale costs and the costs for LPs.

We have started to review metering policies to ensure that they support the best possible retail environment and lower overall market costs. We have also collaborated with the WICS and LPs to develop the "temporary transfer" scheme, which has improved the range of debt management tools within the market for LPs.

As a result of restrictions put in place caused by Covid-19, additional support measures were introduced to help businesses facing difficulties with payments. Further information can be found in the Keeping Services Affordable section on page 93.

Customer and Community Involvement

We generally have a good relationship with the communities we serve, as evidenced by a survey of community representatives we carry out on a monthly basis. However, in common with other utilities, the disadvantage of being a largely silent service, underground and so unseen by customers, is that some communities have low awareness of us. This can be problematic when assets or services fail or when we carry out capital investment. We also recognise the responsibility we carry, as a publicly-owned body, to ensure communities know what we do for them and have opportunities to engage with us about their expectations of the services we provide.

To address this weakness, we undertake a range of activities aimed at strengthening the links we have with the communities we serve through schools, community councils, direct engagement and communications and marketing campaigns. We recognise the need to do more in this area.

Customer Engagement

Over the last two summers we have engaged with more than 35,000 people about the essential services we provide and our plans for the future at a number of large public events.

In 2019 we tailored our engagement programme to areas that had been impacted by the dry summer of 2018, and talked to customers about ways to save water and energy as well as protect the environment. Unfortunately, our 2020 events programme, which we had designed in partnership with VisitScotland's 2020 Year of Coast and Waters, had to be cancelled due to the Covid-19 pandemic.

Working with the Customer Forum, we are planning a National Engagement Programme over the coming years to raise people's awareness of the opportunities and challenges facing the water sector and our strategies and plans to tackle them. Through this we will also listen to people's views on the pace of change they are looking for Scottish Water to make in delivery of our strategic plan.

Community Engagement in Decision Making

We want to ensure the services we provide and the decisions we make align with the needs and expectations of our customers and communities.

As a result of joint work between Scottish Water, CAS and the Customer Forum, in 2019/20, we have been piloting a new approach to planning and delivering our capital investment programme by involving customers and communities earlier in our decision making. While a number of these pilot projects are still live, the key learning so far is the need to engage communities much earlier in the planning of projects.

CASE STUDY
KIPPFORD WASTE WATER TREATMENT WORKS

The plan for this project in Dumfries and Galloway is to build a new waste water treatment works in the village of Kippford to help protect and safeguard the official bathing water status at a nearby beach. It quickly became apparent that the community was unhappy with our proposal for the new treatment works at a site on the edge of the village.

A key learning from this project was that engagement needs to start much earlier in the project planning stage, as a preferred solution and site had already been decided without any significant community engagement about why improvements are needed and what solutions may be possible. We have now paused our planning and are working more closely with the community including the consideration of a possible alternative site. We have also significantly modified plans for a temporary facility that may be required ahead of completion of the new works.

Learning and Education

In Scotland, every school pupil taught in line with the Curriculum for Excellence learns about the water cycle and its importance in their lives. To help achieve this we have developed digital learning hubs for primary and secondary schools in conjunction with partner schools. The learning hubs support the water sector Vision, UN Global Goals as well as the requirements of the Curriculum for Excellence.

Our hubs complement work undertaken by our employees, through volunteering, to deliver in-class lessons on the water cycle. Around 2,000 children participate in these sessions annually, supported by information on Scottish Water's website.

Your Water Your Life and Top Up Taps

Our Your Water Your Life campaign encourages people to enjoy their tap water and help protect the environment. As part of the campaign we have installed a further 19 Top Up Taps in public areas in parks, towns and cities, taking the total to 29. By the end of March 2021, we plan to have a total of 70 Top up Taps in operation. A decision was made twice during the year to temporarily switch off the taps due to freezing weather and the Covid-19 pandemic.

Your Water Your Life's distinctive visual style has featured in television and digital advertising and was recognised with three national marketing awards where judges said the campaign had a powerful influence on public attitudes and behaviour.

Research is helping track customer attitudes and actions, with 94% of people saying topping up from the tap is good for the environment, and almost two-thirds of people saying they now carry a refillable bottle. The campaign also has a positive impact on perceptions of Scottish Water, with 81% trust levels and 83% of people saying Scottish tap water is world class.

One of the aims of the campaign is also to recognise water as a natural precious resource and for customers to consider how they use it in their daily lives, using only what they need. We will continue to encourage customers to top up from the tap, save water and energy to help look after the environment.

Learn to Swim

Over the last three years we have partnered with Scottish Swimming to deliver the national Learn to Swim programme. The programme has now taught more than 105,000 young people to swim and will hopefully help keep them safe around our reservoirs and other bodies of water. We have agreed to continue our sponsorship of the programme for a fourth year with a focus being on accessibility and retention – ensuring those who take part continue to swim after completing the programme.

The programme has now taught more than 105,000 young people to swim.

Enabling Access

As custodians of Scotland's reservoirs, Scottish Water has a duty to safeguard their integrity and protect the water they hold. In our strategic plan we have committed to connecting communities with their local environment and support tourism by enabling access to our assets for leisure purposes. At times, doing both can be a tricky balance to maintain and one we haven't always got right.

While we have always been absolutely committed to meeting the required reservoir and broader health and safety standards, more general preservation or amenity has not been a priority, which local communities have challenged.

AROUND
160,000
VISITORS EACH YEAR

CASE STUDY
CRAIGMADDIE AND MUGDOCK

Craigmaddie and Mugdock reservoirs in Milngavie are among the most visible and popular assets we own with around 160,000 visitors each year. However, decisions taken over many years to restrict investment to only repairs and maintenance needed to continue to supply water meant that the surrounding land and structures had fallen into a state of disrepair. The local community had become unhappy that we were not taking care of a local beauty spot and frustrated by our lack of investment.

In response to this, in October 2019, we initiated a pilot project to work with the community to target investment in non-essential repairs and maintenance that the community felt we should prioritise, backed with a small amount of extra money. We have now started to deliver visible improvements that will enhance the amenity of the reservoirs and relations with the local community are more constructive as a result. We are examining whether a similar approach could be taken at other sites across Scotland.

Community Empowerment Act

The Community Empowerment (Scotland) Act 2015 aims to empower community bodies through the ownership or control of land and buildings and by strengthening their voice in decisions about public services. In 2019/20 Scottish Water completed its first property transfers in support of the scheme.

June 2019 saw ownership of a former water tower in Moray transfer to the Keith Golf Club, and in December 2019 ownership of a redundant septic tank next to a play park was transferred to the community of Edinbane on the Isle of Skye. We are committed to helping communities with these requests wherever possible. We view asset transfer as a positive way we can support the strengthening of Scotland's communities.

Freedom of Information (FOI) Requests

Under the Freedom of Information Act, people have a right to request any recorded information held by a public authority.

The Scottish Information Commissioner's latest annual statement for 2018/19 reported an 8% increase in FOI requests across all public sector bodies. In 2019/20, Scottish Water has seen an increase of approximately 20% in FOI requests. This clearly reflects an increased desire for transparency amongst our customers which we are committed to supporting.

DELIVERING CONSISTENTLY EXCELLENT WATER SUPPLY

Scotland depends on the water we deliver – it helps protect and maintain public health and plays a vital role in the daily lives of millions of people.

We are committed to providing a consistently high quality drinking water supply at all times. The quality of water delivered to customers is monitored from source to tap to ensure it meets stringent regulatory standards.

Water is collected from a range of sources - rivers, lochs, reservoirs and boreholes – and treated before it is distributed to homes and businesses. We maintain 237 water treatment works, over 1,300 treated water storage tanks, and over 30,000 miles of water pipes. We invest around £300 million annually in water assets.

Overall water quality compliance remains high, out-performing Delivery Plan targets, and significant progress has been made to reduce risks associated with contaminants which can impact public health. Our strategy is focused on improving performance further. This will help us close the gap in water quality performance when compared with the average in England and Wales.

Global warming is changing weather patterns, with increased rainfall intensity and prolonged dry spells that impact on source water availability and quality. The age and condition of many assets mean we need to take steps to ensure future performance. We are committed to transforming water services to protect source waters, improve the capability of our water treatment works, increase supply resilience and achieve net zero emissions.

Drinking Water Quality

We carried out over 300,000 quality tests on regulatory samples from our water treatment works, treated water storage tanks as well as at customers' taps. In 2019 we undertook 99.922% of the agreed regulatory sampling programme, an increase from 99.918% in 2018.

The quality of the water recorded at customers' taps in 2019/20 was 99.917% broadly in line with our best annual performance from 2015, and an improvement on the last two years. The number of individual sample test failures was also our lowest ever, 114 fails in 2019 compared to 151 in 2018.

Water is tested against strict microbiological and chemical regulatory standards, which measure parameters such as cryptosporidium, manganese, trihalomethanes, lead and aluminium. We achieved improvements in compliance against these standards in 2019.

Occasionally events occur that may affect water quality and when they do, we report them to the Drinking Water Quality Regulator (DWQR) as well as local authorities and NHS health boards. Last year we reported 833 events to DWQR, a reduction of 54 from the previous year. Events include issues ranging from failures of water treatment processes to a single sample failure taken at a customer's house.

Where DWQR assesses these events as sufficiently serious they are declared incidents and Scottish Water must provide a detailed report. DWQR will investigate these incidents and make recommendations or take further action against Scottish Water. In 2019 DWQR declared 28 incidents, up from 23 in 2018; no major incidents were declared last year. Most incidents are associated with failures in our treatment or disinfection processes or significant customer concern or media interest. Upon investigation the main root causes of these incidents were the capability of our assets, insufficient asset maintenance, and failures in our processes or knowledge.

Improving Source Water Quality

Climate change and land use practices mean that soil erosion, loss of peatland and run-off from farms are increasingly impacting the quality of the source water on which we rely. Existing infrastructure is struggling to cope with the rising level of natural organic matter and will face enormous challenges as levels increase further in the future.

Our sustainable land management team monitor and manage the quality of our water resources by working with landowners and farmers to improve practices and introduce measures to prevent pollutants entering the water environment.

We manage the catchments associated with more than 230 water treatment works across Scotland. In the past year our team has assessed 37 catchments supplying our water treatment works, to assess the condition of the land around watercourses and how we improve source water quality, working with private landowners to complete 28 interventions.

THE QUALITY OF THE WATER RECORDED AT CUSTOMERS' TAPS IN 2019/20 WAS

99.917%

WE CARRIED OUT OVER

300,000

QUALITY TESTS

on regulatory samples from our water treatment works, treated water storage tanks as well as at customers' taps.

Improving Water Treatment Works

In Scotland our source waters are particularly rich in natural organic matter, and the levels of these have increased over recent years, placing significant strain on many of our water treatment works. We expect this challenge will continue to grow.

We have also seen increases in algae in a number of our reservoirs which can lead to contacts from customers about the taste and odour of their water. To overcome this we install more treatment stages and use chemicals to meet drinking water quality standards and provide the great tasting water our customers expect.

Almost £200 million was invested last year on maintaining and enhancing the capability of our water treatment works and their associated assets.

Alongside investment in the capability of our water treatment works we focus on optimising water treatment assets, improving the capabilities of our people and educating both customers and plumbers.

Our Skills Academy has developed a competency framework for the assessment of our people to ensure they have the required technical skills and knowledge. A range of development tools and training modules have been designed to close development gaps including e-classroom options.

Cryptosporidium

Cryptosporidium can be found in most surface water across Scotland and our water treatment processes help remove it. We continue to see the number of detections reduce, with eight detections in 2019, compared to 35 in 2018 and 44 in 2017.

Where we do detect cryptosporidium in our treated water, we undertake a full investigation to identify the root cause of how it got there. These investigations identify where we have weakness in the capability of our water treatment processes. In the past two years we have installed ultraviolet (UV) light treatment processes to reduce the risk of cryptosporidium entering the water supply at a number of our water treatment works including Turriff, Invermoriston, Portree, Papa Stour and Dalwhinnie.

CASE STUDY
INNOVATION: CERAMIC MEMBRANE WATER TREATMENT

In 2019/20 we completed a trial of the use of novel ceramic membranes as an alternative to traditional water filtration processes and our existing polymer membranes for treating water containing cryptosporidium. We were researching these membranes as the ceramic membranes are more durable, with a life span four times longer than our conventional polymeric membranes.

The trials were successful and showed that the ceramic membranes out-performed both our traditional sand filtration processes and the polymeric membranes we use. As a result, we will shortly be constructing our first full-scale ceramic water treatment works to replace Bonnycraig water treatment works in Peebles.

Service Reservoir Programme

Once the water is treated at our water treatment works it is transported through our extensive pipe network. Our network includes tanks, called service reservoirs, that store treated water and ensure balance between supply and demand peaks on the network. There are over 1,300 service reservoirs across Scotland, significantly more per connected property than elsewhere in the UK due to topography.

Effective maintenance ensures these tanks continue to do their job protecting water quality while storing water. In 2019, 72 samples tested from these tanks showed bacteriological fails, up from 66 in 2018. The root causes of these failures are weaknesses in the structural integrity of the tank; poor quality water entering the tank from the water treatment works; or deterioration in the quality of the tap we use to take water samples from the tanks.

For example, the intense rainfall events in July and August 2019 resulted in a higher number of sample failures indicating that the integrity of some of these tanks was not good enough. As part of our inspection programme, we undertake tests to determine the susceptibility of tanks to water ingress, and thus contamination from rainwater or ground water. We have found that around 20-25% of tanks tested require action to prevent water ingress.

Investment to enable all tanks to be taken out of service, inspected and repaired, helping to reduce bacteriological detections, is underway and early signs are that it is proving successful.

Discolouration and Taste

Drinking water quality measured at customers' taps matched our best ever performance. Overall, customer contacts about the taste of water supplies decreased last year. However, we received over 1,000 additional reported contacts about discolouration compared with 2018, despite significant investment in replacing and cleaning our pipes. This increase was due in part to the introduction of a new Customer Relationship Management (CRM) system which now allows us to record where a customer is experiencing multiple issues, for example low water pressure and discolouration at the same time.

We have been working with leading academics at Sheffield University to improve our understanding of the complex multiple factors that may cause discolouration of supplies. This work has identified that bacteria and micro-organisms can build up on the inside of water mains which can hold the metals iron and manganese. When the water flow increases due to greater demand or bursts, these metals can be released causing discolouration.

	2019	2018
Taste	2027	2224
Discolouration	7111	6101
Total	**9138**	**8325**

Table: Number of customer contacts regarding taste and discolouration in 2019 and 2018.

Across Scotland, there are many locations where we have reduced leakage from pipes or there is reduced demand from customers, which means our water mains are bigger than required and therefore unable to clean themselves naturally. We are now simulating this self-cleaning in our networks to reduce the risk of discolouration if a burst happens.

Lead

To ensure customers have water which is safe to use, we are working to remove lead from water pipes across the network to meet standards set by our regulator, the DWQR, based on recommendations by the World Health Organisation.

Lead pipes in the public network will be replaced when they are found or when requested by customers; in the past year we have removed 1,458 lead pipes compared to 1,551 in 2018/19.

We continue to work in partnership with WaterSafe, an industry organisation which maintains a register of approved plumbers, to support customers to remove lead from pipes within their homes, for which customers have legal responsibility.

We have also been working with the DWQR, local authority environmental health services and the NHS to sample supplies in over 600 private schools and nurseries. This work won Customer Initiative of the Year at the 2020 Water Industry Achievement Awards.

CASE STUDY
TIGHNABRUAICH

A pilot project in Tighnabruaich has begun to understand how to remove all lead in pipes connecting customers' properties to the water main to allow phosphate dosing, which is used to control lead, to be switched off. The trial is providing learning on costs, changes required to the process to support the replacement of lead pipes across a water supply zone, and how to effectively engage with customers.

WON
CUSTOMER INITIATIVE OF THE YEAR AT THE 2020 WATER INDUSTRY ACHIEVEMENT AWARDS

Water Supply

The vast majority of our customers receive an excellent service, but many can experience a short unplanned interruption to their supply.

Number of properties	2019/20	2018/19
Interruption resolved in < 6 hrs	488,078	413,084
Interruption resolved in 6 to 12 hours	5,302	4,632
Interruption resolved in 12 to 24 hrs	265	338
Interruption resolved in > 24 hrs	37	19
Total	**493,682**	**418,073**

Table: Comparable number of properties experiencing an unplanned interruption to water supply between 2018/19 and 2019/20

In the last year the total number of properties that experienced interruptions to their water supply was 493,682, an increase from 418,073 in 2018/19, nearly all of which were resolved very quickly. The main cause of these interruptions was burst water pipes. In 2019/20, we had over 7,000 bursts across our network which were caused by the condition of the pipe or changes in the water pressure flowing through the pipes.

Our priority is always to restore customer supplies as quickly as possible and, over the past year, the number of customers affected by an interruption longer than 12 hours fell. The number of interruptions below 12 hours, however, has increased. We have improved our contingency plans to ensure that alternative supply options, such as tankering water into supply networks or using temporary overland pipes are easily available, and escalate incidents which may impact customers much earlier.

Every interruption that lasts longer than six hours is investigated, to learn lessons and drive improvements. Since the start of this regulatory period, we have been building an understanding of the impact of changes in pressure in the water network. This is providing a better insight into our network performance to help reduce the occurrence of interruptions to supply events and their impact. Initial work has focused on networks with the highest number of bursts; here we have reduced the number of bursts by almost 80%.

CASE STUDY
COATBRIDGE WATER SUPPLY INTERRUPTION

In September 2019, we experienced a burst water main affecting water supplies to customers in parts of Coatbridge and the Baillieston area of north east Glasgow.

An estimated 16,000 properties were affected. Our response involved quickly arranging alternative supplies which included mobilising water tankers and arranging the provision of bottled water at distribution points and door-to-door delivery.

Leakage and Water Use

Reducing leakage and customer water use are significant contributors to our net zero emissions strategy.

Managing Leakage

In 2019/20, we reduced leakage from our networks to below 470 million litres per day (ML/D), an all time low, helped by a benign winter and a summer that wasn't too dry.

During 2019, we detected an error in our reporting of leakage for 2018/19. Correcting this error increased our reported leakage for 2018/19 from 480 to 492 ML/D. As a result of identifying the error we have strengthened our processes.

Our leakage level continues to be significantly below the agreed 575 ML/D minimum service level. We will continue to target further reductions in leakage so as to prevent unnecessary waste of treated water and further help reduce the energy and other resources required to produce and distribute water to our customers.

Ageing infrastructure within the network is an ongoing challenge and replacement is currently targeted where we can maximise leakage benefits, as well as support growth or improve the resilience of our water resources. However, to deliver further leakage reduction, without increasing our carbon footprint, will require transformation in how we find and fix leaks.

Water Use

On average, each person in Scotland uses around 165 litres of water per day in and around their home. The UK National Infrastructure Commission has recommended an ambition to reduce consumption to around 118 litres per person per day. Encouraging customers to be more water efficient is an increasing focus of partnership work, communications and engagement to help drive behaviour change.

In summer 2019, 150 Scottish Water volunteers spoke to around 20,000 people at a range of events throughout the country about water efficiency, encouraging them to love their water and to make a pledge, through an interactive survey and game, to use water wisely.

In addition, our partnership with Home Energy Scotland has delivered over 43,000 water saving packs to households throughout Scotland, providing bespoke water and energy advice. The Perthshire community of Dunkeld and Birnam was recognised as Scotland's first water efficient village for the steps taken to save water and drive down greenhouse gas emissions, as part of a pilot programme.

TRANSFORMING WASTE WATER SERVICES

Every day we collect, clean and safely return to the environment almost one billion litres of water that has been used by homes and businesses, as well as surface water which enters our sewer systems.

This waste water service is a vital element in supporting a flourishing Scotland – enabling millions of people to go about their daily lives, protecting the environment and enabling economic and new housing growth.

We run and maintain an extensive asset infrastructure to deliver this service; over 1,800 waste water treatment works, more than 33,000 miles of sewer pipes and 21 treatment centres which recycle sludge, the natural by-product of waste water treatment. In 2019/20, we invested £277 million in our waste water assets.

Twenty of our waste water treatment works and our largest sludge treatment centre are currently operated under long-term Private Finance Initiative (PFI) contracts. By 2040, we expect to bring the waste water treatment works back under our ownership.

We ensure that the treated waste water meets standards set by our regulators before it is safely returned to the environment. In 2019/20, 99.5% of the waste water assets which were sampled in our Annual Monitoring Programme were assessed as meeting regulatory quality standards.

To continue to deliver high performance in waste water services, we need to invest to replace, repair, and refurbish our assets. We will also continue to review our risk management processes and seek further innovation within the waste water service to improve its reliability, efficiency and resilience. Ultimately, we will transform our waste water service to achieve much greater energy and resource recovery, and use telemetry and smart networks to monitor and control our sewer network more effectively.

Waste Water Collection

The vast majority of the time our sewers work effectively, performing a key role transporting society's waste water to our treatment works without any disruption to customers.

Occasionally, when the system does not work as it should, waste water can be discharged inappropriately causing flooding or pollution of the water environment.

Sewer Flooding

Sewer flooding can be caused by blockages, failure of our equipment, third party action or overloading of the sewers as a result of heavy rainfall. When sewer flooding occurs, our responsibility is to restore the flow in the network by removing the blockage, and clean up any debris as well as disinfect the area affected. Reducing flood risk from our sewers is a priority for Scottish Water.

According to the Met Office, last summer was the wettest for 30 years. The number of one-in-30-year storm events has more than doubled every summer since 2017, and also impacted a much wider range of locations.

This pattern and intensity of rainfall has had a significant impact on a small number of our customers and our assets. In 2019/20, we undertook 180 internal sewer flooding investigations, the highest annual number since the start of the 2015-21 period, 158 (88%) of which related to incidents in June, July and August. During 2018/19, there were 75 comparable required investigations with 68 from those three months.

The high number of flooding incidents resulted in the highest monthly volume of sewer flooding related calls in the current regulatory period to the Customer Engagement Centre and highest recorded volume of email correspondence from customers, MSPs and other stakeholders. While we were able to manage our response to these events, summer 2019 has highlighted the need for us to better prepare for such periods of intense weather, both in terms of the capability and resilience of our assets, and in our ability to respond effectively to sewer flooding.

New additions to the register of properties that are at high risk of repeat internal sewer flooding were limited last year as flooding due to extreme rainfall events are not included. This resulted in the second lowest number of annual additions (36) to the register since robust records began. In 2019/20, we completed a number of investment projects to increase the volume of water that can pass through our sewer system, thereby reducing the risk of regular repeat sewer flooding for 62 properties; these were removed from the register, reducing the total number registered to 281.

We have developed a flood risk assessment tool to allow us to understand and predict current and future sewer flooding risk across Scotland. The tool uses hydraulic model predictions including climate change scenarios. To date, 60% of Scotland has been mapped, and the project will complete in 2021.

We are currently focused on delivering community specific investments that will have a big impact where it has been difficult to resolve long-standing flooding issues, such as Prestwick and Aberdeen.

Environmental Pollution

We continue to record levels of Environmental Pollution Incidents (EPIs) that are well below our commitment for the 2015-21 period of no more than 330 per year. In the past year we reported a total of 223 waste water EPIs, an overall increase of four from 2018/19. Five of the EPIs in 2019/20 were more serious Category 2 incidents, compared with nine last year. There were no prosecutions against Scottish Water in 2019 but one conviction in 2020 relating to an event in 2016.

In 2019/20, over 70% of EPIs occurred across gravity sewers, rising mains and combined sewer overflows (CSO). Other EPIs occur at waste water treatment works and waste water pumping stations. Our greatest challenge is that less than 10% of the affected assets are covered by real time monitoring that could alert us to potential incidents. As a result, most EPIs are notified to us by SEPA, customers or other third parties; self-reported EPIs account for only 25-30% of the total.

CASE STUDY
KINNING PARK POLLUTION INCIDENT

In February 2020, Scottish Water was fined £19,000 following a mechanical failure at a waste water pumping station at Kinning Park in Glasgow in 2016. The failure resulted in an unauthorised spill of untreated waste water into the River Clyde. The completion of the Shieldhall Tunnel in 2018 has subsequently reduced strain on the pumping station and further capital investment is planned for the pumping station itself.

CASE STUDY
MARY BURN, MIDLOTHIAN

A campaign by the local community, backed by the local MSP, to highlight a problem with waste water-related debris in and around the Mary Burn, a tributary of the River Esk in Midlothian, prompted us to take urgent action in 2019.

Our investigations found that the pollution was the result of wipes, sanitary items and other unflushable items being discharged from a CSO which had gone unidentified. Large quantities of waste water-related debris had been deposited over a substantial area over many years.

The clean-up took several months due to the volume of debris and the difficulties in reaching parts of the burn. We ran a targeted local awareness campaign to help educate the community in the area about the impact of flushing the wrong items down the toilet. We also made adjustments to our assets at this location to minimise the likelihood of overflows. We continue to monitor the area. Early results indicate there are fewer unflushable items and a reduced number of spills from the CSO.

We have started to invest in early warning systems that will alert us before a pollution incident happens. We have a number of pilot initiatives underway and are slowly expanding our use of telemetry and smart networks to monitor and control our sewer network more effectively.

WE HAVE STARTED TO INVEST IN
EARLY WARNING SYSTEMS
THAT WILL ALERT US BEFORE A
POLLUTION INCIDENT HAPPENS

Protecting our Network

Blockages account for around 80% of all sewer flooding and pollution incidents, and the majority of these blockages are caused by customers disposing of wet wipes, nappies, sanitary items, cooking oils and other unflushable items down toilets and drains.

We respond to over 36,000 sewer blockages a year. This has reduced over recent years but remains a persistent problem, and raising customer awareness of what they can safely flush or dispose of is an ongoing focus of activity. Work continues to be undertaken to promote the 3Ps message – flush only pee, poo and toilet paper, and collaboration with the UK-wide Sewer Network Abuse Partnership (SNAP) remains active.

CASE STUDY
ST. ANDREWS FOG CAMPAIGN

A drive to reduce the amount of fats, oils and grease (FOG) entering the sewers in St Andrews was successfully launched last year. The town was chosen due to its size and population, as well as the number and type of food services operating. Collaborating with inspectors from Environmental Compliance and Services (ECAS) and Fife Council's environment team, we visited 170 businesses which serve food to educate them on the importance of disposing of FOG the right way.

Restaurants, cafes, hotels, fast food outlets, academic institutions, supermarkets and nursing homes were given advice and support on best kitchen practices and grease trapping equipment. The campaign revealed the vast majority of food-serving businesses did not have an effective grease trap in their kitchens but were prepared to pay for them.

The campaign resulted in businesses spending around £600,000 fitting 119 new or improved grease traps, and preventing 140 tonnes of FOG entering the sewer network. Scottish Water also carried out a major sewer clean in the town removing a further 22 tonnes of FOG, in a prevention and cure approach to achieve a healthier network and a significant reduction in blockages. The campaign was expanded to include premises in Cupar and Quayside in Dundee.

BUSINESSES SPENT AROUND
£600,000

119
NEW OR IMPROVED
GREASE TRAPS FITTED

Managing Rainwater

In 2019, we developed a Storm Water Strategy for collecting and managing rainfall to ensure it does not enter our sewers, reducing the risk of overloading. This is based on two principles: ensure new housing developments have sustainable rainwater management systems, and remove rainwater out of sewers and find a new home for it.

Sustainable urban drainage systems (SUDS) ponds, permeable surfaces and natural solutions such as blue-green infrastructure will help reduce pressure on the sewer network. These solutions will also improve the natural environment, creating better places to live, allowing plants and wildlife to thrive, and increasing biodiversity and natural carbon storage.

Partnerships with local authorities are essential for the development of catchment-scale storm water management plans. The Edinburgh and Lothians Drainage Partnership, established in 2019, is looking to develop a plan that will address long-term drainage issues in the area and support future development. Scottish Water is leading on Integrated Catchment Studies with 20 Local Authorities across Scotland.

CASE STUDY
GLASGOW SMART CANAL

Europe's first 'smart canal' scheme became operational in north Glasgow, combining the 250-year-old Forth & Clyde Canal with pioneering technology to mitigate flood risk and enable regeneration.

Scottish Water has partnered with Glasgow City Council and Scottish Canals to deliver the scheme. During periods of heavy rain, a network of newly created urban spaces, from SUDS to granite channels, will absorb and manage canal water in a controlled way, creating space for surface water run-off. The innovative new digital surface water drainage system will unlock 110 hectares across the north of the city for investment, opening the way for more than 3,000 new homes.

110
HECTARES UNLOCKED FOR INVESTMENT, OPENING THE WAY FOR MORE THAN
3,000
NEW HOMES

Waste Water Treatment and Recycling

We treat waste water at our treatment works before returning it safely to the natural environment. Sludge, the natural by-product of waste water treatment, is also removed and recycled in one of our 21 treatment centres. These assets play a pivotal role in protecting the natural environment.

The 50 largest waste water treatment works serve around 80% of customers. As the population continues to grow, so will the pressure on our treatment works to cope with increased demand. Further pressure comes in the form of short intense rainfall events and extended dry spells, which impact the strength of waste water received at our works, the frequency of which we expect to increase as the climate continues to change.

Currently, many of our waste water treatment works are close to capacity and our traditional treatment processes, while providing essential protection of the water environment, are energy and carbon intensive. Going forward, our focus will be on transforming the reliability, resilience and sustainability of waste water services to ensure Scotland's waste water is collected, treated and recycled in ways that generate value and protect the environment.

Waste Water Treatment Works Compliance

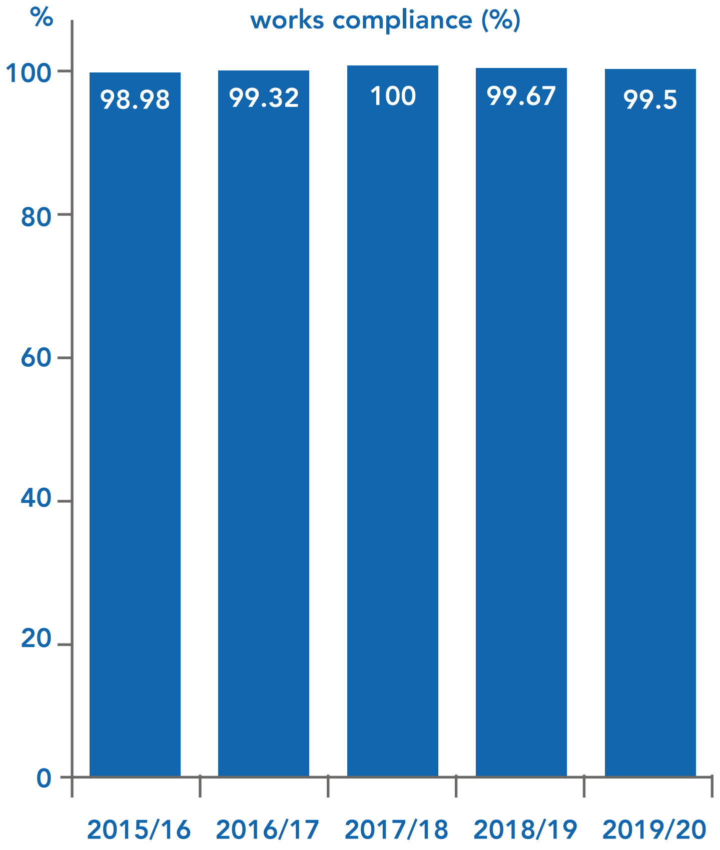
Our waste water treatment works performance has been broadly stable in recent years and ahead of the target we agreed in our Delivery Plan for the 2015-21 period of no more than five works failing to meet the agreed regulatory standards for discharge quality.

In 2019/20, all but three of our waste water treatment works from the 597 sampled (99.5%) on the Annual Monitoring Programme (AMP) met the agreed regulatory standards for discharge quality, an increase of one from 2018/19. Two enforcement notices were received from SEPA and both have been resolved.

Recycling Sludge

Scottish Water's sludge treatment centres produced over 125,000 tonnes of biosolids in 2019. We aim to dispose of biosolids in a manner that balances cost, greenhouse gas emissions and our circular economy aspirations and so 36% of bioresource was recycled to agricultural land and 48% used for land reclamation. 1% was sent to landfill where there was no viable alternative. The remaining 15% was either stored on site or sent on for further processing.

Waste water treatment works compliance (%)



Odour

As part of the treatment process, odours can sometimes occur, impacting customers and communities near waste water treatment works. For those communities worst affected by odour this is a very sensitive and sometimes upsetting issue.

There were 390 contacts regarding odour recorded in 2019/20. We recognise that experiencing odour from a site can impact on quality of life and we engage with customers and communities to help resolve these issues. A number of steps can be taken to reduce the risk of odour including chemical dosing and installing covers. We also work with SEPA and local authority environmental health officials to check and monitor odour levels.

CASE STUDY
SEAFIELD

Scotland's largest waste water treatment works, Seafield, is a challenging site which has to deal with varying volumes and strength of waste water from an extensive catchment area covering the City of Edinburgh and parts of East Lothian and Midlothian.

Despite significant investment in the plant and ongoing operation and maintenance, we recognise odour is still an issue for our customers. In January 2020, we announced significant investment to support greater resilience and sludge processing. This aims to reduce odours that may be associated with maintenance activities, and to lay a pathway to the future upgrade of the plant that will be required to support growth in the region.

Odour risk at Seafield is assessed on a daily basis in order to inform actions and communications with the local community and stakeholders. We have two forms of stakeholder group – the first is focused on operational status, reviewing performance and seeking to improve the site Odour Management Plan. The second, the Seafield Stakeholder Group, has been established with an independent Chair and includes elected members and community groups.

Bathing Waters

Scotland had 86 officially designated bathing water beaches in 2019, of which 73 could potentially be affected by Scottish Water assets. Four of those failed to comply with the 'sufficient' standard of the revised Bathing Waters Directive. Overall, 93% of Scotland's beaches met the minimum standard, compared to 88% last year, and 29 met the 'excellent' standard, an increase from 28 in 2018.

Significant investment and studies have been undertaken, in partnership with SEPA, over recent years to support bathing water quality improvements. Through this process, we have identified where Scottish Water assets may limit the ability of the bathing water to meet the new directive standards and sought to make the most appropriate investment decisions. Further investment is required at: Portobello West, Fisherrow Sands, Rockcliffe and Ayr South.

CASE STUDY
PORTOBELLO WEST AND FISHERROW SANDS

Bathing water modelling carried out in 2017 indicated a long sea outfall (LSO) was impacting Portobello West and Fisherrow. We undertook marine site investigations in 2018 and began planning for an initial upgrade to the LSO, however recalibration of the model determined the LSO was no longer required. Instead, improvement works were carried out and completed in 2019 to increase the flow of waste water to Seafield Waste Water Treatment Works, rather than spilling untreated.

WORKS HAVE DELIVERED **IMPROVEMENTS TO THE QUALITY** OF THE BATHING WATERS

These works have delivered improvements to the quality of the bathing waters and were substantially lower cost than delivering the LSO. In addition, we carried out a large-scale Scottish Government funded study in Edinburgh to identify misconnections and network issues and we worked closely with SEPA to target areas which have the potential to impact Portobello West and Fisherrow Sands. The study identified 21 misconnections to our network, where a property is incorrectly connected to a surface water sewer instead of the waste water sewer. Work to further investigate and rectify these misconnections began in late 2019, and was programmed to finish by April 2020, however due to Covid-19 measures these activities were paused. We also identified and rectified 23 network issues, including sewer blockages and sewer collapses, which have been rectified.

POTENTIAL TO **HALVE THE AMOUNT OF ENERGY USED** DURING THE TREATMENT PROCESS

Innovation

In order to improve performance, increase asset capability and reduce reliance on energy intensive processes, we are using and exploring innovative waste water treatment solutions.

CASE STUDY
NEREDA TECHNOLOGY

Scotland's first waste water treatment works to use innovative Nereda technology was opened at Inverurie in December 2019, with the potential to halve the amount of energy used during the treatment process.

The technology enables multiple treatment processes to take place simultaneously and fast settlement avoids the need for pumps and mixers. This means less energy is used and less space is needed to treat a higher quantity of waste water, reducing the operating costs of the site. This technology also removes the need to chemically treat the effluent. The new works has improved the quality of treated effluent, increasing the protection of the rivers Don and Urie, and providing capacity to support the local community as it grows. Given the success of Nereda at Inverurie, we have plans to extend its use to Winchburgh.

ENABLING SUSTAINABLE AND INCLUSIVE ECONOMIC GROWTH

We have an important role in supporting Scotland's long-term economic success. This includes connecting homes and businesses to our networks; working with the construction and house-building industry to ensure network capacity; and maintaining a robust supply chain which supports jobs and the economy.

We face a number of significant challenges to supporting growth. A history of relatively poor service to developers has damaged our reputation with them. There has been an historic lack of joined-up thinking between us and other public bodies around future development and capacity requirements. As a result, we have made significant investment in improving our services to the development community in recent years although there is much more still to do.

In future, we will face a major challenge as a result of the predicted population shift from west to east and increase in number of single person households requiring us to increase capacity in our infrastructure, particularly in the east of Scotland. However, more immediately, we face the significant but highly uncertain economic impact of the Covid-19 pandemic which may affect the development community, the health of our supply chain, as well as damaging the economy more broadly.

In the face of these challenges, we recognise more than ever our responsibility to help support a sustainable and inclusive economy and have committed to achieve this through our future strategy and plans.

Working with our Supply Chain

Scotland's water sector is an important contributor to the country's economic prosperity, building vital infrastructure and supporting jobs and investment in every part of the country. Research published by Scottish Enterprise in July 2019 found that the sector supported over 16,600 jobs and has a turnover of £3.7 billion. Scottish Water, Business Stream and one other large water retailer, were responsible for generating approximately half of the total sector turnover.

In 2019/20, we spent £671 million on goods and services through 198 frameworks and 432 suppliers, 324 of which are based in Scotland. Over the next two years we will procure over 100 supplier frameworks for goods and services including the development of a new supply chain to support our capital and operational refurbishment and repair requirements. We are negotiating the possible extension of two of our current capital alliance partners for our enhancement and complex refurbishment projects. We also actively seek to support the supply chain in rural and island areas where it can bring significant benefit to smaller economies.

These procurement activities will include a strong focus on working together with the supply chain to minimise embodied and construction carbon and support our target to achieve net zero emissions by 2040.

More than 70% of our supply chain is made up of small and medium sized businesses. While this is positive in supporting the Scottish economy, many organisations do not have the capacity to transform their carbon footprint with an estimated 40% not currently measuring carbon. With more than 50% of the turnover of Scottish Water's regulated business being spent within our supply chain, we have a leading role in helping our supply chain to evolve.

While we already look to work with suppliers who have a focus on sustainability and innovation, to achieve and go beyond net zero emissions we need to further support the supply chain in reducing their emissions footprint, particularly in terms of embodied carbon.

Scottish Water has created a learning hub for suppliers which will help grow our shared capability, supporting the delivery of more effective and efficient services. The learning hub provides a wide range of content to support knowledge development in our supply chain on key areas such as carbon management, our environmental responsibilities, safety, health and wellbeing, and customer excellence. The hub provides a secure mechanism by which best practice and expertise from across the supply chain can be shared consistently, effectively and efficiently.

Brexit and Procurement

In response to some of the risks posed by Britain's exit from the European Union, including the possible implementation of World Trade Organisation tariffs, risks around access to skilled labour and currency fluctuations, our strategy has been to limit exposure by sourcing locally wherever possible.

We faced significant risk of disruption to normal supply chains during 2019 because of the threat of a no-deal Brexit. To manage this risk, we increased stock holdings of key consumable materials and then incurred significant activity managing these as the Brexit deadlines changed. We worked closely with suppliers, put necessary plans in place and executed an approach designed to protect our supply chain and ensure we could maintain essential services.

CASE STUDY
ROSS-SHIRE ENGINEERING LTD (RSE) PARTNERSHIP

Delivering services to remote rural and island communities is often a major challenge but a partnership with Muir of Ord-based RSE has seen a new approach to delivering rural water treatment works using a remote modular construction technique.

This new approach has been transformative, reducing delivery times and impacts on local communities. An example of this is a new water treatment works on Harris in the Western Isles. The modular construction allowed the works to be built in a factory then delivered by road and sea using a specialised barge, with a spectacular beach landing.

So far, 30 new works have been delivered using this approach, with a further five in the pipeline over the next 18 months. This partnership directly supports 340 jobs in Muir of Ord and a further 210 jobs around Cumbernauld, including 49 apprenticeships.

30 NEW WORKS DELIVERED

DIRECTLY SUPPORTING **340 JOBS**

SITE **PRODUCTIVITY INCREASED** UP TO **60%**

CASE STUDY
INCREASING PRODUCTIVITY DURING CAPITAL INVESTMENT

Across Scotland, each month there are approximately 120 live construction sites being led by our partners and suppliers. A study across our sites identified areas for improved efficiency, productivity and consistency of approach across our delivery partners.

These insights were developed into productivity improvements which were shared with our partners. The result was improved levels of productivity through helping sites plan, organise and build better. Construction sites can now undertake an extra five hours of fully productive work per week, so an eight-week construction project can now be delivered in seven weeks.

This approach has helped increase site productivity up to 60% and we are targeting an industry leading 70%. Our approach to driving productivity on our construction sites was recognised with a major award for supply chain excellence in 2019/20.

Working with Developers

Enabling development through new water and waste water connections to homes and businesses is a key part of the role Scottish Water has in supporting the economy. Historically, the service we provided to developers fell below that required.

In recent years, we have built much stronger working relationships with the development community: local authorities, house builders, construction companies, industry bodies and the six City Deals; enabling improvement in service and improved feedback from the development community.

However, our performance over the last year suggests that these improvements may have plateaued with our developer customer satisfaction score showing a small drop from 64.5% to 62.8%, although the number of formal complaints has fallen from 19 to 17. The total number of connections delivered in 2019/20, was 25,213, which is consistent with 2018/19 figures.

We recognise that more needs done to improve the service experience of the development community. We are introducing significant further improvements and we are committed to achieving future levels of service experience that are similar to those of our household and business customers.

Assessing Impacts on the Network

Before a new development can connect to our network, an assessment needs to be undertaken of the impact the development will have on the existing network and whether additional investment may be required to accommodate current and future demand. In the last year, 70 strategic Network Impact Assessments were completed.

We have targeted impact assessments at those areas we believe are a priority for development, using Local Development Plans to inform our decisions. However, we know from experience that development will take place in areas where we have not carried out Network Impact Assessments, which can lead to delays and frustrations for developers. We are working to better understand development priorities, improve the assessment process and increase the number of assessments available.

CASE STUDY
TRANSFORMING SERVICE TO DEVELOPERS

A long-standing source of frustration for developers was the time and cost of waiting for Scottish Water to physically inspect new connections to our water mains. In response, we developed a Track Inspection App which gives developers the ability to submit location and time-stamped photographs of the constructed water assets which can be reviewed remotely. This has reduced timescales for this stage of the connection process from five business days to around four hours, reducing costs, providing improved customer service and contributing to our net zero emissions target.

Alongside this, we have recently launched our new Customer Portal, which has been developed in collaboration with the development community and aims to transform the level of service provided to developers. From initial enquiry through to connection, developers are able to understand if their site is ready to be connected to the water and waste water network, and then track their applications for connection online.

Vesting

When a new development is planned, it is the responsibility of the developer to install the new water and waste water assets to service properties. These installations are formally transferred to Scottish Water when the assets meet the required standards, known as vesting. Since the formation of Scottish Water, the vesting process has been ineffective, for a variety of reasons.

Over the last four years a project team has been addressing a substantial backlog of assets to be vested. This team has developed a number of new processes to deal with issues that had previously prevented formal vesting, such as developers no longer trading or transferring ownership of assets from multiple private homeowners.

To date, more than 3,700 assets have been successfully transferred to Scottish Water

To date, more than 3,700 assets have been successfully transferred to Scottish Water, one quarter of the total number of assets that may be eligible for vesting. Consistent processes are now established for vesting legacy assets and a dedicated team has been trained to complete this work. However, this remains a challenging area to conclude as it requires significant work by both developers and Scottish Water, including in some cases resolving legal matters and improvements by developers to constructed assets such as sewers and SUDS.

Working in Partnership

City Deals

City Deals are agreements between local authorities and the Scottish and UK governments to deliver long-term approaches to improving regional economies. Each deal has a programme of interventions and investments to support positive transformational change relevant for each region.

We are actively involved, often with several partner agencies, to deliver City Deal projects across Scotland, installing new infrastructure or diverting existing services so we can help bring important strategic projects to fruition.

Knowledge Partnerships

As part of a Sustainable Growth Agreement with SEPA we have been working on three innovation projects to explore sustainable solutions to recover value from our waste streams, and manage rainfall and drainage in our urban environment. We are also working with SEPA on a sustainable decision making project, developing methods and tools to consider the wide range of interactions within a catchment. We seek to minimise the use of energy and other natural resources, in order to reduce our carbon emissions, whilst maximising benefits to society and the environment. We are currently piloting this approach in natural and urban catchments through the drainage project above.

Opportunities for New Entrant Farmers

In support of the Scottish Government's drive to create opportunities for new entrant farmers, Scottish Water proactively reviews the land we own to identify possible sites for new farms. In addition to demands to use our land for renewable energy schemes and tree planting for natural carbon capture, we have created three opportunities for new entrant farmers to date.

Horizons Development Centres

Our water and waste water development centres play an important role in allowing companies to test, demonstrate and develop new products for the water sector. In this way, new innovations are developed and brought to market more quickly.

The sites, led and operated by Scottish Water Horizons, are part of the Water Test Network, a group of 14 testing facility sites in five countries. With the test centres not yet reaching a level of commercial sustainability, we plan to utilise them further internally to provide training opportunities, develop our digital technology and support our journey to net zero emissions.

A significant risk to the future of these facilities is our ability to continue to work with European customers and funding partners. We are working in partnership with Scottish Enterprise and Scottish Development International to attract more water technology business to Scotland.

CASE STUDY
BO'NESS WASTE WATER DEVELOPMENT CENTRE

Our Waste Water Development Centre at Bo'ness trialled a new microbial intensification process, Microvi's MicroNiche Engineering, which has the potential to revolutionise the way waste water can be processed. The technology aims to drastically reduce the amount of sludge produced when treating waste water, which cuts the energy, transport and chemical requirements.

PEOPLE

Delivering our ambitions and transforming our services depends on the engagement and capabilities of all our people.

We have more than 4,000 employees carrying out a wide range of roles throughout Scotland, alongside people in our supply chain and alliances. It is vital everyone plays a part in how water and waste water services operate now, and as we transform to ensure we can meet future challenges.

Safety, Health & Wellbeing

Safety, health and wellbeing remains one of our highest priorities. Our expectation is that our people will return home safe and well every day. We have an integrated safety, health and wellbeing strategy which looks to lead the industry in Scotland on a journey to zero harm and create safe, healthy and productive workplaces where our people can fulfil their potential.

Health and Safety

The number of RIDDOR incidents increased from 11 to 15, although over a three-year period the number remains stable.

The number of cases of potentially serious injury reported in the year increased from 13 to 17, arising mainly from contractor activity. The capture of potential incidents continues to be actively promoted to improve learning and reduce actual injury.

The Three-Year Rolling Average Reportable Non-Fatal Injury rate per 100,000 workers was reported for the first time at 201, the UK Continental Shelf (UKCS) offshore oil and gas industry's equivalent 2019 performance is 340.

The number of safety incidents which involve members of the public increased in the year from four to six. All events are an important opportunity for learning, particularly as injury to customers often affects those who are elderly or vulnerable.

Wellbeing

During 2019/20 there was a focus on mental health and wellbeing in particular. Employees highlighted Scottish Water could do more to support mental health issues and help break stigmas. Last year mental health workplace training was mandatory for managers and we introduced 50 mental health first-aiders across the business.

We continued to benchmark our approach to dealing with mental health issues in the workplace by being assessed as part of the Water UK Thriving at Work study, which was commissioned by the UK Government in 2018. We met all 10 criteria for good practice in this study, indicating that, along with other water companies, we were starting to make positive changes in how we support mental health wellbeing amongst employees and deal with the consequences of stress and mental health.

Creating an Inclusive Workplace

The Equality Act 2010 sets out the duties required by public sector bodies to ensure that equality is mainstreamed into all aspects of organisational culture and practice. The Act requires public sector bodies to demonstrate equality of opportunity in decision making, in the design of internal and external policies and in the delivery of services; and to set out desired equality outcomes which are regularly reviewed. Under the requirements of the Act we publish a detailed biennial Public Sector Equality Duties (PSED) report containing a review of our desired equality outcomes, commitments and progress in the areas of equality, diversity, and inclusion. Our most recent PSED report was published in April 2019.

We have four stated equality outcomes:

- Ensure that disability and ethnicity are not seen as a constraint for access to our services.
- Continue to increase our development of STEM (Science, Technology, Engineering and Mathematics) careers for women.
- Ensure that our recruitment and selection practices encourage applications and hires from all under-represented groups.
- Demonstrate a positive commitment to the work of our Belong Networks and support them in extending their reach both within and outside Scottish Water.

We continue to maintain a focus on encouraging women to take up STEM roles and provide structured career development opportunities. Our graduate intake in 2019 was 75% female compared with 36% in 2018. Of the ten female Modern Apprentices who joined us in 2019, eight are in STEM roles.

Encouraging recruitment from under-represented groups remains a priority focus. The number of women being recruited and retained is growing. 4% of people we employed last year were from ethnic minority backgrounds and 1% of new employees declared a disability.

Analysis of ethnic minority recruitment data has identified this is a key area of development we must focus on in the future. While we are successful in attracting applicants from ethnic minority backgrounds, the progression towards selection remains low. We are working to understand the underlying reasons for this.

Our Belong network offers support, advice and guidance for employees on a number of issues. There are seven Belong network groups: Multi-Cultural; Armed Forces; Carers; Disability; LGBT+A; NxtGen; and Women in Scottish Water.

During 2019, our approach to encouraging and developing diversity and inclusion was recognised through being placed in the Times Top 50 Employers for Women list, achieving the Carers Positive exemplary status and silver Defence Employer Recognition Scheme.

Employees also took part in a range of events including Pride marches in Edinburgh, Glasgow and Dundee, menopause workshops, a Belong network conference and the launch of a video celebrating diversity and inclusion in Scottish Water.

We are working on policies which further support diversity and inclusion in the workplace. Among the areas where policy is being developed are on gender transition, family care and child bereavement.

Human Rights, Dignity and Respect

Scottish Water remains committed to respecting human rights. We expect and require all those who work for and with us to show dignity and respect at work and to adhere to our zero-tolerance approach to slavery and human trafficking. Our Dignity at Work policy further clarifies how concerns of this nature are recognised as different from other types of complaint and so are investigated with appropriate sensitivity and protections for all those involved.

We work to provide and maintain a working environment that ensures everyone is treated with dignity and respect. Bullying, harassment, discrimination and victimisation are unacceptable behaviours and are not tolerated. All employees, managers and third parties are responsible for creating a working environment in which dignity is maintained.

We promote an open and honest relationship between management and employees and commit to treating all allegations promptly, seriously and confidentially. Any breach of these standards may result in disciplinary action up to and including dismissal. However, our primary aim is to draw attention to, and therefore prevent, all forms of unacceptable and inappropriate behaviour which do not support dignity at work for all.

Gender Pay Gap

In March 2020, Scottish Water's median hourly base pay for full-time men was £15.28 and for full-time women was £15.99, a base pay gap of 4.63% in favour of women.

Gender pay gap legislation that applies in the UK private sector requires pay comparisons be made between the contractual pay of men and women including base salary, paid leave, pay allowances, shift pay and on-call and standby payments. Although Scottish Water is a public corporation, for transparency we have adopted a reporting approach of disclosing our gender pay gap in line with the private sector calculation, but using the two-year frequency of PSED reporting, last updated April 2019.

Under this calculation, Scottish Water has a gender pay gap in favour of men at both mean (4.37%) and median (1.39%), compared to the gender pay gaps reported in 2019/20 for Scotland (14.3%)[4] and the whole UK (17.3%).

Our gender pay differences reflect distribution by job role and grade, while overall occupational gender segregation remains the most pertinent issue affecting pay. Our gender demographics mean that large numbers of men are employed in roles that require the provision of work outside normal hours, and which therefore attract associated additional contractual payments.

[4] https://nationalperformance.gov.scot/chart/pay-gap

Over the past five years our supply chain partners have started approximately 700 Modern Apprentices and Graduates.

Developing Future Talent

The water industry faces major skills challenges in the short and long-term. Ongoing skills investment in our people and our supply chain is critical to ensuring efficient, safe and cost-effective delivery of our services.

Throughout the year we have focused on developing apprentices, graduates and leaders in Scottish Water, and our supply chain.

Apprentice and graduate programmes ensure young people can work with Scottish Water and enjoy careers in the sector. There were more than 250 graduates and apprentices on structured development programmes in Scottish Water last year. Over the past five years our supply chain partners have started approximately 700 Modern Apprentices and Graduates. In 2019/20, our suppliers employed 81 Modern Apprentices and 66 Graduates to support Scottish Water work. A total of 110 Scottish Water employees have been through our Future Leaders Programme and we are seeing graduates emerge into key leadership roles.

As the organisation begins to transform, we are working to ensure as many employees as possible are carrying out roles which match their skillsets. The Career Transition Programme (CTP) provides structured support to help employees transition to a position elsewhere in the business, if their current role is no longer available or suitable. The programme currently has 36 participants, with 61% of these due to medical redeployment. A further 23 employees have already moved from the programme and transitioned into new roles.

Supply Chain: Investment in Talent

Scottish Water is also committed to working with our supply chain to deliver sustainable skills development and in 2019 we became a member of the Procurement Skills Accord (PSA) which drives a skills step-change in training investment through procurement.

We use responsible procurement practices to promote relevant skills development throughout our supply chain. Our tender process requires suppliers to employ Modern Apprentices and Graduates and we encourage SMEs, in particular suppliers in rural areas, to tender for work to support a skilled workforce in Scotland.

Resource Management

We engage a number of people through agency contracts, allowing greater flexibility to resource projects and access to specialist skills. The table below sets out the number of agency workers at the end of 2019/20. HM Treasury procurement guidance for public appointments broadly defines 'off payroll' workers as those paid £220 or more per day for contracts that last longer than 6 months, so we have used this definition to report the numbers below.

Length of Service	Number of "Off Payroll" Agency Workers	% of total workforce of same service length
< 1 year	3	1.2%
1-2 years	14	4.6%
2-3 years	14	5.5%
3-4 years	12	3.4%
4 years or more	69	2.2%

We engage a number of companies to deliver services in areas such as cleaning, catering, traffic management or ground maintenance. Such contracts do not specify the workers who will deliver each service although as part of our accreditation as a living wage employer, our procurement contracts for these services include the requirement for the employing organisations to pay at least the living wage. We do not use zero-hours contracts.

We operate severance terms as approved by the Scottish Government and which are used in a limited number of different circumstances. We support the Scottish Government's expectation of no compulsory redundancy and where an employee's role does become redundant, all efforts are made to redeploy the individual into another role and/or another part of the business through our Career Transition Programme.

Occasionally, however, redeployment is not possible and where the employee wishes to they can opt for voluntary redundancy. We also operate schemes for Flexible Retirement and Early Retirement which an employee can request in line with the regulations of the Local Government Pension Scheme (Scotland). Any payments made for voluntary redundancies or flexible/early retirements are recovered through cost savings on average within two years. The table below sets out the exit packages made in the financial year 2019/20.

	Number of employees	Total Cost £000	Average Cost £000
Early Retirement and Voluntary Severance	65	397	6.1
Flexible Retirement	48	29	0.6

During the year there were two cases of voluntary severance. Flexibly retired employees continue to work in Scottish Water until their agreed exit date, typically 1-3 years after beginning flexible retirement.

Bribery and Corruption Prevention

We review all policies on a cycle of at least every two years and this includes Anti-Slavery; Code of Ethical Conduct; Whistleblowing; Anti-Bribery and Fraud Management and Response.

A Policy Awareness Communication plan is rolled out annually and is used to ensure all employees are aware of their rights and obligations. For topics such as Fraud and Bribery and Corruption, mandatory compliance training is routinely undertaken by appropriate role-holders, using our online training solution and with completion tracked and refresher training undertaken at regular intervals. All significant frauds are reported to Audit Scotland.

In addition, an externally operated whistleblowing facility is operated on a confidential basis. This facility is open to employees, supply chain and customers.

Cyber Security

Cyber Security has been a digital investment priority since 2014 and we are continuing to mature the required controls to achieve full compliance with the Network & Information Systems Directive (NISD).

We continue to identify, investigate and mitigate threats, share cyber threat data, and partner with others to identify and implement best practice.

Employee Volunteering

In 2019/20, 355 individual employees dedicated almost 3,000 working hours of their time to educational, charitable, environmental and community projects across Scotland.

Each employee is entitled to up to two days paid leave per year to volunteer and make a difference to wider society. As well as making a positive impact in the community and building trust with our customers, the programme also adds great value to our employee wellbeing, skillset, and team morale through the variety of opportunities available.

BEYOND NET ZERO EMISSIONS

Our services rely on infrastructure, processes and activities which are energy intensive, creating greenhouse gas emissions with serious consequences for people and our environment.

These emissions arise from the day-to-day operation of our water and waste water services; maintaining and improving our assets to ensure they run effectively through the capital investment programme; and operating a large organisation with a significant fleet of vehicles and buildings.

They are dominated by carbon dioxide associated with electricity consumption, but methane and nitrous oxide are also potent greenhouse gases that arise from the treatment and break down of waste water. Collectively, these greenhouse gas emissions are measured in terms of tonnes of carbon dioxide equivalent (tCO_2e), and the phrase carbon emissions is also often used.

For more than a decade, Scottish Water has made significant progress in adapting to climate change and mitigating the impact of our activities on the environment. But achieving our target of net zero emissions by 2040, and going beyond that thereafter, will require fundamental transformation of our activities as detailed in *our routemap to net zero emissions*, published on 14 September 2020.

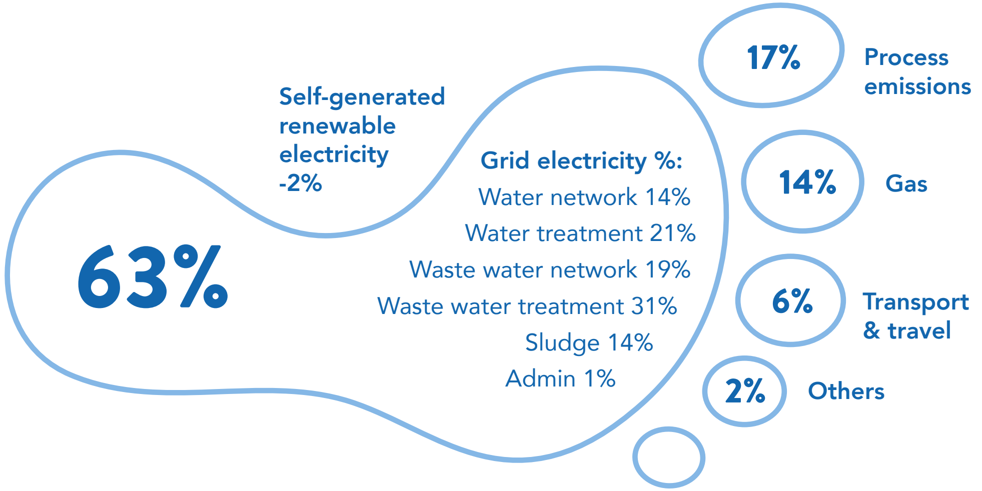
Our long-term strategy is to mitigate our contribution to the causes of global heating by reducing our emissions while maximising our contribution to renewable energy generation and the ability to capture and store emissions in our land.

We rely on Scotland's natural capital, the stocks of natural resources in Scotland's environment, to deliver our services. Considering natural capital can also help us adapt to climate change and help to address emissions by locking up carbon. Working with nature and adopting nature-based solutions offers the opportunity to deliver multiple benefits, improving the water environment, providing additional benefits for biodiversity, creating better places to live, and doing so in a way that supports low emissions.

Transforming our Emissions

Over the next two decades we plan to reduce greenhouse gas emissions across all areas of our activities. We published the net zero emissions routemap on 14 September 2020 which sets out how we will do this. Achieving net zero emissions will be a very significant challenge with many uncertainties and dependencies, and demands we work in partnership with others to support this.

GREENHOUSE GAS EMISSIONS FOOTPRINT BY SOURCE 2019/20



Operational Emissions

We have been monitoring the greenhouse gas emissions associated with delivering water and waste water services to our customers since 2007. Since monitoring began our operational emissions have reduced by 45% to 254,000 tCO_2e in 2019/20.

Grid electricity emissions make up 63% of our operational emissions footprint with waste water treatment representing the greatest proportion of emissions. The continued reduction in the carbon intensity of grid electricity, continued focus on energy efficiency and an increase in our renewable energy generation have contributed to reducing operational emissions.

Capital Investment Emissions

We invested £673 million in 2019/20 to maintain and enhance our assets. Capital investment can lead to significant greenhouse gas emissions associated with the design, procurement and delivery of projects.

This is termed embodied carbon, and describes the emissions associated with the extraction and processing of raw materials such as iron and cement, manufacture of products such as pipes, and the techniques used to construct and maintain assets.

To help measure, manage and drive reductions in capital investment emissions we developed a Capital Carbon Accounting Tool for use on all construction projects valued at more than £1 million. Throughout 2019/20, we have continued to engage with internal design teams and external delivery partners to support teams to apply this to projects. We have also been engaging our supply chain to address data gaps for some of the products we purchase, and, working with key suppliers, we developed an Embodied Carbon Calculator in 2019/20 to assist with emissions' estimates.

Energy Efficiency

We achieved our energy efficiency and self-generation target of 17.5 GWh for this regulatory period in 2018/19. In 2019/20, we have enabled a further energy reduction of 6.3 GWh, which is equivalent to around 1,700 tonnes of carbon dioxide equivalent (tCO_2e). We aim to enable an additional 0.8 GWh of energy efficiency specifically at waste water treatment works by 2021.

Energy Efficiency in Waste Water Treatment

One of the largest drivers of electricity consumption in waste water treatment is at our many aerated treatment works, where air is added to the waste water to support effective and efficient treatment. By linking real time monitoring and real time control of the equipment we are able to optimise the amount of air, delivering only what is required for treatment at that time. This saves electricity used in this process while continuing to maintain treatment performance.

We have introduced real time control at a further three sites in 2019/20 enabling 2.1GWh of energy savings. Further implementation will target sites with the greatest benefits in terms of process control, environmental compliance and energy saving. However, this approach may not be suitable at all sites.

In 2019/20, we have also replaced the blowers used to add air to waste water at five treatment works, with new high efficiency turbo units enabling 1.2GWH of energy saving.

Pumps are used to move waste water through sewers to our treatment works, and then around the site for processing. In 2019/20, we replaced or refurbished these at three sites to ensure they were working efficiently.

Energy Efficient Buildings

We are working to provide energy efficient buildings through technology including motion sensors for lighting, natural ventilation systems, LED lighting and automatic taps. In 2019/20, we have replaced conventional lighting with LED lighting at one of our largest offices in Edinburgh and in nine water treatment works.

Behaviour Change

In August 2019, we launched "Target Energy", a pilot behaviour change project being rolled out to support best practice and energy management at our waste water treatment assets.

Sustainable Fleet

Achieving our net zero emissions commitment will require a significant reduction in mileage travelled as well as investment in low carbon fleet technology. During 2019/20, employees travelled around 19 million miles delivering our services and undertaking essential operational, maintenance and inspection activities.

Business processes to help reduce mileage have been introduced such as promoting the optimisation of routes, reducing sludge transportation, enhancing remote monitoring capabilities to reduce the number of physical site visits required, and enhancing our ability to resolve a problem in a single visit where possible.

Low carbon vehicles have been introduced including 17 fully electric vehicles, around 30 electric/hybrids and an electric mini excavator. We are also currently trialling an electric/hydrogen vehicle.

Renewables

Last year, we generated our highest level of renewable electricity, producing 39.6 GWh, 7.0 GWh ahead of plan. We benefitted from an exceptionally wet winter increasing hydro-generation.

We have committed to increase the amount of renewable generation across our estate, either produced by us or hosted on our sites, to three times our current electricity demand by 2030.

Plans are progressing to increase third-party private generation on our estate, including large-scale windfarms and hydro generation, by making more of our land available. We are working with renewables developers and local communities to identify suitable sites for development including a small hydro scheme (0.6 GWh/annum) under construction at Glendevon Reservoir, which utilises our existing assets. RWE Renewables UK Development Ltd is also developing a large-scale windfarm at Daer Reservoir (estimated 260 GWh/annum).

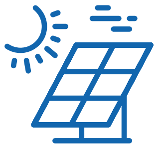
Looking ahead, our focus will be to optimise existing renewable sites and maximise generation, through on-site process changes, as well as identifying new opportunities. A review of our larger operational assets for opportunities for all types of renewables generation, including wind, PV and hydro is being planned.

Wind

We host an estimated 830 GWh of wind generation from private investment in renewables on our land. In 2019/20, the income from our hosted windfarms was £3.4 million, which exceeded our plan by £1.2 million. We have also installed 18 small scale wind schemes at our treatment works, which help to offset the amount of electricity we buy from the grid.

Solar PV Schemes

Scottish Water Horizons delivered five solar photovoltaic (PV) schemes in 2019/20, taking the total to 45 on Scottish Water assets, and this programme is being up-scaled significantly. Work has also started to develop the ability to deploy floating solar PV on reservoirs.



Scottish Water Horizons delivered five solar photovoltaic schemes in 2019/20

CASE STUDY
CASTLE MOFFAT WATER TREATMENT WORKS

Castle Moffat Water Treatment Works, near Haddington, is one of our most energy efficient operational sites, generating more energy than it uses. This self-sufficiency is a result of hydro power which is supplied by a new generator and control panel which were upgraded in May 2019. It generates 750,000 kWh/annum - enough to power over 2,400 homes. The site uses around 80% of the electricity it generates from the turbine with the remaining 20% exported to the National Grid.

Supporting the Circular Economy

We aim to follow circular economy principles in all we do. Specifically, we seek to minimise our demands on the planet's resources, keep resources in use for as long as possible, and recover products and materials at the end of their service life to return them to productive use.

To maximise the value within our existing assets, we will improve our understanding of asset capabilities, value and associated risks, and change our asset management decisions to reflect circular economy thinking.

Our approach will help us to make the most of the value provided by our existing assets, retaining the structures and resources that were used to build them.

Low Carbon Heat from Waste

Our long-term aim is to maximise the value recovered from society's waste water – and to turn our assets into energy and resource recovery centres wherever possible.

Heat captured in our sewer systems presents an opportunity to extract value from a waste stream. It is estimated that around 300 GWh may be accessible and usable.

Whilst Scottish Water sewer systems can provide heat, new infrastructure is needed to extract and supply this to customers. We have been able to deliver this into local heating schemes at Borders College in Galashiels and in Stirling, where we worked in partnership with the local councils. Such projects require considerable collaboration between the suppliers and the recipients of the heat.

A key element in encouraging partners to work with us to deliver these schemes is the current Renewable Heat Incentive, intended to help support the development of these sustainable technologies.

CASE STUDY
STIRLING DISTRICT HEAT NETWORK

The Stirling District Heat Network is now delivering affordable green heat to the local community, including The Peak Leisure Centre and Forthside Conference Centre.

Led by Scottish Water Horizons, in partnership with Stirling Council and with funding from the Scottish Government, the energy hub harnesses low carbon energy from waste water using a combined heat and power (CHP) engine, heat from a heat pump system, thermal stores, biogas from an anaerobic digester and back-up gas boilers. The scheme was projected to save Stirling Council around 380 tCO_2e per year.

Currently the CHP engine requires natural gas which impacts on the overall carbon balance of the scheme. This is partially offset by the reduction in natural gas used by the local community and by the reduction of propane gas used on site. Further benefits will be realised in the future from the CHP as the gas grid decarbonises.

PROJECTED TO SAVE STIRLING COUNCIL AROUND

380tCO_2e
PER YEAR

Enhancing the Natural Environment

Scotland's natural capital is the stock of natural resources, which includes geology, soils, air, water and biodiversity. Scottish Water's reservoirs and land are a big part of Scotland's natural capital. Enhancing natural capital through measures such as woodland creation and peatland restoration helps support net zero emissions by taking carbon dioxide out of the air and locking it away.

High stocks of natural capital will help us make our services more resilient to the challenge of climate change and future demands, as well as creating better places to live. We want to work with nature across our land and assets to contribute to Scotland's natural capital.

As set out in our strategic plan, over the next 25 years we will seek opportunities to enhance the natural environment, reduce the water we take and use our land and assets to increase biodiversity, create woodland, restore peatland and create better places to live.

We will work with the Scottish Government, regulators and developers to secure policy and planning approaches that maximise the role our land and catchments can play in providing natural carbon solutions. This work will also help achieve a sustainable urban drainage landscape, increase the resilience of our water supplies and enhance urban living and biodiversity. This will require major change in areas such as town planning, housing, regulation and a wide range of business sectors. Working in partnership with SEPA, we aim to drive forward change to better protect and enhance the natural environment.

Peatland Restoration

Peatland covers more than 20% of Scotland's land area, which equates to around 1.7 million hectares of Scotland - and studies suggest that roughly a third of it is degraded. Poor quality peatland is a major source of greenhouse gas emissions. Our work to restore peatland has a significant benefit to Scotland's emissions as well as improving source water quality. We are collaborating with Scottish Government funded Peatland ACTION, NatureScot and landowners to restore peatland in our drinking water catchments.

To date, we have funded or co-funded 190 hectares of restoration including Loch Orasaigh on the Isle of Lewis. We have supported another 250 hectares, with a further 55 hectares currently under active restoration. In total, this restored peatland locks away between 100 and 500 tCO_2e per year.

We have worked in partnership with Peatland ACTION on several projects, such as Sandy Loch on Shetland, and the River Ugie catchment in Aberdeenshire.

GREAT VALUE & FINANCIAL SUSTAINABILITY

OUR INVESTMENT PROGRAMME

During 2019/20, we invested £673 million across Scotland to maintain and enhance existing assets and build new infrastructure. By the end of the 2015-21 regulatory period, we will have delivered over 4,000 investment projects, providing benefits to customers through improved customer service, higher drinking water quality, protection for the environment and supporting economic growth.

Working with our network of delivery partners, alliances and wider supply chain partners, we maintained momentum in our investment delivery with 95% of the 2015-21 reported enhancement programme having started on site or been completed. This programme is being delivered ahead of plan, as measured by the Overall Measure of Delivery (OMD), which assesses our performance in delivering Ministerial Objectives by tracking progress against the milestones set out in our Delivery Plan at the beginning of the period, and subsequent updates.

We have worked hard to meet our plan commitments and, in some communities, we have delivered projects, and their associated benefits, early. However, some areas of the programme are being delivered later than planned.

We have been recognised over the last year with several awards for delivery excellence and performance. We have received awards for projects including the new Lochmaddy Water Treatment Works, Paisley Tunnel and Shieldhall Tunnel waste water and flooding improvements, and Loch Ness water supply improvements.

We continue to seek innovative solutions such as our Roundknowe pipe bridge replacement project in Uddingston, which won an industry innovation award. However, even in these successful projects there are lessons which we can learn to improve how we deliver investment in the future.

Our ongoing challenge is our ability to deliver projects within the time and cost allowances which we set at project inception.

Delivering our Capital Programme

Since April 2015, we have delivered over £3 billion of investment and last year invested, on average, over £55 million a month.

As we entered 2020/21, the final year of the 2015-21 period, we had been expecting to increase our annual level of investment further. However, following Scottish Government advice in light of the Covid-19 pandemic, we paused our investment programme and closed all construction sites on 24 March. With our capital supply chain, we developed comprehensive and common safe working standards, including requirements for safe working practices and stringent protocols for close proximity tasks. These will inevitably reduce site productivity, adding time and cost to the completion of capital projects. Following the publication of the Scottish Government's construction industry guidance, our capital programme has been steadily remobilised with the new safe standards.

Improvements to be Delivered in the Regulatory Period

Overall delivery of our reported enhancement programme was on or ahead of the year-end targets, apart from in three areas. Those behind target include the number of water treatment works improved, and the number of improvements to meet the Water Framework Directive. The latter programme area has 9 outputs which are behind target due to the decision to keep Amlaird Water Treatment Works temporarily in operation as part of the revised strategy for Ayrshire water supplies.

Objective	Programme area	2019/20 year end Outputs Target	2019/20 year end Outputs Actual	Programme delivery status March 2020
Improving drinking water quality and reliability	Number of water treatment works improved	12	10	Behind target
	Number of zones made compliant with iron and manganese standards	33	38	Ahead of target
	Number of improvements to reliability of supply (catchments and treatment)	8	12	Ahead of target
	Number of improvements to reliability of supply (networks and storage)	9	22	Ahead of target
	Distribution mains cleaned (km)	364	564	Ahead of target
	Number of water quality etc studies to inform future periods	124	220	Ahead of target
	2010-15 outputs planned to complete in the 2015-21 period	14	13	Behind target
Improving drinking water security of supply	Water supply resilience strategy and improvements made	9	12	Ahead of target
	Number of zones with improved security of supply	4	4	On target
	Number of security measures and improvements to the infrastructure of critical reservoirs	118	460	Ahead of target

Objective	Programme area	2019/20 year end Outputs Target	2019/20 year end Outputs Actual	Programme delivery status March 2020
Protecting and enhancing the environment	Number of waste water treatment works improved to meet Urban Waste Water Treatment Directive (UWWTD)	21	21	On target
	Number of waste water networks improved to meet UWWTD	21	29	Ahead of target
	Number of improvements required to meet UWWTD - Glasgow completion	61	61	On target
	Number of improvements required to meet the Water Framework Directive	11	2	Behind target
	Studies to inform requirements under the revised Bathing Waters Directive	2	8	Ahead of target
	Number of environmental studies to inform future periods	32	66	Ahead of target
	Number of improvements required by the Compliance Assessment Scheme; odour reduction and sludge management	24	31	Ahead of target
	2010-15 outputs planned to complete in the 2015-21 period	12	13	Ahead of target
Improving flood risk management	Reservoirs Act – number of improvements to dams	24	36	Ahead of target
	Flood Risk Management Act: models and integrated catchment studies	66	140	Ahead of target

Objective	Programme area	2019/20 year end Outputs Target	2019/20 year end Outputs Actual	Programme delivery status March 2020
Supporting economic development	Number of new connections to households and businesses	Demand driven	90,169	Demand driven
	Delivery of new waste water capacity for 73,290 people	Demand driven	6,002	Demand driven
	Number of first time non-household meters installed	Demand driven	15,198	Demand driven
	Number of business (or non-household) meters replaced	Demand driven	65,337	Demand driven
Mitigating climate change	Number of climate change vulnerability assessments	57	59	Ahead of target
Improving the long-term cost of service	Improvements in renewable power and energy efficiency (GWh)	11.0	17.5	Ahead of target

Our Challenges and Key Learning

Over the 2015-21 period, our investment programme has made good progress. However, even without delays that will be caused by Covid-19, there are a number of projects in our reported enhancement programme which we do not expect to be complete by the end of the period and which we are managing closely. The delays in these challenging projects are due to extended planning, third party issues and the impact of adverse weather conditions. We work hard to understand and mitigate risks to delivery, and we will work with our supply chain partners to further develop the skills and capabilities needed to manage these.

The 'Plan Prepare Deliver' process, which was introduced in 2015, is working well, with clear benefits to understanding the risks to delivery and minimising those being realised in construction. We expect our new process for planning and prioritising investment for the next regulatory period will bring more focus to the early stages of project development. This will further ensure we identify and understand risks early, and can meet the commitments we make to our customers and regulators.

Forecasting the cost and time of projects is a recognised issue in the construction industry, and we know we must work hard with our supply chain to improve our understanding of scope, third party and construction risks that can impact our forecasts so we can provide more accurate commitments to our customers and regulators.

To ensure a continual focus on delivery, and performance reporting, we engage regularly with our delivery partners, alliances and wider supply chain to check the health of individual projects, resolve issues and monitor progress. We are transforming the way we work using integrated teams, ensuring all parties involved in project delivery are streamlined and collaborating at the right time.

In the next regulatory period, our investment profile will alter to reflect the new challenges we face. There will be a greater emphasis on asset repair and replacement, and an increasing focus on capital projects which deliver good value while reducing the greenhouse gas emissions associated with both construction and in-life operation. We are working with our partners and suppliers on our supply chain for the future to ensure we have the capability to manage and deliver efficiently and in line with our purpose to support a flourishing Scotland.

KEEPING SERVICES AFFORDABLE

Customer Charges

Over the last ten years, when there has been pressure on household finances in the aftermath of the 2008 financial crisis, household water charges have increased by only 12%; this represents a 10% real reduction when adjusted to take account of the impact of inflation. In January 2020, we announced a very small increase of 0.9% in household charges for 2020/21.

Although we have succeeded in reducing real customer charges over the past 10 years, over the next 20 years we will need to set real increases in customer charges to pay for the necessary increase in capital investment.

We are very aware our customers face economic uncertainty and difficulties beyond the current Covid-19 pandemic. However, the long-term investment and financing needs of essential water and waste water services remain.

As a result of the economic impact of the Covid-19 pandemic, the WICS has announced that their Determination process, the next step in the strategic review of charges which was due to commence in May, has been delayed until later in the year.

Wholesale Charges

The retail market for water and waste water services gives business customers a choice of retailer. Scottish Water plays a key role in the market as the wholesaler, collaborating with all participants and leading market changes to facilitate the effective operation of the market.

We have been working to ensure all customers connected to our services are charged correctly. A key part of this work is to identify premises that have, by mistake, been missed from the market data set and to identify premises which are no longer connected. In addition, we update the market information by examining routinely the data from the Scottish Assessor and adding or removing properties where needed.

On 24 March 2020, due to the Covid-19 pandemic, payment terms to LPs were temporarily relaxed, providing £60 million of cashflow support to the market to enable LPs to extend payment flexibility to their customers. Scottish Water has also worked with the WICS and other market participants to support the introduction of a deferral scheme to provide further support to business customers impacted by the crisis.

TRANSFORMING HOW WE WORK

In our strategic plan we set out three challenging ambitions - Service Excellence; going Beyond Net Zero Emissions; and delivering Great Value and Financial Sustainability. Taken alone, these three ambitions are not easy. Together, they require radical and transformative change to be achieved.

Improving how we work and deliver our services is something we have always done within Scottish Water. However, in 2019, we reviewed the scale of transformation now required. We have implemented a new approach to delivering transformation projects to quickly pilot new ways of working, often harnessing digital technologies.

We have also started to develop an integrated transformation plan that will enable us to achieve our strategic ambitions. We have appointed a Director accountable for driving this work, building the capacity and skills needed across the organisation to lead and inspire new approaches.

Our Transformation Plan

Our transformation plan, which we expect to publish in 2021, will outline the organisation that Scottish Water will become and the routemaps that will take us there. It will include routemaps to transform the management of our assets and reach net zero emissions. It will also set out how we will drive value, cost efficiency and service excellence, how we will inspire and engage our people, and involve customers and communities more fully in our decision-making.

Transformation Programme

In 2019/20, we adopted a new approach to exploring and delivering transformation projects. By harnessing agile methods, we aim to quickly identify areas for improvement and pilot new ways of working and evaluate their impact.

Where pilots are successful, they can be quickly scaled-up. Equally, where a pilot does not deliver benefits, lessons can be learned for the future and focus moved to other aspects of activity. These projects have targeted areas with significant scope for simplification, streamlining and automation, delivering efficiencies, improved service and a reduction in our carbon footprint.

CASE STUDY
DEPLOYING TO SITE IN HALF THE TIME

This ambitious early demonstrator aimed to reduce the time taken to develop investment projects to solve sewer flooding. The demonstrator focused on improving communications, ways of working, and minimising the inevitable abortive work. Using a programme of live projects, we enabled more effective collaboration and introduced new efficient processes.

This blueprint for deploying to site in half the time has since been applied to other projects with savings of up to 42% in the time incurred in developing projects for investment delivery.

Digital Technology and Enablement

We have changed how we deploy new technology to maximise benefits it can bring. As an example, we have created an "apps factory" with our partner CapGemini to enable the rapid development of mobile device applications which are transforming the way we work with each other and our customers. We have also established a small team of digital innovation graduates with capability to build rapid, low-cost apps to meet business needs.

We are committed to achieving the benefits of flexible working, and recognise the part technology plays. Initiatives to enable our people to work where, when and how they choose were in place before Covid-19. These have proved to be critical in ensuring we have been able to continue to run our services effectively during the pandemic.

FINANCIAL SUSTAINABILITY

Group Overview

The principal activities during the year were the supply of water and waste water services to homes and businesses across Scotland as highlighted in the Overview on page 5.

Scottish Water's regulated business supplies water and waste water services to households and is also the wholesaler to the 30 retailers (Licensed Providers (LPs)) who operate in the water retail market for businesses in Scotland. Within the Scottish Water group, our subsidiary, Business Stream, operates as an LP, competing with other LPs in the Scottish and English markets to supply water and waste water retail services to business customers. The group also provides non-regulated and other commercial services to clients both within Scotland and internationally and, since December 2018, has owned the companies that operate four waste water treatment works in North-East Scotland, under contract to Scottish Water through Scottish Water Horizons Holdings (SWHH).

This report highlights Scottish Water's performance over the period 1 April 2019 to 31 March 2020.

In accordance with the Non-Financial Reporting Regulations, additional information on Scottish Water's policies and training in respect of the following items are detailed:

Human rights	**page 77**
Anti-corruption and anti-bribery	**page 80**

Group Structure

The Members of Scottish Water's Board are accountable to the Scottish Government. Details of the current Board Members are provided on pages 113 to 116.

Scottish Water's principal subsidiary undertakings, all of which are disclosed in note 11 to the financial statements, have their own Boards of directors.

Business Stream is operated in accordance with the Governance Code (agreed with the WICS). The code sets out the operating regime that Scottish Water and Business Stream must comply with to enable the operation of the licensed retail market. Business Stream has the same Chair as Scottish Water but has its own independent Board and management team. Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings Ltd (SWBSH) in accordance with the above code.

Strategic Framework

Scottish Water operates within a broad strategic framework set by Scottish Ministers. The well-established framework which Scottish Water operates, with a Delivery Plan, continues to the end of 2020/21. Engagement between Scottish Water, the Scottish Government, the WICS and other stakeholders through the Strategic Review of Charges is well advanced to determine how this will change beyond March 2021.

Sound financial management is essential to provide great value and financial sustainability in order to deliver high quality services for our customers and support a flourishing Scotland.

Our primary source of finance is revenue from customers but we also access borrowing from the Scottish Government. Scottish Water aims to maintain a level of financial strength that ensures its income is sufficient to meet its expenditure, while achieving its objectives at the lowest reasonable cost, in line with the requirements of the Water Industry (Scotland) Act 2002. To support a flourishing Scotland, Scottish Water aims to ensure its services are affordable for its customers while Scottish Water itself is financially sustainable.

Financial Performance – Group

Financial Summary

The group surplus before tax for the year to 31 March 2020 decreased by £0.4 million to £85.7 million (2019: £86.1 million). The decrease was primarily due to increased bad debt provisioning in Business Stream, due to the anticipated impact of the Covid-19 pandemic on trade receivables, partly offset by increased profits in Scottish Water and the non-regulated business services.

Since March 2020, the SW group has developed a number of financial scenarios to assess the potential range of financial impacts of the pandemic on its businesses, to ensure adequate funding is available where required to meet any shorter-term liquidity impacts.

We expect that our 2020/21 financial performance will be significantly adversely affected by the impact of the Covid-19 pandemic as we experience lower customer revenue and additional costs, particularly associated with our capital investment programme. As a result of government measures imposed to limit the spread of Covid-19, we closed all our construction sites in late March. We have since started to open sites, in line with government guidance. In terms of income, undoubtedly Scottish Water and Business Stream will both suffer reductions in customer revenue and increased bad debt.

Further coverage of the performance for the three main business areas covering regulated and non-regulated services and Business Stream is detailed on pages 100 to 109.

Consolidated revenue in the year increased by £146.8 million to £1,615.9 million (2019: £1,469.1 million). This benefit was accompanied by a £147.0 million increase in costs to £1,361.0 million (2019: £1,214.0 million). The acquisition of Yorkshire Water Business Services and Three-Sixty from the Kelda Group by Business Stream, in October 2019, accounted for £98.8 million of the increase in revenue with a similar increase in costs. Net finance costs of £169.2 million were £0.2 million higher than in 2019.

In the year, consolidated net debt increased by £118.2 million to £3,437.7 million (2019: £3,319.5 million). The increase was driven by additional net new borrowing of £215.0 million, partially offset by a £96.8 million increase in cash balances to £531.6 million. The movement in cash is summarised below:

	Scottish Water group £m	Business Stream group £m	Horizons group £m	Total £m
Opening balance at 1 April 2019	310.9	81.5	42.4	434.8
Cash generated	80.5	11.2	5.1	96.8
Closing balance at 31 March 2020	**391.4**	**92.7**	**47.5**	**531.6**

Cash balances within Scottish Water increased by £80.5 million to £391.4 million. Cash balances are planned to be consumed significantly over the period to March 2021 under the agreed Delivery Plan and in dealing with the impact of the Covid-19 pandemic.

Cash balances within the Business Stream group of companies increased by £11.2 million over the year to £92.7 million. The increase was mainly driven by the increased activity in England, following the acquisition of Yorkshire Business Water Services and Three-Sixty from the Kelda Group in October 2019. Cash balances within the Horizons group of companies increased by £5.1 million to £47.5 million mainly due to the dividend received by SWHH from SWBSH.

Taxation

Scottish Water was awarded the Fair Tax Mark for 2019/20. The Fair Tax Mark is the world's first independent accreditation for fair responsible tax and it was established in response to widespread public concern about apparent tax avoidance. To meet the criteria set by the Fair Tax Mark, Scottish Water is transparent about its tax affairs and has demonstrated with the publication of its tax strategy a firm commitment to shun tax avoidance, not take an aggressive interpretation of tax legislation and not use tax havens to secure a tax benefit.

The Fair Tax Mark is reviewed on an annual basis with the expectation it will be awarded in future years demonstrating the continued commitment from Scottish Water to play fair by tax.

The consolidated tax charge on the income statement was £65.1 million (2019: £17.9 million). Further detail is included in note 8 to the financial statements.

Other taxes incurred by the group, and included in the cost base, totalled £86.2 million (2019: £83.8 million) and are summarised in the following table:

	2019/20 £m	2018/19 £m
National Insurance	16.8	16.2
Local Authority rates	68.0	66.2
Land fill tax	0.7	0.7
Apprenticeship levy	0.7	0.7
Normalised annual cost	**86.2**	**83.8**

Scottish Water is currently appealing the rateable value of its Water Undertaking listing but is unlikely to know the outcome of this until 2021.

Group Pension Arrangements

Scottish Water is a participating employer in the Scottish Local Government Pension Schemes (SLGPS) across three 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 SLGPS 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 three-year period. The last full actuarial valuations were carried out as at 31 March 2017 but were updated at 31 March 2020 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. Thus, movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities.

At 31 March 2020, the gross pension liability decreased by £27.8 million from £248.3 million to £220.5 million. The actuarial movements, net of deferred tax, are presented in the consolidated statement of comprehensive income with all movements detailed in note 23 to the financial statements (on pages 180 to 183).

Further detail is included in note 23 to the financial statements.

Employees who joined Business Stream after December 2016 participate in a defined contribution scheme, administered by Standard Life.

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 24 to 42 with the specific risks as a consequence of the Covid-19 pandemic covered in the following business reports and in the Risk section in Strategic Report.

Scottish Water – Regulated Services

Strategic Framework

Scottish Water's regulated business supplies water and waste water services to households and is the wholesaler to the water retail market for businesses in Scotland.

Scottish Water generates value for its customers by planning for, and delivering, continuous efficiency improvements in operational and capital investment activities associated with regulated water and waste water services. The planned efficiency improvements are referenced in the regulated charges for customers, as set out in the WICS final determination for the 2015–21 period. The value generated by the out-performance of these efficiency targets is retained in Scottish Water until it is returned to customers through further investment to improve services.

Financial Framework

The Scottish Water regulated business is subject to incentive-based regulation by the WICS.

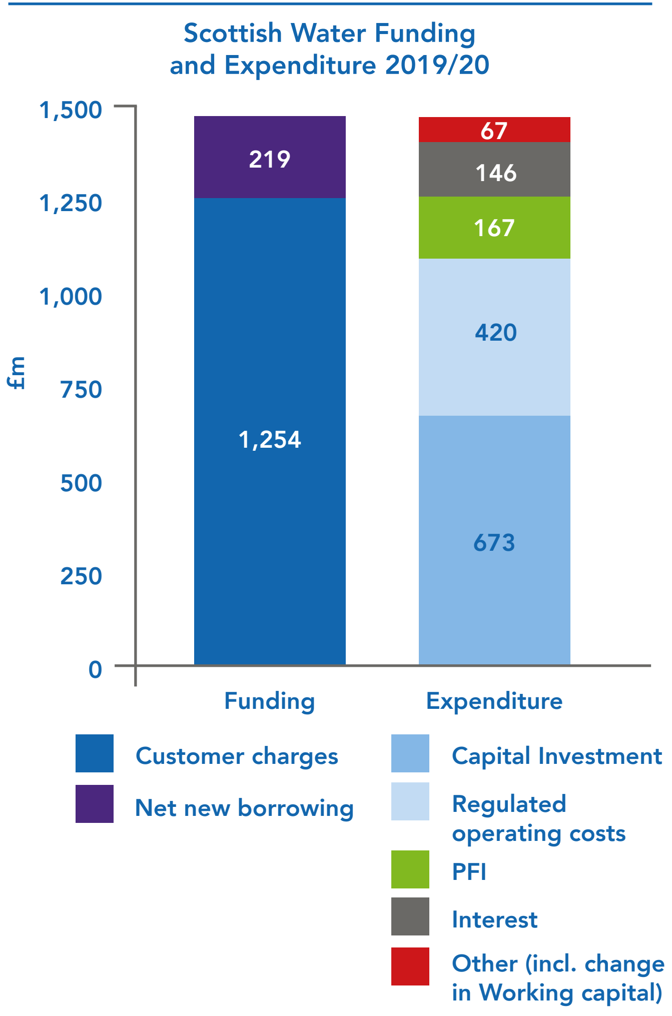
In 2014, the WICS carried out a six-year price review for the 2015–21 period, which caps the prices that Scottish Water charge for water and waste water services. The combination of regulated price caps and constraints on borrowing from the Scottish Government creates a clearly defined limit on the financing available to Scottish Water.

Within this financial framework, Scottish Water has an agreed Delivery Plan with Scottish Ministers that sets out its planned level of investment to deliver the required improvements and the expenditure to run the operation in respect of core water and waste water services. 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 investment programme, operating costs, Private Finance Initiative service fees and interest charges on loans.

The diagram opposite illustrates Scottish Water's funding and expenditure for the year ended 31 March 2020. The surplus made by Scottish Water is reinvested in the provision of services to customers. Commentary and analysis of the financial performance of Scottish Water's regulated services is provided on pages 101 to 106.



Financial Performance Review

Financial Summary

The financial performance of Scottish Water's regulated activities is measured on a regulatory accounting basis. The following tables and commentary have therefore been presented on that basis. Where appropriate, reconciliations to Scottish Water's company results (as detailed in the Financials section on pages 152 to 187), including cross-references to the relevant notes to the financial statements, have been provided.

The *Regulated Income Statement* table opposite presents the results of Scottish Water's regulated business activities, on the regulatory accounting basis.

The regulated surplus before tax in the year was £128.0 million (2019: £105.4 million). This surplus is reinvested towards funding the capital investment programme and customer service improvements, as demonstrated in the chart on page 100.

The second table, *Reconciliation to retained surplus*, provides the reconciliation of Scottish Water's regulated surplus before tax to the Scottish Water company retained surplus for the year taken to reserves.

Regulated Income Statement	Note	2019/20 £m	2018/19 £m	Change £m
Turnover	2	**1,254.4**	**1,216.9**	**37.5**
Operating costs		(419.8)	(428.1)	8.3
PFI operating costs	4	(126.0)	(106.8)	(19.2)
Infrastructure maintenance costs		(126.3)	(130.0)	3.7
Depreciation & amortisation charges		(290.1)	(279.2)	(10.9)
Total costs		**(962.2)**	**(944.1)**	**(18.1)**
Operating surplus before interest		**292.2**	**272.8**	**19.4**
Finance costs - net		(146.3)	(148.2)	1.9
PFI finance charges		(17.9)	(19.2)	1.3
Regulated surplus before tax		**128.0**	**105.4**	**22.6**

Reconciliation to retained surplus	Note	2019/20 £m	2018/19 £m	Change £m
Scottish Water:				
Regulated surplus before tax (per table above)		**128.0**	**105.4**	**22.6**
Non-regulated surplus before tax		0.2	0.3	(0.1)
Retirement benefit obligation (*):				
Operating costs		(24.7)	(17.0)	(7.7)
Finance costs		(6.3)	(5.1)	(1.2)
Taxation		(66.1)	(16.4)	(49.7)
Retained surplus for the year	21	**31.1**	**67.2**	**(36.1)**

*These are non-cash adjustments required under International Accounting Standard 19 'Employee Benefits'

Revenue

Regulated revenue for the year totalled £1,254.4 million (2019: £1,216.9 million) and is analysed by category in the table opposite.

Revenue from services supplied to household customers increased by £22.0 million, or 2.5%, to £903.7 million reflecting the 1.6% tariff increase, effective from 1 April 2019, and the increase in properties connected to the network.

Revenue from wholesale services supplied to Licensed Providers increased by £14.6 million or 4.5% to £338.2 million reflecting an average tariff increase of 2% and a £15 million change in the income uncertainty provision, partly offset by a reduction in consumption by customers. Revenue from other sales increased by £0.9 million to £12.5 million, driven mainly by increased land rental income from hosted windfarm developments.

Household and wholesale annual tariffs are set in accordance with the Scheme of Charges as approved by the WICS, see Keeping Services Affordable section on page 93.

Regulated revenue	Notes	2019/20 £m	2018/19 £m	Change £m
Household		903.7	881.7	22.0
Wholesale		338.2	323.6	14.6
Other		12.5	11.6	0.9
Total regulated revenue	2	**1,254.4**	**1,216.9**	**37.5**

Operating Costs

On a regulatory accounting basis, total costs increased by £18.1 million or 1.9% to £962.2 million (2019: £944.1 million).

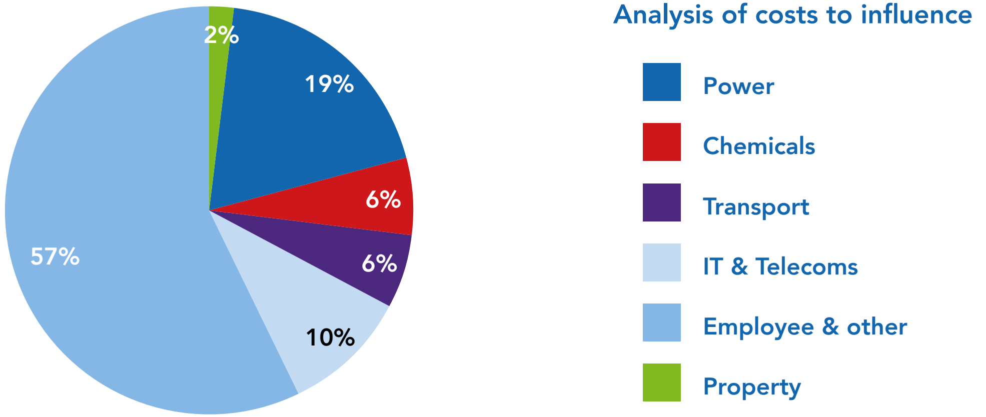
Operating costs decreased by £8.3 million, or 1.9%, to £419.8 million (2019: £428.1 million). However, after adjusting for specific cost movements and the impact of RPI inflation, like-for-like operating costs reduced in real terms by £6.0 million or 1.5% as listed in the table opposite.

Scottish Water is unable to influence approximately one third of its operating costs over the short-term. These include costs such as local authority rates, insurance and legislative costs. The pie-chart opposite illustrates the key operating cost components that Scottish Water is able to influence in the short-term. The diagram highlights that of those costs which Scottish Water is able to influence in the short-term, employment costs make up over 50%.

PFI operating costs in the year were £126.0 million (2019: £106.8 million). However, after excluding the benefit received in 2018/19 of the settlement of a commercial claim, the underlying increase of £5.4 million or 4.5% was due primarily to annual contract indexation.

Infrastructure maintenance costs were £3.7 million lower than in 2018/19 at £126.3 million, reflecting the demand driven profile of maintenance expenditure.

	2019/20 £m	2018/19 £m	Inc/(dec) £m	Inc/(dec) %
SW headline operating costs	419.8	428.1	(8.3)	**-1.9%**
Digital transition costs	–	(5.7)	5.7	
Brexit preparation costs	(0.3)	(1.7)	1.4	
Power price increases above inflation	(4.2)	–	(4.2)	
New legislative costs	(7.2)	(7.7)	0.5	
Incident and weather related costs	(1.4)	(10.7)	9.3	
Bad debt charges	(17.0)	(18.4)	1.4	
New operating costs	(1.9)	–	(1.9)	
Like-for-like controllable costs	**387.8**	**383.9**	**3.9**	**1.0%**
Average RPI inflation at 2.59%	–	9.9	(9.9)	
Like-for-like real costs reduction	**387.8**	**393.8**	**(6.0)**	**-1.5%**



Total depreciation and amortisation charges, net of the gain on sale from asset disposals, increased by £10.9 million to £290.1 million (2019: £279.2 million) due to the profile of capital investment and completed projects coming into beneficial use.

Finance Costs

As at 31 March 2020, the weighted average interest cost of the outstanding long-term debt within Scottish Water's regulated business reduced to 3.70% (2019: 3.98%). This was due to the repayment of £125.0 million loans with a weighted average interest rate of 5.22% offset by £344.3 million new and replacement loans drawn down during the year from the Scottish Government with a weighted average interest rate of 1.21%. Net interest payable in 2019/20 decreased by £1.9 million to £146.3 million.

Finance costs associated with finance lease liabilities on PFI assets were £1.3 million lower at £17.9 million reflecting the repayment pattern of the lease liabilities as they reduce year-on-year over the related contract periods.

During the year, net debt increased by £138.8 million to £3,537.5 million (being loans of £3,928.9 million less cash balances of £391.4 million). The increase was driven by net new borrowing from the Scottish Government of £219.3 million partly offset by an increase in cash balances of £80.5 million.

Capital Investment

Scottish Water's capital investment in the year, as reported in note 9 to the financial statements (Property, plant & equipment), was £502.7 million (2019: £503.4 million). When measured on a regulatory accounting basis, 2019/20 gross capital investment was £673.0 million (2019: £659.9 million). The table below reconciles investment as stated in the statutory accounts with investment on a gross regulatory accounting basis.

More information about Scottish Water's capital programme and projects is provided in Our Investment Programme on pages 87 to 92.

Capital Investment	2019/20 £m	2018/19 £m
2019/20 investment on a regulatory accounting basis	672.1	659.8
Add PFI capital additions	0.9	0.1
Total capital investment on a regulatory accounting basis	673.0	659.9
Less infrastructure maintenance included in operating costs (IAS 16)	(126.3)	(130.0)
Less investment financed by infrastructure charges & contributions	(44.0)	(26.5)
Company capital additions per note 9 to the financial statements	**502.7**	**503.4**

Performance Against the Regulatory Contract

Regulated Cash Performance

Within the regulated financial framework, Scottish Water aims to out-perform the targets set out in its Delivery Plan and the WICS' Final Determination for the 2015-21 regulatory period.

The closing cash balance forecast in the Final Determination for 31 March 2020 was £70.0 million. The actual cash balance at 31 March 2020 was £391.4 million. The £321.4 million increase in cash to the end of the financial year, compared to the Final Determination, is summarised in the table presented opposite.

In the year the regulated business generated additional cash of £105.2 million compared to the Final Determination. After adjusting for timing differences this provided a further £82.9 million to support the capital investment programme for customers. The out-performance in the year was driven primarily by additional revenue of £50.4 million, which was mainly attributable to the success of the GAPS project to maximise wholesale revenue collection and a £32.5 million decrease to interest costs. The decrease in interest cost reflected a sustained period of low interest rates compared to that assumed within the Final Determination.

Closing Cash	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	Total £m
Final Determination 2014	265.0	216.3	165.0	114.1	94.7	70.0	
Actual results	345.4	368.6	235.3	270.6	310.9	391.4	
Difference	**80.4**	**152.3**	**70.3**	**156.5**	**216.2**	**321.4**	
Generated/(utilised) in prior years	–	80.4	152.3	70.3	156.5	216.2	
Generated/(utilised) in year	**80.4**	**71.9**	**(82.0)**	**86.2**	**59.7**	**105.2**	**321.4**
Timing differences	50.5	9.3	(150.8)	2.8	(11.8)	22.3	(77.7)
Available to support investment	29.9	62.6	68.8	83.4	71.5	82.9	399.1
	80.4	**71.9**	**(82.0)**	**86.2**	**59.7**	**105.2**	**321.4**

Total cumulative timing differences, some of which may reverse out over the remainder of the regulatory period, are, £77.7 million at 31 March 2020 relative to the Final Determination. The increase in cash balances will, as set out in our 2020 Delivery Plan update, be used to:

- Support exceptional capital maintenance associated with the Ayrshire Resilience Scheme and Strategic Mains diversions;
- Augment allowances for additional regulatory outputs identified at the Investment Review carried out during 2018 (IR18); and
- Augment capital maintenance to address emerging risks to customer service and to manage any cost pressures in the overall investment programme.

Future Developments

In its 2020 Delivery Plan update, Scottish Water's out-turn cash balance at the conclusion of SR15 Investment was forecast to be £173 million, within a range of £120 million to £200 million. However, this plan update was prepared before the Covid-19 pandemic had started in Scotland.

As highlighted above, the performance in the first five years of the 2015-21 period has been strong. However, as the regulated business enters the final year of the 2015-21 period it faces significant financial challenges as a consequence of the Covid-19 pandemic. At this stage the impact of the pandemic is highly uncertain in terms of duration and the near-term and residual financial consequences.

The potential shortfall in cash receipts from customers could be significant and will be influenced mainly by household collection levels driven by customers cancelling direct debit payments and reductions in consumptions within the wholesale sector driven by business shutdowns. There will also be additional costs associated with delays in the delivery of the capital investment programme due to the closedown of construction sites and the introduction of new safe working and social distancing arrangements as capital projects are restarted, all of which will impact on the final cost of completing the 2015-21 capital investment programme.

Business Stream

Overview

Business Stream is Scottish Water's licensed retail subsidiary which supplies water and waste water services to business customers throughout Scotland and England. Business Stream is a wholly owned subsidiary of Scottish Water with its own Board and independent management team. Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings (SWBSH).

Revenue from this business segment totalled £477.7 million (2019: £372.1 million) (per note 3 to the financial statements). This represents 26.8% (2019: 23.0%) of the group revenue, before intercompany eliminations. The operating loss within this segment was £14.0 million (2019: £0.3 million profit) but this was after recognising a £13.2 million charge for doubtful debt provisions in relation to the anticipated impact of the Covid-19 pandemic on trade receivables, and £2.8 million of business transformation costs.

Strategic and Financial Framework

Business Stream is one of the Licensed Providers operating in the Scottish retail market and one of the retailers licensed to operate in the English market. The commercial strategy is to retain and grow market share by exploring options that will provide scale through a combination of acquisition and organic growth. With the aim of being the water and waste water services supplier of choice for businesses, Business Stream offers additional services, including water efficiency, waste water treatment solutions, new connections support, trade effluent consultancy, treatment hire plant and automated meter reading.

Within the Scottish Water group, the licensed and commercial activities are generally self-financing with any profits generated being retained and invested in future developments of the business. Where additional financing is required to fund operations and planned expansion, Business Stream is limited to borrowing from SWBSH, subject to the appropriate board approvals.

Performance Review

In October 2019, Business Stream completed the acquisition of Yorkshire Water Business Services (YWBS) 140,000 non-household customers. This acquisition has almost doubled Business Stream's market share and, alongside organic growth, has helped cement the company's position as the second largest water retailer in the UK market.

In Scotland, Business Stream remains the market leader. In January 2020, it was confirmed that Business Stream had successfully secured the Scottish Public Sector Framework Contract for Water and Waste Water Billing Services, effective from 1 April 2020. The three-year contract is worth around £200 million and covers public sector bodies across Scotland.

Both retail water markets continue to present opportunities and challenges. In England, whilst the market offers huge growth opportunities, the operating environment remains challenging for retailers. The quality of the market data, the complexity of the wholesale charging structures and the low retail margins are all widely acknowledged as issues that need to be addressed to enable the market to function in a more resilient and effective manner. Concerns over the longer-term resilience of the retail market have also been heightened as a consequence of the Covid-19 pandemic.

The introduction of the Covid-19 lockdown measures towards the end of March 2020 is presenting unprecedented challenges to businesses and the wider economy. It is difficult to predict what the medium to long-term financial impact will be on Business Stream of a sustained period of reduced revenue, customer payment default and increased bad debt exposure although the immediate impact on reduced cash flows is already apparent.

Whilst Business Stream's balance sheet was strong and debt free at 31 March 2020, Business Stream recognised that there would be a potentially significant financial impact on its business. Consequently, Business Stream has developed a number of financial scenarios to assess the potential range of financial impacts of the pandemic on its business. These were shared with its shareholder, SWBSH, as part of a formal funding request to ensure that the business has access to the necessary facilities to meet the shorter-term liquidity impacts which will arise as a result of the pandemic.

Financial Performance

Business Stream reported a loss before tax of £12.9 million (2019: £1.3 million profit) for the year. This was as a result of recognising a £13.2 million charge for doubtful debt provisions in relation to the Covid-19 pandemic.

The reported results include the 6 months of trading activity for the newly acquired Yorkshire non-household customer book following legal completion on 1 October 2019. This was reflected in the increase both in revenue for the year (£477.7 million; 2019: £372.1 million) and the related operating costs.

Expenditure included £2.0 million of amortisation charges (2019: £3.2 million), in relation to the Southern Water and Yorkshire acquisitions where the intangible assets are following an 8-year amortisation approach. The reduction in the year-on-year charge was due to the reassessment of the Southern Water intangible asset from 5-year to 8-year amortisation.

Cash balances were £59.8 million at 31 March 2020 (2019: £40.7 million).

Future Developments

As a water retailer, Business Stream's role is to deliver great service for its customers and to deliver a positive return for its shareholder. As a progressive business, its ambition is to make a positive difference to its customers, its people, the environment and the local communities that it operates within, as well as helping contribute towards the Scottish Government's ambitious net zero carbon targets.

To fulfil its ambitions, Business Stream has launched a wide range of initiatives, including aligning its business plan to the Community Responsible Business Map. The map is designed to help responsible businesses assess the contribution they make to the United Nations Sustainable Development Goals, with a key focus on supporting healthy communities and a healthy environment.

Over the last three years Business Stream's customer base has grown by over 200%. In order to provide excellent levels of services to its customers and improve operational efficiency, Business Stream is embarking on a business-wide transformation programme. The transformation programme will include significant investment in systems, processes and people. However, this programme may be impacted if there are further significant consequences of the Covid-19 pandemic.

Non-Regulated Businesses

Overview

Our non-regulated business activities are governed and monitored within Scottish Water Horizons Holdings (SWHH) and mainly operate through Scottish Water Horizons (SWH) and the North-East Scotland PFI waste water treatment operations, which were acquired in December 2018.

Revenue from this business segment totalled £49.1 million (2019: £27.7 million) (per note 3 to the financial statements). This represents 2.8% (2019: 1.7%) of the group revenue, before intercompany eliminations. Operating profit within this segment was £5.0 million (2019: £0.6 million). This reflects £5.4 million operating profit from North-East Scotland PFI waste water activities, (before interest charges of £3.1 million) a £0.6 million profit from SWH activities and the charging of costs associated with the Your Water, Your Life campaign and the Learn to Swim programme in partnership with Scottish Swimming. 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.

Scottish Water Horizons

Strategic and Financial Framework

The activities of SWH are aligned to support Scottish Water's core objectives, with particular emphasis on supporting its innovation agenda, carbon reduction targets and renewable energy ambitions. The main objectives of the business activities within SWH are to harness the skills and expertise of our people and use innovative ideas, knowledge and Scottish Water assets to encourage economic growth across Scotland, develop the use of sustainable technologies and provide water and waste water consultancy services to utilities, governments and other international clients.

Performance Review

It has been a challenging year for SWH with profit before tax for the year of £0.6 million (2019: £0.8 million). The main factors contributing to the reduction were:

- Implementing a recovery plan for the Deerdykes food waste recycling centre to improve the resilience of the plant.
- Delayed starts to four key development projects, which are now underway and are due to be completed during 2020/21.
- Delays in respect of both existing international contracts and prospective bids resulting in the decision to stop further business development in Ireland.

Highlights from the year include:

- Completion of the Stirling energy centre, in collaboration with Stirling Council, to provide power to the local waste water treatment works and heat into a new district heating network.
- The launch of a new collaboration agreement to support the design and build service for pumping stations provided to developers using an intelligent control system. This ensures new developments have more energy efficient assets and reduces the number of potential operational interruptions.
- Increasing the pipeline of research and testing opportunities at our Water and Waste Water Development Centres to support innovation and growth in the water industry.

A further investment of £1.8 million in renewable energy schemes bringing delivered output of renewable energy generation since April 2015 to 5.7 GWh.

Future Developments

Detailed plans are in place to mitigate where possible the impact on the safety, health and wellbeing of our people as well as the impact on cash flow because of the current Covid-19 pandemic on the business.

The Covid-19 pandemic is impacting significantly on the food stock available for the Deerdykes recycling plant, and this will impact on the performance of that plant in 2020/21. Similarly, the current construction restrictions will also impact on various developer projects and their completion.

North-east Scotland Waste Water PFI

Strategic and Financial Framework

On 19 December 2018, SWHH acquired the companies that operate waste water treatment works in the North East of Scotland which are being managed under a Private Finance Initiative (PFI). The PFI project consists of the concessionaire, Aberdeen Environmental Services (AES) and the operator, Scottish Water Services Grampian who run the four waste water treatment works under contract to Scottish Water. The acquisition enables opportunities for Scottish Water to deliver value for customers through changes including shared purchasing with Scottish Water's waste water operations and optimisation of the works with waste water networks.

Performance Review

In the first full financial year within the Scottish Water group, the North-East Scotland PFI companies returned an operating profit for the year of £5.4 million (2019: £2.1 million, from acquisition on 19 December 2018). Interest charges for the year were £3.1 million (2019: £1.0 million, from acquisition date) in respect of the external loans held by AES.

STREAMLINED ENERGY AND CARBON REPORTING (SECR)

Energy consumption data is dominated by electricity use by Scottish Water core business. This is from metered data, properly documented and recognised as the best method of assessment, with an accuracy range of between +/- 5% and +/- 1%. Natural gas consumption and exported Renewable Energy Guarantees of Origin (REGO) electricity are similarly calculated from metered data. Fuel is predominantly used in Scottish Water core business owned and leased (Scope 1) vehicles and is from measured fuel volumes. A small amount of transport data was unavailable this year, it is not possible to provide an estimate of the value, but it is not significant relative to other emissions and we will amend processes to capture this information in further years.

Energy consumption (kilowatt-hours (kWh)) of fuels is calculated using the densities and net calorific values (CVs) in the Defra, BEIS 2019 Government Greenhouse Gas Conversions Factors for Company Reporting, Version 1.2 (with the exception of two minor fuel sources, calculated from older references).

Greenhouse gas emissions are likewise calculated using Defra emissions factors.

The operational carbon footprint (CFP) of the Scottish Water core business, which we have been reporting annually for 14 years, has a different boundary from this SECR. The operational CFP can be found in the Beyond Net Zero Emissions section, pages 81 to 86. This is further detailed within our Public Bodies Climate Change Duty Report which is submitted to the Scottish Government in November of each year, and in our carbon footprint report published on our website.

The boundary of the CFP is of the regulated business only, which excludes other parts of the Scottish Water Group (except the North-East Scotland Waste Water PFI) and includes waste water treatment works operated on Scottish Water's behalf by Private Finance Initiatives. In addition, the CFP includes more sources of emissions than this SECR, such as water and waste water process emissions and public transport. In contrast, this SECR includes the whole Scottish Water Group of companies but excludes PFI activities, except the North-East Scotland Waste Water PFI. The two sets of emissions are therefore not comparable.

Scottish Water Group	Current Reporting Year 2019/20	Comparison reporting year 2018/19
GROSS Energy Consumption (to the nearest 10,000 kWh)	546,320,000	536,300,000
NET Energy Consumption (to the nearest 10,000 kWh)	519,270,000	512,010,000
Emissions from combustion of gas (tCO_2e)	2,762	1,614
Emissions from combustion of other on-site fuels (tCO_2e)	4,075	3,678
Emissions from combustion of fuel for transport purposes (tCO_2e)	13,236	13,571
Emissions from business travel in rental cars or employee-owned vehicles where company is responsible for purchasing the fuel (Scope 3[1]) (tCO_2e)	1,091	1,149
Emissions from purchased electricity (Scope 2[2], location based) (tCO_2e)	127,825	140,704
Total gross tCO_2e based on above	148,989	160,717
Intensity ratio: tCO_2e gross figure based from mandatory fields above per £1 million revenue	92	109

[1] Scope 3: Indirect emissions: business travel by private vehicles used for company business

[2] Scope 2: Indirect emissions: use of grid electricity.

Energy Efficiency Actions

The majority of energy efficiency actions by Scottish Water Group in 2019/20 were undertaken by Scottish Water core business and are reported in the Beyond Net Zero Emissions section on pages 81 to 86. Actions taken by other parts of the group include:

- Cleaning of digesters at one of our largest waste water treatment works, within the North-East Scotland Waste Water PFI, leading to an increase in biogas production and a consequent reduction in grid electricity use.
- Upgrading the SCADA system at our Horizons recycling centre, providing improved visibility of generation and consumption that will improve the efficiency of the plant.
- Resetting the communal area BMS system in Business Stream's main office, ensuring energy is not used when the office is closed.
- In addition, Business Stream is working towards obtaining accreditation against the environmental standards set by ISO 14001 and has set an energy reduction target of 10% for 2020/21.


GOVERNANCE

BOARD MEMBERS
2019/20 BOARD MEMBER BIOGRAPHIES

Executive Members

Douglas Millican, Chief Executive

Douglas was appointed as Chief Executive in 2013 having previously been Finance and Regulation Director since Scottish Water was formed in 2002. He was formerly with East of Scotland Water and, prior to this, he worked with Price Waterhouse and Tyco. Douglas is Vice Chair of World Vision UK. He is a Chartered Accountant with a BCom from the University of Edinburgh and is an Associate Member of the Association of Corporate Treasurers.

Peter Farrer, Chief Operating Officer

Peter was appointed as Chief Operating Officer in 2013 having formerly been Customer Service Delivery Director, General Manager of Asset Planning and Business Performance and General Manager of Operations. Prior to this he held various operational and engineering roles within Scottish Water's predecessor organisations, East of Scotland Water and Lothian Water and Drainage. He has 35 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.

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. He was Finance Director of Miller Construction for 8 years and has also held Finance Director positions in the oil service industry. He 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.

Non-Executive Members

Dame Susan Rice DBE

Dame Susan was appointed Chair of Scottish Water on 1 June 2015. She is also Chair of the Scottish Fiscal Commission, the Banking Standards Board, Senior Independent Director of J Sainsbury Plc and of the North American Income Trust. She was a member of the First Minister's Council of Economic Advisors, Managing Director of Lloyds Banking Group Scotland and previously Chief Executive and then Chair of Lloyds TSB Scotland plc. She is also the Chair of Business Stream and has held a range of other senior Non-Executive appointments, including a 7 year term as a Non-Executive Director of the Bank of England and 11 years as a Non-Executive Director of SSE plc. She sits on the Court of Edinburgh University and the Advisory Board of the UK's Place-based Climate Action Network.

Samantha Barber

Samantha Barber has worked at CEO and Board level in both the UK and internationally for over 20 years. She worked in Brussels as a Policy Advisor in the European Parliament for 4 years and was CEO at Scottish Business in the Community for 9 years. Samantha took up her first Non-Executive Director position in 2000 joining the Board of Right Track in Glasgow.

She also joined the Scottish Power Advisory Board in 2007 and was appointed to the main Board of the parent company, Iberdrola, in 2008 where she is currently Chair of the Sustainable Development Committee and a member of the Executive Committee. Samantha is also Chair of the Scottish Ensemble and an Advisory Board member at Imperial College London.

James Coyle

James is a Non-Executive Director and Chairman of the Audit Committee of HSBC Bank Plc, Chairman of HSBC Trust Co (UK) Ltd and Marks and Spencer Unit Trust Management Limited. He is also a Non-Executive Director and member of the Audit and Risk Committees of M&S Bank Plc and HSBC Private Bank (UK) Limited. He is also a member of the Board and Chairman of the Audit Committee of Honeycomb Investment Trust Plc, and an independent non-executive member of the Deloitte UK Oversight Board. His former appointments include: Deputy Finance Director for Lloyds Banking Group; Group Chief Accountant of Bank of Scotland; member of the Audit Committee of the British Bankers Association; a Director of Scottish Financial Enterprise; a member of the Board and Chairman of the Audit Committee of Vocalink Plc, a member of committees of the Financial Reporting Council, the ICAS Council, a Non-Executive Director of the Scottish Building Society and a member of the Board of Worldfirst and Chair of its Audit and Risk Committee.

Iain Lanaghan

Iain Lanaghan is an experienced Non-Executive Director and former Main Board finance director. He is also a Non-Executive Director of UK MOD Defence Equipment and Support agency (DE&S) and of the UK Oil and Gas Authority. His previous Non-Executive Director roles have included UK National Nuclear Laboratory and Cabot Energy plc. Previously, he was Finance Director of FirstGroup plc, Faroe Petroleum plc, PowerGen International and Atlantic Power. He is a member of the Institute of Chartered Accountants of Scotland, having qualified with KPMG in London.

Ken Marnoch

Ken brings 29 years of energy industry experience having worked for Shell since graduating from Heriot-Watt University in 1988. Initially based offshore in the North Sea and onshore in Aberdeen, and subsequently 17 years in assignments overseas. His recent roles include leading regional and country businesses in the Gulf of Mexico, USA and Brunei, South-East Asia focusing on corporate responsibility, safety, bottom line delivery, digitalisation and investment in people. His international career has also included leading Internal Audit, major asset and infrastructure project delivery, strategic planning, managing Government and corporate joint ventures and delivering significant organisational change.

Deirdre Michie OBE

Deirdre was appointed CEO of OGUK in May 2015. She has an LLB Hons in Scots Law and extensive experience as a senior business leader in the global energy sector; Deirdre is a Non-Executive Director of Scottish Water, a Board member of Opportunity North East, a member of the Scottish Government's Energy Advisory Board and a member of the Women's Business Council, a UK Government body focused on increasing women's contribution to economic growth. Previously Deirdre was a Board member of the North East of Scotland College (NESCOL) and Chair of the Aberdeen Science Centre. In 2018, Deirdre was awarded an OBE for her services to the Oil and Gas industry in the Queen's Birthday Honours. Deirdre was also awarded a Fellowship from NESCOL in 2018 and is a Burgess of Aberdeen.

Matt Smith OBE DL

Matt is the former Scottish Secretary of UNISON and STUC President. He is a member of: the Scottish Police Authority; the Employment Appeal Tribunal; the Central Arbitration Committee; the ICAS Regulation Board and CIPFA's Investigation Committee. He is a Fellow of the Scottish Council for Development and Industry and a former member of the Scottish Standards Commission, the Scottish Human Rights Commission and the Broadcasting Council for Scotland. Matt served as a Justice of the Peace for over 30 years and is a Deputy Lieutenant for Ayrshire and Arran.

Paul Smith

Paul currently has a portfolio of Non-Executive and Advisor roles across the Energy, Infrastructure and Utility sectors. He chairs the Board of Capstone Infrastructure Corporation, is a Non-Executive Director of South East London CHP, and also a Non-Executive Director of Orbital Marine Power Ltd. He is also Senior Advisor to Icon Infrastructure LLP. Prior to this Paul was Managing Director of Generation at SSE plc. He is a Chartered Chemical Engineer from Edinburgh University with an MBA from Henley Management College. He is a Fellow of both the Institute of Chemical Engineers and the Energy Institute.

CORPORATE GOVERNANCE REPORT

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 this report and their biographies are set out on pages 113 to 116.

Executive Board appointments are based on merit and 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 Public Appointments team of the Scottish Government in accordance with the Code of Practice published by the Commissioner for Ethical Standards in Public Life in Scotland, which is applicable to all public appointments.

The Board of Scottish Water comprised 11 members: 8 Non-Executive Board Members and 3 Executive 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 also benefits from the expertise of its Non-Executive Board 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 2019/20, 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 revised UK Corporate Governance Code published by the Financial Reporting Council (FRC) in July 2018, 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 Financial Conduct Authority (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 122 to 127 covers the appointment of the external auditor.

Board and Committees

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

	Board		Audit Committee		Remuneration Committee	
	Held	Attended	Held	Attended	Held	Attended
Dame Susan Rice	10	10	–	–	–	–
Samantha Barber	10	9	–	–	3	3
James Coyle	10	9	5	5	–	–
Peter Farrer	10	10	–	–	–	–
Iain Lanaghan	10	10	5	5	–	–
Ken Marnoch	10	9	–	–	3	3
Deirdre Michie	10	9	5	4	–	–
Douglas Millican	10	10	–	–	–	–
Alan Scott	10	4	–	–	–	–
Matt Smith	10	10	–	–	3	3
Paul Smith	10	9	5	5	3	3

Notes:

(i) Mr Scott had a six month absence from Scottish Water during the year due to ill health, returning to work in March 2020.

Audit Committee

The Audit Committee reviews the financial reports of Scottish Water and considers the results of the auditor's 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 and Assurance Committee Handbook. Each year the Committee presents a report of its activities to the Board prior to the Board's consideration of this report.

A more detailed report of the Audit Committee's activities is provided on pages 122 to 127.

Remuneration Committee

The Remuneration Committee, in accordance with the requirements of the Scottish Water Governance Directions 2009 (as amended), 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 considers appropriate. A more detailed report of the Remuneration Committee's activities is provided on page 128.

Board and Committee Performance

An internal review of Board and Committee effectiveness was carried out during the financial year of 2019/20 and actions arising from it have been 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. An external review of Board and Committee effectiveness will be undertaken during the financial year of 2020/21.

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 Members are:

Douglas Millican Chief Executive

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 (as amended). 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.

Risk Management

Scottish Water operates a systematic approach to managing risk which is detailed more fully in pages 24 to 42. These risk management processes have been in place for the full year under review and up to the date of approval of this report and financial statements.

As part of the risk management system, Scottish Water has established a comprehensive risk management policy which sets out a consistent approach to the management of risk within the organisation and clearly defines our risk appetite.

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

The business identifies risks at corporate, directorate and functional levels. Risks are evaluated and prioritised by considering their consequences and likelihood. They are then assessed against Scottish Water's risk appetite and managed effectively to ensure the achievement of service delivery and business objectives. Existing arrangements for managing the risks are considered and, where these are not assessed to be effective, action plans are established which aim to achieve the appropriate balance between risk and control.

Risks are managed in a reasonable and prudent manner, having regard to Scottish Water's risk appetite, the current regulatory framework in which we operate, and the resources available to us.

The Corporate Risk Register is reviewed bi-annually by the Executive Leadership Team, Audit Committee and Board, supplemented by a further two reports which review the status of the most significant business risks. The Corporate Risk Team periodically reviews supporting risk management processes, with approval by the Audit Committee.

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.
- A statement of general principles pertaining to rules and procedures for the regulation of the business.
- 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.
- Close monitoring undertaken by the Board and management of safety, health and wellbeing issues.

High quality personnel are viewed as an essential part of the control environment. Ethical behaviour is incorporated into conditions of employment. Demanding recruitment criteria, pre-employment vetting and, where required, additional government security checks, combine with the development and training of our people to support 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.

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 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 Auditor

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

Independence of External Auditor

The Auditor General for Scotland is responsible to the Scottish Parliament for securing the audit of the financial statements of Scottish Water. The Auditor General for Scotland appointed KPMG LLP as the auditor of Scottish Water for the financial years 2016/17 to 2021/22.

Under the terms of KPMG LLP's appointment, they may not carry out any non-audit work for Scottish Water without the prior approval of Audit Scotland, and must comply with Scottish Water's policy on provision of non-audit services (see page 127).

AUDIT COMMITTEE REPORT

Annual statement by the Chair of the Audit Committee

I am pleased to present this report covering the role and function of the Audit Committee for the year ended 31 March 2020. I am the Chair of the Audit Committee and during the year I was supported by 3 other Non-executive Members; Iain Lanaghan, Deirdre Michie and Paul Smith. I have relevant financial experience and my Committee members have been selected with the aim of providing the wide range of financial, governance and commercial expertise necessary to fulfil the Committee's duties and obligations. Emma Campbell, Scottish Water's Group Legal Counsel, is Secretary to the Committee and during her absence on maternity leave Susan Hill performed this role.

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 and assessment 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.

Scottish Water business strategy and Regulated Delivery Plan

Risk appetite

Risk management reporting

Assurance and assessment

The Committee's main responsibilities are to oversee and report to the Board on:

- The strategic processes for the assessment of risk, control and governance and their effectiveness;
- The accounting policies, the financial statements, and the interim Accounts and Performance & Prospects reports;
- The planned activity and results of both internal and external audit, including approval of the annual Internal Audit plan and strategy and annual Cost Audit plan;
- The adequacy of management response to issues identified by audit activities;
- The assessment of the effectiveness of the internal control environment;
- The corporate governance requirements for the organisation;
- Anti-fraud policies, whistleblowing processes, arrangements for special investigations and activities and reports by the Business Ethics Committee;
- Scottish Water's arrangements for complying with legislation and Directions issued by the WICS, including the Annual Return;
- The annual plan and report prepared by the compliance officer;
- The annual statement published by Scottish Water under the Modern Slavery Act 2015; and
- The annual tax strategy and statement.

The Terms of Reference of the Committee are approved by the Board and in accordance with the Scottish Government Audit and Assurance 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 per year, 2 of which are co-ordinated with external reporting timetables. During 2019/20 the committee met on 5 occasions, with an extra meeting in May 2019 to focus on corporate reporting requirements.

In addition to the Committee members, the Board Chair, Chief Executive, Finance Director, Head of Internal Audit, Group Financial Controller, General Manager Revenue & Risk, Director of Digital and the external audit partner also attend the meetings by invitation. The Committee invites other senior management to present to the Committee on a regular basis on a variety of topics relevant to its work. In line with best practice, the Committee meets in private, excluding any Executive Members, with the external auditor and the Head of Internal Audit at least on an annual basis, or more frequently if required.

The Committee's Activities

The Committee agrees an annual work programme including reports to be received from senior management, Internal Audit and external audit during the year. As well as the normal financial reporting activities, the Committee's main activities during the year included the following:

- Reviewing compliance with the 2018 UK Corporate Governance Code;
- Assessment of risk management controls covering risk appetite and business culture, risk management and control systems, the monitoring and review thereof including sources of assurance and associated public reporting covering going concern and future viability;
- Discussing the work, the issues and management actions in Internal Audit reports;
- Outcomes of investigations resulting from fraud allegations, whistleblowing and results from the Audit Scotland National Fraud Initiative;
- Forming its view of the "fair, balanced and understandable" and viability reporting obligations; and
- In March 2020, the Committee's activities included consideration of Scottish Water's Covid-19 short and medium-term risk assessment.

Covid-19 Pandemic

- The Committee at its meetings in March and May 2020 considered the risks associated with the Covid-19 pandemic which will have a significant impact on the future finances of the group beyond 2019/20. The current and residual impact of the pandemic is highly uncertain on the Group and in particular Business Stream. The Scottish Water Business Stream Holdings Ltd (SWBSH) Board will monitor Business Stream's recovery plan for 2020/21 and beyond, receiving regular progress updates from Business Stream.
- The Audit Committee will keep the whole group financial position under active review by monitoring the position in Scottish Water and relying on the SWBSH Board to monitor the position in Business Stream with cash updates at least monthly to the SWBSH Board.

This combined with the format and agreed sources of the financial support for Business Stream has enabled the issuing of a letter of financial support to Business Stream from SWBSH in connection with their 2019/20 financial statements, thus allowing them to be prepared on a going concern as at 17 November 2020.

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 Accounts and the Annual Report and Accounts: Performance & Prospects:

- The appropriateness and quality of accounting policies;
- 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 the external auditor 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 also considered and was satisfied with the papers prepared by the Group Financial Controller and the external auditor covering the financial statements for full year 2019/20. These included a section from Management supporting the going concern basis which the external auditor confirmed was appropriate. Our view was supported by statutory and regulatory provisions applicable to Scottish Water, namely that:

- Ministers have commissioned the WICS to do a strategic review for 2021-27;
- The Scottish Government want the industry to be financially sustainable for the long-term which requires Scottish Water to be adequately funded to meet its future challenges and that Scottish Water can count on those resources being available;
- Under the Water Industry (Scotland) Act 2002, Scottish Water is deemed to have exercised their core functions effectively in making use of those resources to achieve the ministerial objectives and do so at the lowest reasonable cost;
- The WICS have a duty, under the same legislation, to ensure Scottish Water's receipts are sufficient to meet the expenditure required for Scottish Water to exercise its core functions; and
- The legislation therefore ensures, as far as possible, that Scottish Water will be sufficiently funded to meet its core functions, including the power to apply to the WICS to increase Scottish Water's charges if there is a material change in Scottish Water's ability to finance expenditure on core functions.

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 SWBSH. The Board of SWBSH has several Directors in common with Scottish Water and receives reports from Business Stream's management covering financial performance and specific risks facing Business Stream. The main risks covered were the impact of competition within the Scottish business retail market, its strategy for developing growth opportunities in the English business retail market and latterly the assessment of the specific risks identified as a consequence of the Covid-19 pandemic that will have an impact in 2020/21 and potentially beyond.

The primary areas of judgement considered by the Committee in relation to the 2019/20 Accounts were:

- Risks within the corporate risk register which could impact on the financial statements and judgements therein;
- The primary areas of focus included the sensitivities on future household cash collection rates, the associated level of bad debt provisioning;
- The delivery costs associated with Scottish Water's capital investment programme and the associated expenditure classifications;
- Revenue recognition, in particular within the wholesale operational arena, including the impact of the vacant charging regime and the move to live rateable values for charging purposes; 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 £12 million, representing 1% of total expenses, incurred in 2018/19 (excluding interest), in the consolidated income statement for 2019/20. However, the Committee agreed with the external auditor that the firm would report any misstatements identified during the audit above £250,000, as well as misstatements below that amount that, in their view, warranted reporting for qualitative reasons.

In addition, the General Manager Strategy and Economic Regulation, the Head of Internal Audit and the General Manager Revenue and Risk carried out a review to verify that the Annual Report & Accounts 2019/20: Performance and Prospects is fair, balanced and understandable, the results of which were considered by the Committee prior to recommending Board approval of the Annual Report & Accounts 2019/20: Performance and Prospects.

Consequently, and supported by a comprehensive management and statutory accounts process, with written confirmations provided by senior management on the 'health' of the financial and risk control environment, the Committee and the Board are satisfied that the Annual Report & Accounts 2019/20: Performance and Prospects, taken as a whole, are fair, balanced and understandable, and provide the information necessary to assess Scottish Water's performance, business model and strategy.

Scottish Water's Internal Control and Risk Management Processes

Over the year the Committee received papers from Group Finance associated with the 2018 Corporate Governance Code, one of which included a risk management assessment control schedule. This schedule included a detailed 23-point checklist supported by a detailed record of evidence sources and satisfaction ratings of that evidence.

Evidence sources were grouped into 6 categories including risk register and management processes, policy and procedure processes, assurance statements and independent reviews.

In addition, 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;
- Reports covering the quantitative and qualitative stress testing of the principal risks facing the Scottish Water group of companies;
- Topical in-depth risk assessments;
- Bi-annual report from the Business Ethics Committee;
- An annual report from the compliance officer;
- An annual corporate governance report;
- An Internal Audit annual opinion and report;
- An annual report on regulatory compliance;
- An annual statement of compliance with the Modern Slavery Act 2015; and
- An annual Tax strategy.

During the year the Committee requested specific reports on cyber risks including cloud computing and resilience, SR21 Delivery Assurance Framework, the wholesale revenue operational arena and fraud investigations. In addition, a specific Covid-19 in-depth risk assessment was carried out and presented in March 2020 and remains under ongoing consideration.

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 annually the Internal Audit Charter and the annual Internal Audit plan, with any subsequent changes requiring Committee approval. It also reviews the scope and results of Internal Audit reviews and its effectiveness throughout the year, including implementation of recommendations following the external quality assessment by the Institute of Internal Auditors in 2019. At each main 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, fraud allegation investigations and details of relevant Audit Scotland reports. 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

The Auditor General for Scotland is responsible for the appointment of the Scottish Water external auditor and undertook a robust tender and assessment exercise for Scottish Water and many other public sector organisations, which resulted in the appointment of KPMG as Scottish Water's external auditor for a 6-year period from 2016/17 to 2021/22.

The Committee received from KPMG 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.

Auditor Independence

During 2015/16, the Committee approved a policy on provision of non-audit services to Scottish Water by the firm appointed as external auditor and this was extended to all subsidiaries in 2016/17.

The Committee monitors implementation of the policy through receipt of a report every 6 months, or as required, analysing fees paid for any non-audit work by the external auditor, with additional commentary on assignments and on work carried out or to be done relating to safeguards of independence.

Having considered compliance with our policy, the Committee is satisfied that KPMG has remained independent.

James Coyle
Chair of the Audit Committee

REMUNERATION COMMITTEE REPORT

Annual Statement by the Chair of the Remuneration Committee

I am pleased to present the Members' remuneration report for the year ended 31 March 2020, in the preparation of which I am thankful for the support of fellow Remuneration Committee and Non-executive Members, Matt Smith, Paul Smith and Ken Marnoch.

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 three meetings of the Committee in 2019/20. At each meeting a quorum of independent, Non-executive Members was present. No Executive Member was present during discussions about their own remuneration.

As required, the Committee receives internal advice and information from the Chair of Scottish Water, the Chief Executive, the Director for People, and the Group Legal Counsel.

We maintain and 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 2019/20 period were as follows:

Decisions/remuneration for 2019/20

- Agreeing the base salary increase of 1.5% plus £1,600 for Executive Members and Chief Executive from 1 April 2019.
- Confirming the 2019/20 AOIP payment calculated at 36% out of the 40% maximum opportunity for Executive Members and Chief Executive.
- Agreeing changes to the reporting of CEO/employee pay ratio data in the 2019/20 remuneration report, with reference to the Companies (Miscellaneous Reporting) Regulations 2018.
- Noting management's proposed salary increases for Scottish Water employees.
- Review of succession planning for posts on the Executive Leadership Team.

Decisions/remuneration for 2020/21

- Agreeing base salary increases for Executive Members, with effect from 1 April 2020, at £2,000 in line with the Scottish Government's Public Sector Pay Policy.
- Setting the performance criteria for the 2020/21 AOIP.

Our Remuneration Policy and our Performance & Prospects Report on Remuneration is set out on pages 128 to 140.

Samantha Barber
Chair of the Remuneration Committee

MEMBERS' REMUNERATION REPORT

The presentation of this Remuneration Report complies with the HM Treasury Financial Reporting Manual 2019/20 (December 2018) and, as far as is appropriate, also adopts the same practice as quoted companies even though Scottish Water is not a quoted company.

1. Statement of Executive Remuneration Policy

a. General Policy

Scottish Water's purpose is to support a flourishing Scotland through being trusted to care for the water on which Scotland depends. Building on past success, we seek to provide levels of service, out-performance and efficiency which exceed the expectation of customers, regulators and the Scottish Government.

Scottish Water will continue to provide a working environment that matches the expectations placed on our people to deliver best value outcomes in an empowered organisation. 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 the organisation is perceived as a fair employer that encourages excellence, rewards performance and empowers its people while providing scope for personal development.

The 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 as well as out-performance.

b. Remuneration Elements

The Remuneration Policy for Executive Members consists of five 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-driven business, where Executive Members' remuneration should be closely linked to corporate performance and out-performance.

The aim is to pay a base salary that is competitive, but appropriate for a public corporation. Incentive pay is earned for exceeding demanding targets in the Delivery Plan, with the required degree of out-performance reviewed on an annual basis.

d. Base Salary

Scottish Water is publicly owned and accountable to the Scottish Parliament and Scottish Ministers. Within the context of public sector ownership, the company 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 Korn Ferry Hay Group 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. The aim is to pay in line with 95% of the median of an agreed industry benchmark group, reflecting remuneration levels in comparable organisations for similar work.

In addition, bespoke benchmark analysis is carried out approximately every three years and when last undertaken by Mercer in November 2018, showed that Executive Members' base salaries were below 70% of an industry median, a deterioration of the comparative position indicated three years previously.

e. Annual Out-Performance Incentive Plan

Scottish Water has an AOIP designed to incentivise and reward the out-performance of targets agreed with regulators. Targets are set out in the Delivery Plan for the regulated business that has been approved by Scottish Ministers and reflect those set by the WICS in its Final Determination of charges.

The Remuneration Committee maintains the right to withhold or vary AOIP payments (potentially to zero) should events undermine the financial stability or reputation of Scottish Water. Such variation may be carried out at any time prior to AOIP payments being made and may affect all or only some of the AOIP recipients. During 2019/20 there was no requirement to exercise these step-in rights.

The potential maximum annual incentive attainable for out-performance by Executive Members is 40% of base salary and is non-pensionable. Delivery Plan targets, out-performance targets, and actual performance in 2019/20 are set out on the following page.

Measure	Weight	Delivery Plan Target	Out-performance target	Actual performance
Regulated financial surplus before tax ex. depreciation	40%[1]	£429m	Financial surplus before tax and depreciation to exceed Delivery Plan by £0 to £50m. Sliding scale with 0% at Delivery Plan figure and 100% at +£50m.	£488m
Customer service OPA performance	25%	384 to 400 points	Overall Performance Assessment (OPA) based on sliding scale discussed with Customer Forum where, for 2019/20, the Leading score is 384 points and Best in Class is 400 points. Below leading score 0%; at leading score 30%; at best in class 90%; beat best in class 100%.	402 points
Customer Experience Measure	20%	Exceed 82.6 hCEM points	Improvement in the Household Customer Experience Measure (hCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 82.60 points; 30% payable at 82.60 points; 100% payable for greater than or equal to 87.82 points.	88.02 points
	5%	Exceed 73.74 nhCEM points	Improvement in the Non-Household Customer Experience Measure (nhCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 73.74 points; 30% payable at 73.74 points; 100% payable for greater than or equal to 82.0 points.	85.19 points
Customer Benefit – Overall Measure of Delivery	10%	Exceed 209 points	Exceed the target Overall Measure of Delivery (OMD) of 209 points and ensure forecast capital programme cost is within the regulatory allowance[2].	215 points; programme cost outside of regulatory allowance

Notes

(1) Financial surplus is a gateway on the AOIP scheme i.e. payments must be funded from financial out-performance; the Delivery Plan figure will be as updated for inflation and regulatory out-turn assumptions.

(2) 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 (LTIP) to Incentivise Out-Performance in the Six Years to March 2021

The 2015-21 LTIP has been agreed with the Scottish Government and provides clear targets for out-performance of the WICS' Final Determination for the 2015-21 period. The LTIP is funded by 10% (2010-15 LTIP: 12%) of base salary that will be in payment at the end of the performance period being accumulated each year during the 6 years to March 2021, ultimately vesting as determined by the performance targets opposite and being paid as a single sum at the end of the 2015-21 period. Any LTIP payment is funded from financial out-performance after payment of any incentive awards to employees and is non-pensionable. The LTIP will only be payable if there is overall financial out-performance of the Final Determination.

The Remuneration Committee maintains the right to withhold or vary LTIP payments (potentially to zero) should events undermine the financial stability or reputation of Scottish Water. Such variation may be carried out at any time prior to LTIP payments being made and may affect all or only some of the LTIP recipients.

The LTIP structure for the 2015-21 period 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

Payments generated under the LTIP will be included in the Members' Remuneration Report when those are made.

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

Note:

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

g. Pension

All employees, including Executive Members, are eligible to participate in the Scottish Local Government Pension Scheme (SLGPS) 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. All members may also choose to take full Early Retirement from age 55 with a reduction in pension value applied by the pension fund.

The value of pension provided through the SLGPS 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 for business needs. For those opting out of car provision, a car allowance is payable instead. 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 benefits received is set out in the relevant column of the single figure table in the Members' Remuneration Report.

i. 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 recommend a 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 anticipated for each role and are detailed in the Members' Remuneration Report.

j. Payments on Loss of Office

Executive Members are expected to work the notice periods in their service contracts. 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.

The Remuneration Committee may decide that a portion of the incentive payment is payable to former Executive Members 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. If an Executive Member leaves the employ of Scottish Water for any other reason and before incentive payments under the AOIP or LTIP would be due, their payment will normally be forfeit.

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

SLGPS then access to pension benefits on leaving will be determined by the regulations of that pension scheme, as for any other SLGPS member.

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

k. 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 received by other employees; as well as consideration of the ratio between the lowest and highest potential total pay in the organisation.

When determining incentive payments to be made under the AOIP, the Remuneration Committee considers the proportion of potential payment resulting to Executive Members from corporate out-performance and how that same out-performance drives incentive payments to other employees. Any review of executive pay is informed by reports on employee and manager pay progression, consideration of public sector pay policy and an understanding of the pay adjustment opportunities available to other employees as may be negotiated with the company's recognised trades unions.

Under the Industry (Scotland) Act 2002, Schedule 3, one of the Non-executive Members appointed to the Board of Scottish Water must be a person appearing to the Scottish Ministers to have special knowledge of the interests of the employees. One current Board Member, who is also on the Remuneration Committee, fulfils that requirement.

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.

l. 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
Chief Operating Officer	Peter Farrer	1 April 2013
Finance Director	Alan Scott	24 September 2013

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 Members

Non-executive Members do not have service contracts. Expiry dates of Non-executive appointments are as follows:

Dame Susan Rice, Chair	31 May 2023
James Coyle	31 July 2024
Paul Smith	31 July 2024
Samantha Barber	31 March 2021
Iain Lanaghan	31 March 2021
Matt Smith	30 April 2021
Deirdre Michie	30 November 2021
Kenneth Marnoch	31 March 2022

2. Members' Remuneration Report

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

a. Single Total Figure Table

Notes:

(1) Benefits include the value of car benefit or car allowance and annual life assurance premiums associated with the Scottish Water Life Assurance Scheme as described in the Executive Remuneration policy. The value of each benefit is described in a separate table below.

(2) Annual Out-performance Incentive Plan as described in the Executive Remuneration Policy.

(3) The value of pension benefits accrued is calculated in accordance with section 5.3.21 (d) of the HM Treasury's Government Financial Reporting Manual 2019/20. This requires the real increase in accrued benefits, as detailed in section 2c below, to be multiplied by 20, plus the real increase in accrued lump sum and reduced by the contribution made by the individual member.

(4) Mr Millican waived his entire AOIP payment of £96,184 for 2019/20. Scottish Water donated an equivalent sum to the charity World Vision to support their global Coronavirus emergency response to limit the spread of Covid-19 and reduce its impact on vulnerable children and families.

(5) Figures for Mr Scott reflect a brief and temporary reduction in working hours and salary in line with normal policies from 1st March 2020, as part of a phased return to work following a period of absence. Mr Scott's AOIP figure also reflects absence during the year.

(6) 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.

		Salary/Fees £000	Benefits[1] £000	AOIP[2] £000	Total £000	Pension[3] £000	Total £000
Executive Members							
Douglas Millican[4]	2020	267	12	0	279	31	310
	2019	262	12	93	367	-1	366
Peter Farrer	2020	195	11	70	276	36	312
	2019	191	12	68	271	4	275
Alan Scott[5]	2020	191	11	34	236	14	250
	2019	188	10	67	265	9	274
Non-executive Members[6]							
Chair - Dame Susan Rice	2020	103			103		103
	2019	102			102		102
Samantha Barber	2020	27			27		27
	2019	26			26		26
James Coyle	2020	27			27		27
	2019	26			26		26
Iain Lanaghan	2020	21			21		21
	2019	21			21		21
Deirdre Michie	2020	21			21		21
	2019	21			21		21
Kenneth Marnoch	2020	21			21		21
	2019	21			21		21
Matt Smith	2020	21			21		21
	2019	21			21		21
Paul Smith	2020	21			21		21
	2019	21			21		21
Total Remuneration	**2020**	**915**	**34**	**104**	**1,053**	**81**	**1,134**
	2019	900	34	228	1,162	12	1,174

The Committee approved a £2,000 increase in base salaries for the three Executive Members with effect from 1 April 2020, although this increase was waived by Mr. Millican before taking effect. Consequently, base salaries for 2020/21 are as follows: Douglas Millican £267,179; Peter Farrer £197,030; and Alan Scott £194,798. Fee levels for Non-executive Members, including the Chair, for 2020/21 will increase by £8 per day, also with effect from 1 April 2020 and in line with Public Sector Pay Policy for Senior Appointments.

b. Details of Benefits Received 2019/20

Name	Car benefit or car allowance £000	Life assurance premium £000	Total £000
Douglas Millican	10	2	12
Peter Farrer	10	1	11
Alan Scott	10	1	11

c. Total Pension Entitlements to End of Financial Year 2019/20

The Executive Members Douglas Millican, Peter Farrer and Alan Scott are eligible to participate in the Lothian Pension Fund, a defined benefit scheme. The table opposite presents pension accruals under the regulations of the SLGPS.

Notes:

(i) Members of the pension scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table opposite.

(ii) The normal retirement age of Executive Members is determined by the rules of the Scottish Local Government Pension Scheme. For pension accrued up to 31 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.

(iii) 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.

(iv) The transfer value of accrued pension is calculated in a manner consistent with Actuarial Guidance Note GN11.

(v) The rate of tax payable on pension savings above the lifetime allowance of £1.073m depends on how the money is paid to individuals. The current rate is 55% if the individual takes a lump sum, or 25% if the individual takes it as pension payments or cash withdrawals.

	Increase in accrued benefits during the year net of inflation			Accumulated total accrued benefits at 31 March 2020		Transfer Values		
	Years in Scheme	Pension £000	Lump sum £000	Pension £000	Lump sum £000	At 31 March 2020 £000	At 31 March 2019 £000	Increase in 2019/20 net of Member's own contributions and inflation £000
Douglas Millican	25.1	3	1	78	141	1,796	1,567	173
Peter Farrer	35.7	3	1	92	180	2,010	1,797	181
Alan Scott	6.5	2	–	18	–	327	246	56

d. Pay Multiples

Scottish Water has reported the ratio of Chief Executive (CE) pay to that of other employees for several years. This has been done by comparing the CE total pay figure to the average (mean) pay for all others below Executive Director.

The Companies (Miscellaneous Reporting) Regulations 2018 set out a different method of comparison so that the CE total pay figure is compared to that received by other employees at the 25th, 50th and 75th percentile of earnings. Since this changes the ratio calculation, the table opposite shows the figures for 2018/19 as reported for that year; the recalculation of the ratios for 2018/19 using the new percentile method for that year's data; and the ratios calculated for 2019/20 against the current percentiles.

	Remuneration excluding movement in pension[1] £000		
	2019/20 new percentile calculation	2018/19 new percentile calculation	2018/19 previous mean calculation
Chief Executive[2]	375.0	367.0	367.0
Employees[3] 25th percentile	26.5	25.8	
Employees[3] 50th percentile	30.7	29.9	Mean 34.6
Employees[3] 75th percentile	39.5	38.7	
Ratio at 25th percentile	14.2	14.2	
Ratio at 50th percentile	12.2	12.3	Mean 10.6
Ratio at 75th percentile	9.5	9.5	

Notes:

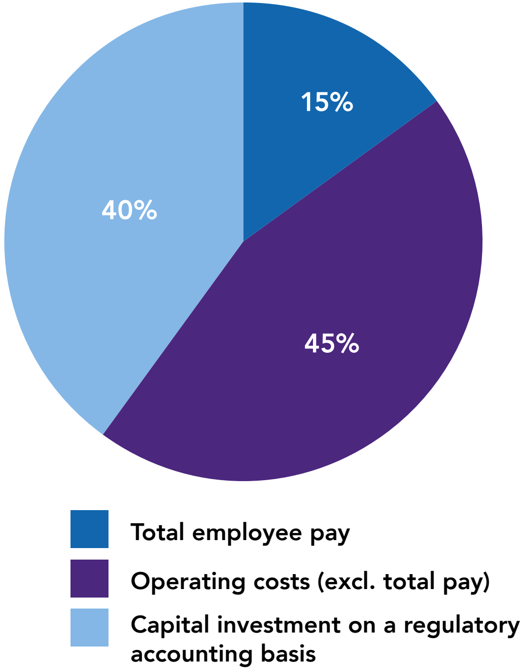
(1) The total excludes the calculation of change in pension as the value relies heavily on length of pensionable service and so has little meaning when comparing one person (the Chief Executive) against a group of employees with varying lengths of service, i.e. an individual with greater pensionable 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.

(2) For fair comparison, the figure for the Chief Executive in 2019/20 uses that from the single total figure table at 2(a), excluding pension as per the above note but including the value of waived AOIP.

(3) Percentile earnings shown are for full time equivalent salary, AOIP and benefits of all employees with a full year of service, other than Executive Members.

e. 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.



f. Implementation of Remuneration Policy in 2020/21

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, the degree of required out-performance has been increased each year over the course of the current regulatory period. For 2020/21 the Remuneration Committee has determined the following out-performance targets.

Measure	Description	Weighting
Financial Out-performance	Financial surplus before tax and depreciation to exceed Delivery Plan by £0 to £50m. Sliding scale with 0% at Delivery Plan figure and 100% at +£50m.	40%[1]
Customer Service Provision	Overall Performance Assessment (OPA) – based on maintaining a score on a sliding scale between 385 and 400 points. 0% payable below 385; 30% payable at 385; 90% payable at 400; 100% payable for beating 400 points.	25%
Customer Experience	Improvement in the Household Customer Experience Measure (hCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 82.60 points; 30% payable at 82.60 points; 100% payable for greater than or equal to 88.42 points.	15%
	Improvement in the Non-Household Customer Experience Measure (nhCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 77.50 points; 30% payable at 77.50 points; 100% payable for greater than or equal to 86.50 points.	10%
Customer Benefit Delivery	Exceed the Delivery Plan target Overall Measure of Delivery (OMD) of 240 points and ensure forecast capital programme cost is within the regulatory allowance[2].	10%

Notes:

(1) Financial surplus 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.

(2) Plus customer contributions.

g. 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. In line with this policy, Douglas Millican, Chief Executive, was appointed as a non-executive director and trustee of World Vision UK in March 2017, from which no remuneration is payable.

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

Samantha Barber
Chair of the Remuneration Committee

MEMBERS' REPORT

The Members present the Members' report together with the audited consolidated financial statements for the year ended 31 March 2020.

The Government Financial Reporting Manual 2019/20 (FReM), published by HM Treasury, sets out the form and content for the Annual Report & Accounts 2019/20: Performance and Prospects. This includes the requirements to show a Performance Report and Accountability Report. The Members have reviewed the requirements of the FReM, and are satisfied that they are covered within the Overview, Strategic and Governance reports of this report.

The Members' report comprises pages 140 to 142 and the sections of this report incorporated by reference are as follows:

Corporate governance report	See pages 117 to 121
Strategic report, including information in respect of: Scottish Water's results, key financial information and service performance, future developments and the principal risks and uncertainties faced by Scottish Water's group of companies	See pages 14 to 111
Going concern and viability statements	See pages 43 to 44
Greenhouse gas emissions	See pages 81 to 86
People	See pages 75 to 80
Accounting requirements and basis of account preparation	See Note 1.2, page 156
Financial risk management	See pages 184 to 185

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.

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 to 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. Details of the Members' service contracts are on page 134 of the Members' Remuneration Report.

Employee Relations and Involvement

The Scottish Water group of businesses employed an average of 4,451 (2019: 4,467) 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 164. Scottish Water is committed to ensuring equality is mainstreamed into all aspects of organisational culture and practice, and all employees have equal opportunities irrespective of race, religion, sex, sexual orientation, disability or age. A number of forums are used 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 safety, health and wellbeing. Through an extensive safety awareness campaign, safety briefings and ongoing training, awareness of safety, health and wellbeing issues is being encouraged and increased among employees.

Further information can be found in the People section.

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. In addition, Horizons has developed and operates specialist innovation development centres at Gorthleck and Bo'ness to test new products and processes associated with the treatment of drinking water and waste water.

Further information can be found in the Enabling Sustainable and Inclusive Economic Growth section.

Political Contributions

No political contributions were made during the year (2019: nil).

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 & Accounts 2019/20: Performance and Prospects. The report for this financial year will be available later in 2020.

Members' Responsibilities

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities included in the Independent Auditor's Report on pages 144 to 151, is made with a view to distinguishing the respective responsibilities of the Members and of the auditor 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.

The Members are responsible for the maintenance and integrity of Scottish Water's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Members, as at the date of this report, consider that the Annual Report & Accounts 2019/20: Performance and Prospects taken as a whole is fair, balanced and understandable and provides the information necessary to assess Scottish Water's performance, business model and strategy.

Each of the Members, whose names and functions are listed in the Board Members section on pages 113 to 116, confirms that to the best of their knowledge and belief:

- the Group and Company financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and interpreted by the Government Financial Reporting Manual (FReM), give a true and fair view of the assets, liabilities, financial position and surplus of Scottish Water;
- the Strategic Report includes a fair review of the development and performance of the business and the position of Scottish Water, together with a description of the principal risks and uncertainties that it faces.

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 auditor is unaware; and
- 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 auditor is aware of that information.

By order of the Board,

Douglas Millican,
Chief Executive

17 November 2020

FINANCIALS

INDEPENDENT AUDITOR'S REPORT

Independent auditor's report to the members of Scottish Water, the Auditor General for Scotland and the Scottish Parliament

Report on the audit of the financial statements

Opinion on financial statements

We have audited the financial statements in the annual report and accounts of Scottish Water for the year ended 31 March 2020 under the Water Industry (Scotland) Act 2002. The financial statements comprise the Group and Company Balance Sheets, the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flow and notes to the financial statements, including a summary of significant accounting policies. 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 2019/20 Government Financial Reporting Manual (the 2019/20 FReM).

In our opinion the accompanying 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 body and its group as at 31 March 2020 and of the group surplus 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 2019/20 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.

Basis for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the Code of Audit Practice approved by the Auditor General for Scotland. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We were appointed by the Auditor General on 31 May 2016. The period of total uninterrupted appointment is four years. We are independent of the body and its group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the body. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusion relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report and accounts, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report and accounts that describe the principal risks and explain how they are being managed or mitigated;
- the board members' confirmation in the annual report and accounts that they have carried out a robust assessment of the principal risks facing the body and its group, including those that would threaten its business model, future performance, solvency or liquidity;
- the board members' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements, and their identification of any material uncertainties to the ability of the body and its group to continue to do so over a period of at least twelve months from the date of the approval of the financial statements; and
- the board members' explanation in the annual report and accounts as to how they have assessed the prospects of the body and its group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the body and its group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We draw attention that we identified going concern as a key audit matter which is described in the next section of our report.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the audit team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The risk		Our Response
Capital additions (£502.7 million, 2019: £503.4 million) Refer to page 124 (Audit Committee Report), page 156 (accounting policy) and page 167 (note 9 to the financial statements) Risk of material misstatement v/s 2018-19	*Accounting application* Capital additions related to the delivery plan for regulated activities for the period 2015-16 to 2020-21 are significant. Executive members are incentivised across a number of financial and other measures including profit and completion of capital investment programmes. There is judgement involved in the allocation of expenditure between capital and revenue which can affect profit and investment measures reported in the financial statements.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the allocation of costs between capital and revenue within the financial ledger at the project initiation stage and on an ongoing basis; and • Testing the design and operating effectiveness of controls over the appropriateness of reclassification from assets in the course of construction. *Test of details* • Building on our work over control design we compared the reports of Scottish Water's capital project monitoring group at the year end to amounts recorded as capital additions; • In respect of a sample of capitalised additions, we evaluated the appropriateness of the classification as capital by considering the nature of the expenditure with reference to invoice, certificate or timesheets and considering the application of the relevant accounting policies; • We assessed a sample of items allocated to revenue expenditure and considered whether they were correctly classified by considering the application of the relevant accounting policies; and • We also reviewed material journals related to capital additions.

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INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

	The risk	Our Response
Bad debt provision (£408.8 million, 2019: £399.0 million) Refer to page 124 (Audit Committee Report), page 156 (accounting policy) and page 186 (note 27 to the financial statements) Risk of material misstatement v/s 2018-19 ↑	*Forecast-based valuation* There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data. As at 31 March 2020, the Scottish Water regulated business reported a household revenue debtor of £450.2 million (2019: £435.5 million) and a corresponding bad debt provision of (£408.8 million, 2019: £399.0 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 authorities and cannot be influenced by Scottish Water. As part of our risk assessment, we determined that the recoverability of household revenue debtors has a high degree of estimation uncertainty, in particular because of the potential effects of the COVID-19 pandemic.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the review and approval of the provision and associated assumptions by the Members during the year and at the year end; and • Testing the design and operating effectiveness of controls in respect of the reconciliation of information provided on a monthly basis by local authorities to Scottish Water in respect of amounts billed and collected. This historical information forms the basis of the forecast collection rate. *Tests of detail* • We compared the information on historical collection rates, recorded by Scottish Water as the basis for the current year provision calculation, to the records held in respect of prior years; and • We agreed the total amount billed and collected in respect of 2020 as recorded in Scottish Water's records, to confirmations received from individual local authorities. *Historical comparison* • We compared the change in forecast collection rate in the current year, to the historical trend of increasing collection rates since 1996-97. *Sensitivity analysis* • We performed sensitivity analysis and challenged management in respect of the forecast collection rate by increasing and decreasing it based on our judgement and assessing the impact on the provision. *Assessing transparency* • We assessed the disclosure of sensitivities by the Members, and description of the provision in note 27 of financial statements.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

	The risk	Our Response
Pension liability (£178.6 million (2019: £206.1 million) Refer to page 124 (Audit Committee Report), page 156 (accounting policy) and page 180 (note 23 to the financial statements) Risk of material misstatement v/s 2018-19 ⟷	*Subjective valuation* Small changes in the assumptions and estimates used to value the pension obligation (before deducting scheme assets) would have a significant effect on the net pension liability. Employees of Scottish Water participate in three local government defined benefit pension schemes; North East Scotland pension fund, the Lothian pension fund and the Strathclyde pension fund.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation. *Benchmarking assumptions* • Challenging, with the support of our own actuarial specialists, the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy against externally derived data; and • Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as the regulatory Delivery Plan and our understanding of Scottish Government expectations. *Assessing transparency* • Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions.
Going concern Refer to page 124 (Audit Committee Report), page 156 (accounting policy) New risk of material misstatement v/s 2018-19 ⟷	All entities are required to provide appropriate disclosures in the financial statements in regard to the going concern assumption. Under ISAs (UK), we are required to report to you if we have anything material to add or to draw attention to in relation to the Members' statement, set out in the Annual Report and Accounts about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements.	Our procedures included: *Funding assessment* • We have considered the availability of existing funding from the Scottish Government, including reviewing the repayment profile and the external financing limit set for the period 2020-21; *Review of regulatory framework* • We have reviewed the regulatory framework for Scottish Water and Scottish Water Business Stream's ability to secure required funding, including sources of funds for the latter in the event of any shortfall, to support their going concern assumptions as applicable; • Reviewing the regulatory delivery plan update (March 2020) and considering the associated economic assumptions against our commercial understanding; and **Continued overleaf**

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

	The risk	Our Response
Going concern (continued)	That judgement is based on an evaluation of the inherent risks to the group's and company's business model and how those risks might affect the group's and company's financial resources or ability to continue operations over a period of at least 12 months from the date of approval of these financial statements. The evaluation of going concern is based on forecast cash flows which have a greater level of estimation risk because of the impact of the COVID-19 pandemic.	*Retrospective review* • We have considered the budget to actual results for the period from year end to the date of signing of these financial statements *Sensitivity analysis* • We considered sensitivities of the key assumptions used in the cash flow forecasts and assessed their related impact on the financial resources and headroom available. *Assessing transparency* • We assessed the completeness and accuracy of the matters covered in the going concern disclosure through procedures performed above, along with our assessment of the viability statement.

Change to key audit matters

The 'purchase of new entities' key audit matter in the prior year was specific to an acquisition by Scottish Water Horizons Holdings Limited, a subsidiary of Scottish Water. There were no such acquisition during the year and we have consequently removed it as a key audit matter.

Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £12.0 million, determined with reference to a benchmark of group total expenditure of which it represents 1%. We consider total expenditure to be the most appropriate benchmark as the most significant part of the Group is its regulated business which is a Scottish Government owned body where the level of expenditure is the most important measure.

Materiality for the parent company financial statements as a whole was set at £11.9 million (2019: £11.8 million), determined with reference to total expenditure, of which it represents 1% (2019: 1%).

We reported to the Audit Committee all corrected or uncorrected identified misstatements exceeding £250,000. We did not identify any misstatements that warranted reporting on qualitative grounds.

Of the group's seven (2019: ten) reporting components, we subjected four (2019: four) to full scope audits for group purposes and one (2019: one) to specified risk-focused audit procedures over profit recognition. The latter was not individually financially significant enough to require a full scope audit for group purposes, but did present specific individual risks that needed to be addressed. Together these entities accounted for 99% of each of the Group's total revenue, total expenditure and total assets.

For the residual components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these. The work on all of the components, including the parent Company, was performed by the Group team. The component materialities ranged from £110,500 to £2.0 million, having regard to the mix of size and risk profile of the Group across the components.

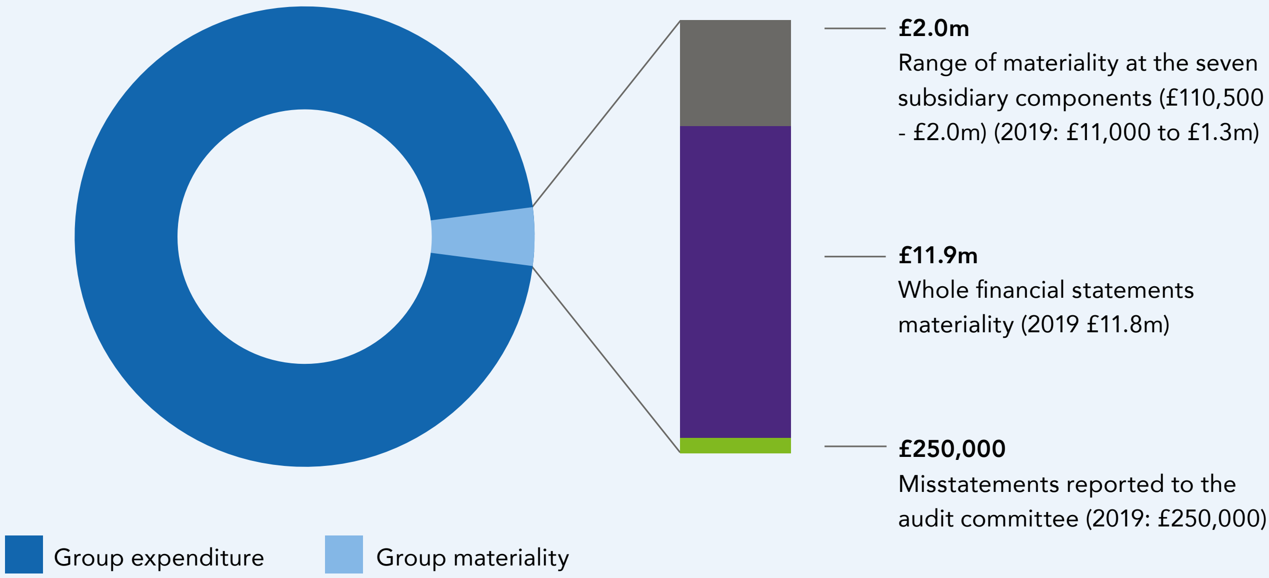
INDEPENDENT AUDITOR'S REPORT CONTINUED

GROUP EXPENDITURE

£1,361.0m
(2019: £1,214.0m)

GROUP MATERIALITY

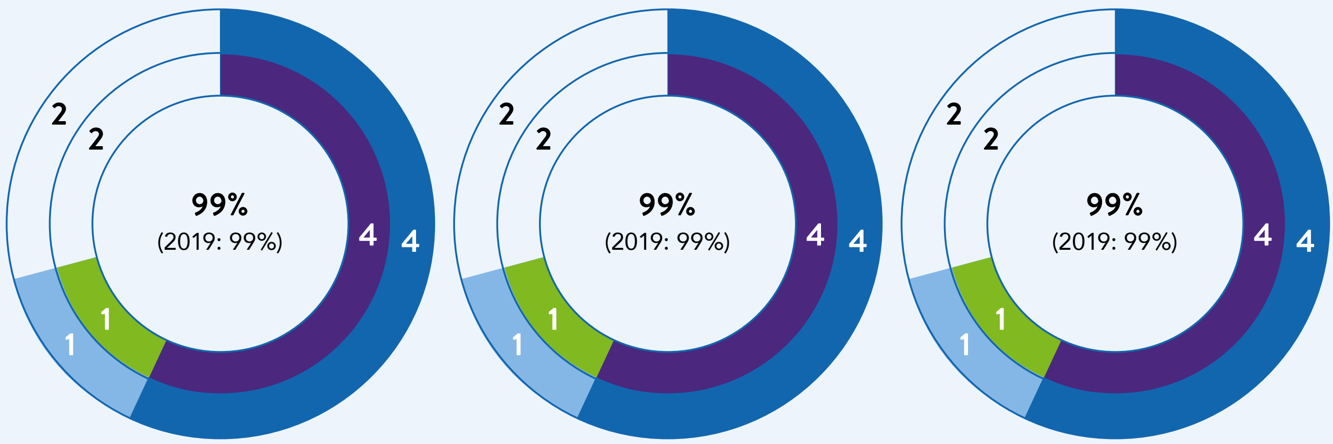
£12m
(2019: £11.8m)



GROUP EXPENDITURE

GROUP REVENUE

GROUP TOTAL ASSETS



KEY:

- Full scope for group audit purposes 2020
- Specified risk-focused audit procedures 2020
- Full scope for group audit purposes 2019
- Specified risk-focused audit procedures 2019
- Residual components

INDEPENDENT AUDITOR'S REPORT CONTINUED

Responsibilities of the board members for the financial statements

As explained more fully in the Statement of Members' Responsibilities, the board members are responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the board members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Accountable Officer is responsible for assessing the ability of the body and its group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. We therefore design and perform audit procedures which respond to the assessed risks of material misstatement due to fraud.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other information in the annual report and accounts

The board members are responsible for the other information in the annual report and accounts. The other information comprises the information other than the financial statements, the audited part of the Members' Remuneration Report, and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Auditor General for Scotland to the extent explicitly stated later in this report.

In connection with our audit of the financial statements, our responsibility is to read all the other information in the annual report and accounts and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In this context, we also have a responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- The statement given by the board members that they consider that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for stakeholders to assess the position and performance, business model and strategy of the body and its group is materially inconsistent with our knowledge obtained in the audit; or
- The Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of the above responsibilities.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Report on regularity of expenditure and income

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.

Responsibilities for regularity

The board members are responsible for ensuring the regularity of expenditure and income. We are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Report on other requirements

Opinions on matters prescribed by the Auditor General for Scotland

In our opinion, the audited part of the Members' Remuneration Report has been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the directions made under the Water Industry (Scotland) Act 2002 by the Scottish Ministers.

Matters on which we are required to report by exception

We are required by the Auditor General for Scotland to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the audited part of the Members' Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to our responsibilities for the annual report and accounts, our conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in our Annual Audit Report.

Use of our report

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 120 of the Code of Audit Practice, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Hugh Harvie
for and on behalf of KPMG LLP
Chartered Accountants
Saltire Court
20 Castle Terrace
Edinburgh
EH1 2EG

24 November 2020

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 MARCH 2020

	Note	2020 £m	2019 £m
Revenue	3	**1,615.9**	**1,469.1**
Cost of sales		(1,185.2)	(1,047.4)
Gross surplus		**430.7**	**421.7**
Administrative expenses		(175.8)	(166.6)
Operating surplus	3,4	**254.9**	**255.1**
Finance income	7	2.6	2.1
Finance costs	7	(171.8)	(171.1)
Surplus before taxation		**85.7**	**86.1**
Taxation	8	(65.1)	(17.9)
Surplus for the year	21	**20.6**	**68.2**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 2020

	Note	2020 £m	2019 £m
Surplus for the year	21	20.6	68.2
Other comprehensive income:			
Items which will not subsequently be reclassified to the income statement			
Actuarial gain/(loss) on post employment benefit obligations, net of deferred taxation	23	49.7	(43.5)
Effective portion of changes in fair value of cash flow hedge, net of deferred taxation		1.2	0.5
Total comprehensive income for the year		71.5	25.2

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

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Cash flow hedging reserves £m	Retained earnings £m	Other reserves £m	Total £m
Balance at 1 April 2018		–	1,519.0	133.4	1,652.4
Balance at acquisition of subsidiaries	27	(9.0)	–	–	(9.0)
Surplus for the year	21	–	68.2	–	68.2
Other comprehensive (loss)/gain:					
Actuarial loss on post employment benefit obligations, net of tax	23	–	(43.5)	–	(43.5)
Effective portion of changes in fair value of cash flow hedge, net of tax	27	0.5	–	–	0.5
Total comprehensive income for the year		0.5	24.7	–	25.2
Balance at 31 March 2019		**(8.5)**	**1,543.7**	**133.4**	**1,668.6**
Surplus for the year	21	–	20.6	–	20.6
Other comprehensive gain:					
Actuarial gain on post employment benefit obligations, net of tax	23	–	49.7	–	49.7
Effective portion of changes in fair value of cash flow hedge, net of tax	27	1.2	–	–	1.2
Total comprehensive income for the year		1.2	70.3	–	71.5
Balance at 31 March 2020		**(7.3)**	**1,614.0**	**133.4**	**1,740.1**

COMPANY STATEMENT OF CHANGES IN EQUITY

	Note	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2018		1,345.9	133.4	1,479.3
Surplus for the year	21	67.2	–	67.2
Other comprehensive loss:				
Actuarial loss on post employment benefit obligations, net of tax	23	(41.4)	–	(41.4)
Total comprehensive income for the year		25.8	–	25.8
Balance at 31 March 2019		**1,371.7**	**133.4**	**1,505.1**
Surplus for the year	21	31.1	–	31.1
Other comprehensive gain:				
Actuarial gain on post employment benefit obligations, net of tax	23	47.0	–	47.0
Total comprehensive income for the year		78.1	–	78.1
Balance at 31 March 2020	21	**1,449.8**	**133.4**	**1,583.2**

The 'Statement of changes in equity' above excludes Government loans which, in accordance with the Scottish Water Governance Directions 2009, are recorded on the balance sheet under Equity. Full details of Government loans are provided in note 19.

BALANCE SHEETS
AS AT 31 MARCH 2020

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Assets					
Non-current assets					
Property, plant and equipment	9	6,430.2	6,214.7	6,395.0	6,184.7
Intangible assets	10	14.0	10.0	–	–
Investments	11	–	–	37.6	37.6
Deferred tax asset	16	3.6	1.8	–	–
		6,447.8	6,226.5	6,432.6	6,222.3
Current assets					
Inventories	12	3.9	3.7	3.3	2.9
Trade and other receivables	13	246.8	204.4	98.9	78.3
Current tax asset		3.2	2.7	1.0	0.8
Cash and cash equivalents	14	531.6	434.8	391.4	310.9
		785.5	645.6	494.6	392.9
Total assets	3	**7,233.3**	**6,872.1**	**6,927.2**	**6,615.2**
Liabilities					
Current liabilities					
Trade and other payables	15	(532.6)	(462.1)	(399.9)	(385.5)
Other loans and borrowings	18	(24.6)	(24.8)	(23.1)	(23.4)
Current tax liabilities		–	(0.1)	–	–
Provisions for liabilities	17	(12.9)	(10.4)	(16.4)	(13.5)
		(570.1)	(497.4)	(439.4)	(422.4)
Non-current liabilities					
Trade and other payables	15	(77.5)	(89.0)	(61.1)	(71.7)
Other loans and borrowings	18	(252.8)	(277.4)	(256.6)	(279.7)
Deferred tax liabilities	16	(432.7)	(368.1)	(426.2)	(364.2)
Retirement benefit obligations	23	(220.5)	(248.3)	(217.1)	(243.3)
Provisions for liabilities	17	(11.2)	(14.7)	(15.2)	(20.2)
		(994.7)	(997.5)	(976.2)	(979.1)
Total liabilities		**(1,564.8)**	**(1,494.9)**	**(1,415.6)**	**(1,401.5)**
Net assets		**5,668.5**	**5,377.2**	**5,511.6**	**5,213.7**
Equity					
Government loans	19	3,928.4	3,708.6	3,928.4	3,708.6
Retained earnings	21	1,614.0	1,543.7	1,449.8	1,371.7
Cash flow hedge reserve	27	(7.3)	(8.5)	–	–
Other reserves		133.4	133.4	133.4	133.4
		5,668.5	**5,377.2**	**5,511.6**	**5,213.7**

The financial statements on pages 152 to 187 were approved by the Board of Members on 17 November 2020 and signed on its behalf by:

Douglas Millican
Chief Executive

STATEMENTS OF CASH FLOW
FOR THE YEAR ENDED 31 MARCH 2020

	Note	Group		Company	
		2020 £m	2019 £m	2020 £m	2019 £m
Surplus before taxation		85.7	86.1	97.2	83.6
Depreciation charges	9	297.0	282.6	292.2	281.1
Amortisation of intangible asset	10	2.0	3.2	–	–
Amortisation of grants		(1.2)	(1.3)	(1.0)	(1.0)
Surplus on disposal of property, plant and equipment		(0.9)	(0.9)	(1.2)	(0.9)
Non cash gain on consolidation		–	(0.5)	–	–
Non cash adjustment for retirement benefit obligations		26.1	17.9	24.7	17.0
Finance costs - net		169.2	169.0	170.5	172.5
Operating cash flow before changes in working capital and provisions		**577.9**	**556.1**	**582.4**	**552.3**
Changes in working capital and provisions:					
(Increase)/decrease in receivables		(42.6)	–	(20.9)	(1.8)
Increase in inventories		(0.2)	(0.2)	(0.4)	(0.3)
Increase/(decrease) in payables		56.0	(11.7)	(1.5)	(3.2)
(Decrease)/increase in provisions		(2.8)	7.5	(3.9)	11.2
Cash flows from operating activities		**588.3**	**551.7**	**555.7**	**558.2**
Taxation paid		(11.4)	(5.7)	(10.8)	(4.7)
Net cash generated from operating activities		576.9	546.0	544.9	553.5
Cash flows from investing activities					
Purchase of property, plant and equipment		(525.4)	(511.6)	(515.2)	(506.6)
Sale of property, plant and equipment		1.4	1.5	1.4	1.4
Purchase of intangible asset	10	(6.0)	0.7	–	–
Acquisition of subsidiary companies - cash acquired		–	10.3	–	–
Acquisition of subsidiary companies - consideration paid		–	(16.2)	–	–
Government grant income received		0.6	1.3	–	–
Infrastructure income receipts		17.7	16.4	17.7	16.4
Net cash used in investing activities		(511.7)	(497.6)	(496.1)	(488.8)
Cash flows from financing activities					
Repayments of loans		(129.3)	(124.8)	(125.0)	(123.0)
Proceeds from borrowings		344.3	288.3	344.3	288.3
Interest received		2.7	2.1	2.0	1.5
Interest paid		(166.1)	(166.6)	(166.7)	(169.5)
Payment of finance lease liabilities		(20.0)	(19.0)	(22.9)	(21.7)
Net cash generated from / (used in) financing activities		31.6	(20.0)	31.7	(24.4)
Net increase in cash and cash equivalents		**96.8**	**28.4**	**80.5**	**40.3**
Cash and cash equivalents at beginning of year	14	434.8	406.4	310.9	270.6
Cash and cash equivalents at end of year	14	**531.6**	**434.8**	**391.4**	**310.9**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2020

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 2020 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 Government Financial Reporting Manual (FReM). The FReM 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 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 Scottish Water'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.

Going concern

The financial statements have been prepared on the going concern basis which the Members consider to be appropriate for the following reasons.

In considering the basis of accounting, cash flow forecasts have been prepared for a period of at least 12 months from the date of approval of these financial statements which consider various scenarios taking into consideration severe but plausible downsides impact of the Covid-19 pandemic. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. They also consider the risks associated with the Covid-19 pandemic including the impacts in relation to reduced cash collection levels (up to a maximum of 10%) and the reduction of water consumption by business customers (up to a maximum volumetric impact of 40%) over the period of review. Under all of the scenarios, Scottish Water will be able to operate within its available facilities and is well placed to withstand the challenges presented by the Covid-19 pandemic.

Consequently, the Members are confident that Scottish Water will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of these financial statements and therefore have prepared the financial statements on a going concern basis.

1.3 Changes in accounting policy

There were no new standards, amendments or interpretations that were effective for the first time during the year that had a material impact on Scottish Water. The amendments to standards which were adopted by Scottish Water with effect from 1 April 2019 were:

– Annual improvements to IFRSs 2015 - 2017 Cycle; and

– Amendments to the Conceptual Framework, IAS 19 'Employee benefits'

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

1. Accounting policies (continued)

1.4 Accounting standards not yet adopted by Scottish Water

As at the date of authorisation of these financial statements, Annual improvements to IFRSs 2018-2020 Cycle had been issued but was not yet effective and consequently has not been applied by Scottish Water in the preparation of the financial statements.

IFRS 16 Leases came into effect for financial periods beginning on or after 1 January 2019 for the subsidiary companies. However, the FReM has deferred implementation for the public sector to 1 April 2020. Early adoption was not an option for Scottish Water as the relevant criteria, based on the size of relevant subsidiary companies, were not met. This standard is not expected to have a material impact on the results and net assets of Scottish Water.

1.5 Basis of consolidation

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 Scottish Water group of companies.

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 it is probable that economic benefits will flow to Scottish Water and that the revenue can be reliably measured. Revenue is recognised when, or as, the performance obligations to the customer are satisfied. Revenue is shown net of associated sales taxes and 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

1. Accounting policies (continued)

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 Scottish Water 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 tax 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.

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 Scottish Water 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 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

1. Accounting policies (continued)

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
Fixtures, fittings and furniture within non-specialised operational buildings	5 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 property, plant and equipment 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 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 Intangible assets

Intangible assets represent the acquisition of a non-household customer base, by Business Stream. Intangible assets are recognised at cost and treated as having a finite life. They are stated at cost less accumulated amortisation. Amortisation is charged to the income statement to write off the cost, less any residual value, on a straight-line basis over the expected useful life from the date of beneficial use. The expected useful life is currently set at 8 years.

The expected useful lives and residual values are reviewed annually, and adjusted if appropriate, at the balance sheet date.

1.16 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.

1.17 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

1. Accounting policies (continued)

1.18 Financial instruments

Financial assets and liabilities are recognised in the 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 initially measured at fair value and are subsequently measured at amortised 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 Scottish Water 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 with the exception of derivatives that qualify for cash flow hedge accounting.

f. Cash flow hedges

Where the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost the effective part of any gain or loss on the derivative financial instrument is recognised in other comprehensive income (OCI). Any ineffective portion of the hedge is recognised immediately in the income statement.

When the hedging relationship ends or when a hedge no longer meets the criteria for hedge accounting, any hedging gain or loss recognised in OCI is reclassified to the income statement.

1.19 Employee benefit obligations

Employees of the Scottish Water group of companies participate in the Scottish Local Government Pension Scheme (SLGPS) 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

1. Accounting policies (continued)

Within the subsidiary companies there are also two defined contribution pension schemes under which the companies pay fixed contributions and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement.

1.20 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.

1.21 Foreign currency transactions

Transactions 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.

1.22 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.

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. The group has adopted IFRS 9 'Financial instruments' from 1 April 2018 which requires an expected loss method of impairment of financial assets to be used. This is 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, including the potential future impacts of the Covid-19 pandemic, which could impact positively or negatively on operating results (see sensitivity analysis in note 27).

c. Carrying value of property, plant and equipment

Property, plant and equipment (PPE) represents the majority of the asset base and a significant proportion of annual expenditure (see funding chart on page 100). Therefore the estimates and assumptions made in determining the carrying values and related depreciation are critical to Scottish Water's financial performance and position.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

2. Accounting estimates and judgements (continued)

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 Scottish Water's depreciation charges.

The determination of whether expenditure is enhancement or maintenance also requires judgement. Expenditure that replaces or significantly refurbishes an existing asset, enhances or increases the capacity of the network is capitalised while those classed as repair or maintenance are expensed in the period they are incurred. There are controls in place to ensure that the classification is appropriate and in line with the applicable accounting standards.

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 Scottish Local Government Pension Schemes (SLGPS) which are defined benefit schemes. Actuarial valuations of the schemes are carried out by the administering authorities triennially in line with SLGPS 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 23) and, while these assumptions are believed to be appropriate, a change to the assumptions would impact the surplus of Scottish Water 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 of companies 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 business customers in Scotland and England) and non-regulated businesses. 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.

	2020 £m	2019 £m
Revenue		
Scottish Water regulated water and waste water services	1,254.4	1,216.9
Business Stream	477.7	372.1
Scottish Water non-regulated activities	49.1	27.7
	1,781.2	1,616.7
Intercompany elimination	(165.3)	(147.6)
	1,615.9	**1,469.1**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

3. Segmental analysis (continued)

	2020 £m	2019 £m
Operating surplus		
Scottish Water regulated water and waste water services	267.5	257.8
Business Stream	(14.0)	0.3
Scottish Water non-regulated activities	5.0	0.6
Reversal of IFRIC 12 adjustments on consolidation	(3.6)	(3.6)
	254.9	**255.1**

	2020 £m	2019 £m
Total assets		
Scottish Water regulated water and waste water services	6,880.1	6,577.2
Business Stream	262.9	217.8
Scottish Water non-regulated activities	122.1	111.1
Reversal of IFRIC 12 adjustments on consolidation	(31.8)	(34.0)
	7,233.3	**6,872.1**

	Capital additions to property, plant & equipment		Depreciation on property, plant & equipment	
	2020 £m	2019 £m	2020 £m	2019 £m
Scottish Water regulated water and waste water services	502.7	503.4	292.2	281.1
Business Stream	2.8	1.0	1.7	1.3
Scottish Water non-regulated activities	7.5	4.8	3.1	0.2
	513.0	**509.2**	**297.0**	**282.6**

Revenue by geographical location of customers is as follows:

	Revenue	
	2020 £m	2019 £m
United Kingdom	1,615.3	1,468.0
Rest of the World	0.6	1.1
	1,615.9	**1,469.1**

£0.6m of revenue has been generated outside the UK (2019: £1.1 million) and this resulted in a current tax charge of £nil (2019: £nil). The revenue was derived from Australia (£0.3m) and Ireland (£0.3m) where we have tax residencies and registered branches. There are no offices in Australia or Ireland and only one member of staff in Australia.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

4. Operating surplus

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

	Note	2020 £m	2019 £m
Scottish Water PFI operating costs *		126.0	106.8
Depreciation of property, plant and equipment	9	297.0	282.6
Amortisation of intangible asset	10	2.0	3.2
Surplus on sale of property, plant and equipment		(0.9)	(0.9)
Release of deferred income in relation to capital grants		(1.2)	(1.3)
Operating lease rentals		3.8	3.5
Auditor's remuneration			
audit fee for audit of the company and consolidated financial statements (including £116,000 (2019: £118,000) in respect of the audit of subsidiary companies)		0.3	0.3
other services		–	–
Research and development expenditure		0.6	1.5
Acquisition fees relating to investment in subsidiaries		–	2.1

*PFI costs for 2019 include a £13.75 million credit in settlement of the commercial claim raised in 2016/17.

5. Staff costs

	Note	2020 £m	2019 £m
Wages and salaries		162.8	156.8
Social security costs		17.5	16.9
IAS 19 total service costs	23	63.0	54.1
Other pension costs		0.4	0.3
Employee benefit expense		243.7	228.1
Less: charged as capital expenditure		(92.6)	(91.0)
		151.1	**137.1**

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

	2020	2019
Regulated water and waste water services	3,954	3,976
Business Stream	378	362
Scottish Water non-regulated activities	119	129
	4,451	**4,467**

6. Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 129 to 140.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

7. Finance income and costs

	Note	2020 £m	2019 £m
Interest income:			
Short-term deposits		2.6	2.1
Finance income		**2.6**	**2.1**
Interest expense:			
Government loans		(145.6)	(147.4)
Other loans		(4.8)	(2.5)
Finance lease liabilities		(15.0)	(16.1)
Interest on pension scheme net liabilities	23	(6.4)	(5.1)
Finance costs		**(171.8)**	**(171.1)**
Net finance costs		**(169.2)**	**(169.0)**

8. Taxation

	Note	2020 £m	2019 £m
Analysis of tax charge recognised in the income statement			
Current tax: UK corporation tax		8.8	2.9
Current tax: Overseas corporation tax		–	–
Current tax: Adjustment in respect of prior years		2.1	0.6
		10.9	3.5
Deferred Tax: origination and reversal of timing differences - current year		10.2	14.8
Deferred Tax: origination and reversal of timing differences - prior years		(1.1)	(0.4)
Remeasurement of deferred tax - change in UK corporation tax rate		45.1	–
	16	54.2	14.4
Total tax charge		**65.1**	**17.9**
The charge for the year can be reconciled to the surplus per the income statement as follows:			
Group surplus before tax		85.7	86.1
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2019: 19%)		16.3	16.4
Adjustment in respect of prior years		1.0	0.2
Re-measurement of deferred tax due to change in UK corporation tax rate		45.1	(1.6)
Accounting gain with no capital gain		(0.2)	(0.2)
Depreciation on non qualifying additions		2.2	1.9
Other permanent differences		0.7	1.1
Deferred tax not provided		–	0.1
Total tax charge for the year		**65.1**	**17.9**

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

8. Taxation (continued)

The main UK corporation tax rate reduced from 20% to the current rate of 19% on 1 April 2017. The Finance Act 2016 included legislation that would reduce the tax rate further to 17% from 1 April 2020. This rate was enacted when The Finance Act 2016 received Royal Assent on 15 September 2016. In his Budget speech on 11 March 2020, the Chancellor announced the cancellation of the reduction in the main UK corporation tax rate to 17%. As such, the main UK corporation tax rate will remain at 19% from 1 April 2020. This cancellation of the reduction in the rate to 17% was substantively enacted at the balance sheet date, by virtue of the required Budget Resolutions passing on 17th March 2020. Therefore, closing UK deferred tax assets and liabilities have been recognised at 19%. The impact of the cancellation of the rate reduction has resulted in an increase to the net UK deferred tax liability of £45 million.

	2020 £m	2019 £m
Additional Disclosure		
The table below reconciles the notional tax charge at the UK corporation tax rate to the total current tax charge for the year:		
Group surplus before tax	85.7	86.1
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2019: 19%)	16.3	16.4
Relief for capital allowances in excess of depreciation	(7.8)	(16.8)
Financial transactions timing differences	7.0	2.3
Utilisation of tax losses	(9.6)	(2.0)
Expenses not deductible for tax purposes	0.7	1.1
Depreciation on non qualifying additions	2.2	1.9
Adjustment in respect of prior years	2.1	0.6
Current tax charge for the year	**10.9**	**3.5**

The Group's current tax charge is lower than the UK headline rate of 19% primarily due to the availability of capital allowances. Tax relief is available in relation to qualifying items of capital expenditure instead of accounting depreciation to encourage such investment. In 2019/20 Scottish Water invested £673 million on our assets, including treatment works, large diameter mains, historic sewers and IT. This investment has been aimed at improving customer service, drinking water quality, protecting the environment and supporting economic growth. The total capital investment in this regulatory period to the end of 2019/20 is £3.1 billion.

The Group is able to utilise losses carried forward in compliance with the loss restriction rules to reduce the current tax charge.

Some expenses are disallowed for tax purposes. These include the private use element of lease car rentals.

There are also various other adjustments where there is a simple timing difference between recognition of the income or expense in the accounts and in the related tax computations submitted to HMRC. The main adjustment is the movement in general provisions which are disallowed unless utilised.

For all of the timing differences, the corresponding deferred tax movements are at 19% as the rate of corporation tax will remain at 19% from April 2020.

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Tax charge/(credit) recognised directly in reserves					
Deferred tax relating to:					
Pension scheme actuarial movements	23	8.5	(8.9)	8.1	(8.5)
Movements in cash flow hedge	27	0.1	0.1	–	–
Total	16	**8.6**	**(8.8)**	**8.1**	**(8.5)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

9. Property, plant and equipment

	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
Group						
Cost						
At 1 April 2018	3,159.4	82.3	2,387.6	2,714.1	848.3	9,191.7
Additions	0.1	–	–	1.8	507.3	509.2
Acquisition of subsidiary companies:						
Cost at acquisition	–	–	–	104.0	–	104.0
Reversal of IFRIC 12 adjustments	(19.0)	–	–	(57.1)	–	(76.1)
Disposals*	(2.8)	–	–	(113.8)	–	(116.6)
Reclassifications	38.9	1.8	170.1	169.4	(380.2)	–
At 31 March 2019	3,176.6	84.1	2,557.7	2,818.4	975.4	9,612.2
Additions	0.9	–	–	5.3	506.8	513.0
Disposals*	(0.8)	–	–	(137.4)	–	(138.2)
Reclassifications	114.6	1.1	177.2	224.4	(517.3)	–
At 31 March 2020	3,291.3	85.2	2,734.9	2,910.7	964.9	9,987.0
Accumulated depreciation						
At 1 April 2018	1,104.4	25.2	522.5	1,557.8	–	3,209.9
Acquisition of subsidiary companies:						
Depreciation at acquisition	–	–	–	60.9	–	60.9
Reversal of IFRIC 12 adjustments	(5.7)	–	–	(34.2)	–	(39.9)
Charge for the year	68.4	2.6	18.0	193.6	–	282.6
Disposals*	(2.4)	–	–	(113.6)	–	(116.0)
At 31 March 2019	1,164.7	27.8	540.5	1,664.5	–	3,397.5
Charge for the year	69.0	2.5	19.4	206.1	–	297.0
Disposals*	(0.4)	–	–	(137.3)	–	(137.7)
At 31 March 2020	1,233.3	30.3	559.9	1,733.3	–	3,556.8
Net book value						
At 31 March 2020	**2,058.0**	**54.9**	**2,175.0**	**1,177.4**	**964.9**	**6,430.2**
At 31 March 2019	2,011.9	56.3	2,017.2	1,153.9	975.4	6,214.7

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 £0.3 million (2019: £1.3 million). No capital grants were received during the year in respect of infrastructure assets.

*Disposals include the write down of redundant assets no longer in beneficial use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

9. Property, plant and equipment (continued)

	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
Company						
Cost						
At 1 April 2018	3,137.3	82.3	2,387.6	2,697.9	847.7	9,152.8
Additions	0.1	–	–	–	503.3	503.4
Disposals*	(2.7)	–	–	(113.3)	–	(116.0)
Reclassifications	37.4	1.8	170.1	169.4	(378.7)	–
At 31 March 2019	3,172.1	84.1	2,557.7	2,754.0	972.3	9,540.2
Additions	0.9	–	–	–	501.8	502.7
Disposals*	(0.5)	–	–	(136.5)	–	(137.0)
Reclassifications	109.6	1.1	177.2	224.3	(512.2)	–
At 31 March 2020	3,282.1	85.2	2,734.9	2,841.8	961.9	9,905.9
Accumulated depreciation						
At 1 April 2018	1,097.9	25.2	522.5	1,544.3	–	3,189.9
Charge for the year	67.7	2.6	18.0	192.8	–	281.1
Disposals*	(2.3)	–	–	(113.2)	–	(115.5)
At 31 March 2019	1,163.3	27.8	540.5	1,623.9	–	3,355.5
Charge for the year	68.1	2.5	19.4	202.2	–	292.2
Disposals*	(0.3)	–	–	(136.5)	–	(136.8)
At 31 March 2020	1,231.1	30.3	559.9	1,689.6	–	3,510.9
Net book value						
At 31 March 2020	2,051.0	54.9	2,175.0	1,152.2	961.9	6,395.0
At 31 March 2019	2,008.8	56.3	2,017.2	1,130.1	972.3	6,184.7

*Disposals include the write down of redundant assets no longer in beneficial use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

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 Scottish Water group and company.

	Group Total £m	Company Total £m
Cost		
At 31 March 2018	568.8	568.8
Acquisition of subsidiary companies - reversal of IFRIC 12 adjustments	(76.1)	–
At March 2019 and March 2020	492.7	568.8
Accumulated depreciation		
At 1 April 2018	285.0	285.0
Acquisition of subsidiary companies - reversal of IFRIC 12 adjustments	(39.9)	–
Charge for the year	13.1	15.3
At 31 March 2019	258.2	300.3
Charge for the year	13.1	15.3
At 31 March 2020	271.3	315.6
Net book value		
At 31 March 2020	**221.4**	**253.2**
At 31 March 2019	234.5	268.5

The reversal of IFRIC 12 adjustments relates to the acquisition of the North-East Scotland PFI companies.

10. Intangible asset

The intangible asset relates to the acquisition of the non-household customer base of Southern Water Services Limited in April 2017. In addition, in October 2019, Business Stream acquired the non-household customer books of Yorkshire Water Business Services and Three-Sixty, both part of the Kelda Group.

The intangible asset is treated as having a finite life and is being amortised on a straight-line basis over its expected useful life, currently set at 8 years. In 2019/20 a re-assessment was undertaken on the expected life of the intangible assets and extended from a period of 5 years. The cost, additions, amortisation charge and carrying value are shown in the table below.

	As at 1 April 2019 £m	Additions £m	Amortisation charge £m	As at 31 March 2020 £m
Acquisition cost	16.7	6.0	–	22.7
Amortisation total	(6.7)	–	(2.0)	(8.7)
Net book value	**10.0**	**6.0**	**(2.0)**	**14.0**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

11. Investments

	Company	
	2020 £m	2019 £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[1]	Scotland	100.0	Holding company
Scottish Water Business Stream Limited[2]	Scotland	100.0	Licensed water and waste water services
Scottish Water Horizons Limited[1]	Scotland	100.0	Commercial non regulated water and waste water services
Scottish Water International Limited[1]	Scotland	100.0	Non trading
Scottish Water Solutions 2 Limited	Scotland	100.0	Non trading
Aberdeen Environmental Services Limited[3]	Scotland	100.0	PFI concession operator
Scottish Water Services (Grampian) Limited[1]	Scotland	100.0	Waste water services operator
Bandwidth Energy Limited[5*]	Scotland	100.0	Heat from waste water projects
Aberdeen Environmental Services (Holdings) Limited[4]	Scotland	100.0	Holding Company
Aberdeen Holdco Limited[1]	England & Wales	100.0	Holding Company

[1]owned by Scottish Water Horizons Holdings Limited

[2]owned by Scottish Water Business Stream Holdings Limited

[3]owned by Aberdeen Environmental Services (Holdings) Limited

[4]owned by Aberdeen Holdco Limited

[5]owned by Scottish Water Horizons Limited

Scottish Water owns shares in a further 8 companies which did not trade during the year ended 31 March 2020. 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. The companies are:

Scottish Water Ltd

Scottish Water Retail Ltd

Scottish Water Technology Ltd

Scottish Water Utilities Ltd

Scottish Water Wholesale Ltd

OneSource Infrastructure Services Ltd

Water Solutions Ltd

Business Stream Ltd[6]

[6]owned by Scottish Water Business Stream Limited

[*]Bandwidth Energy Limited is exempt from the requirement of the Companies Act 2006 relating to the audit of accounts under Section 479A of the Companies Act 2006.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

11. Investments (continued)

Group

On 19 December 2018, Scottish Water Horizons Holdings Limited (SWHH) acquired 100% of the issued share capital of Aberdeen Environmental Services Limited and Scottish Water Services (Grampian) Limited (formerly Kelda Water Services (Grampian) Limited) which operate waste water treatment sites in the North-East of Scotland under PFI service concession arrangements. At the same time, the 2 holding companies, Aberdeen Environmental Services Holdings Limited and Aberdeen Holdco Limited, were also acquired from the Kelda Group.

12. Inventories

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Raw materials and consumables	4.1	3.9	3.5	3.1
Less provision held	(0.2)	(0.2)	(0.2)	(0.2)
	3.9	**3.7**	**3.3**	**2.9**

All inventories will be recovered within 12 months.

13. Trade and other receivables

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Trade receivables	27	594.4	545.1	463.4	444.6
Less provision for impairment of trade receivables	27	(452.3)	(425.9)	(411.8)	(402.0)
Net trade receivables		142.1	119.2	51.6	42.6
Other receivables		29.7	25.6	26.1	23.7
Prepayments and accrued income		75.0	59.6	12.2	11.8
Amounts due from subsidiaries		–	–	9.0	0.2
		246.8	**204.4**	**98.9**	**78.3**
The following table shows the development of the provision for impairment of trade receivables:					
Balance at 1 April		425.9	411.3	402.0	391.2
Charge for the year		36.3	25.8	17.0	18.4
Amounts written down during the year		(9.9)	(11.2)	(7.2)	(7.6)
Balance at 31 March		**452.3**	**425.9**	**411.8**	**402.0**

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

14. Cash and cash equivalents

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Cash at bank and in hand	256.8	160.0	116.6	36.1
Short-term bank deposits	274.8	274.8	274.8	274.8
Cash and cash equivalents per the statement of cash flows	**531.6**	**434.8**	**391.4**	**310.9**

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

In Business Stream, during January 2020, letters of credit to the value of £11.9 million (2019: £10.6 million) were renewed in relation to ongoing wholesale payments made to English wholesalers.

15. Trade and other payables

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Current					
Trade payables		73.6	27.6	24.1	16.0
Non trade payables and accruals		124.6	109.6	124.1	109.2
Accruals		207.5	188.6	153.1	154.9
Payments received in advance		91.5	103.3	57.7	74.8
Other payables		25.5	26.1	0.8	1.1
Deferred income		5.6	2.7	1.5	1.4
Other taxes and social security		4.3	4.2	3.9	3.8
Amounts due to subsidiaries		–	–	34.7	24.3
		532.6	**462.1**	**399.9**	**385.5**
Non-current					
Payments received in advance		51.6	62.2	51.6	62.2
Deferred income		16.9	16.5	9.5	9.5
Other financial liabilities - interest rate swap	27	9.0	10.3	–	–
		77.5	**89.0**	**61.1**	**71.7**

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

16. Deferred taxation

The following are the deferred tax liabilities and assets recognised by Scottish Water and the 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 2018		420.6	(29.8)	(22.0)	(9.6)	359.2
Charge/(credit) to income statement	8	15.4	(3.5)	2.6	(0.1)	14.4
(Credit)/charge to reserves	8	–	(8.9)	–	0.1	(8.8)
Addition of balances of companies acquired		3.4	–	–	(1.9)	1.5
At 31 March 2019		439.4	(42.2)	(19.4)	(11.5)	366.3
Charge/(credit) to income statement	8	56.1	(8.2)	7.0	(0.7)	54.2
Charge to reserves	8	–	8.5	–	0.1	8.6
At 31 March 2020		**495.5**	**(41.9)**	**(12.4)**	**(12.1)**	**429.1**
Company						
At 1 April 2018		420.2	(29.5)	(22.0)	(9.4)	359.3
Charge/(credit) to income statement		15.6	(3.3)	2.8	(1.7)	13.4
Credit to reserves	8	–	(8.5)	–	–	(8.5)
At 31 March 2019		435.8	(41.3)	(19.2)	(11.1)	364.2
Charge/(credit) to income statement		56.1	(7.9)	8.9	(3.2)	53.9
Charge to reserves	8	–	8.1	–	–	8.1
At 31 March 2020		**491.9**	**(41.1)**	**(10.3)**	**(14.3)**	**426.2**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Deferred tax assets	(3.6)	(1.8)	–	–
Deferred tax liabilities	432.7	368.1	426.2	364.2
At 31 March	**429.1**	**366.3**	**426.2**	**364.2**

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 income 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 £117 million (2019: £143 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 2020 **(CONTINUED)**

17. Provisions for liabilities

	Income uncertainty provision £m	Restructure and other provision £m	Total £m
Group			
At 1 April 2018	14.6	1.5	16.1
Charged to the income statement	11.6	0.4	12.0
Utilised during the year	(2.8)	(0.2)	(3.0)
At 31 March 2019	23.4	1.7	25.1
Charged to the income statement	2.3	0.2	2.5
Utilised during the year	(3.1)	(0.4)	(3.5)
At 31 March 2020	**22.6**	**1.5**	**24.1**
Company			
At 1 April 2018	19.5	1.5	21.0
Charged to the income statement	17.8	0.4	18.2
Utilised during the year	(5.3)	(0.2)	(5.5)
At 31 March 2019	32.0	1.7	33.7
Charged to the income statement	5.0	–	5.0
Utilised during the year	(6.7)	(0.4)	(7.1)
At 31 March 2020	**30.3**	**1.3**	**31.6**

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Analysis of total provisions				
Current	12.9	10.4	16.4	13.5
Non-current	11.2	14.7	15.2	20.2
	24.1	**25.1**	**31.6**	**33.7**

The income uncertainty provision relates to non-household revenues. The reconciliation process, through the Central Market Agency (CMA), relating to each financial year will normally be finalised 18 months after the end of the relevant financial year. It is expected that the provision will be utilised over 2021 and 2022.

The restructuring and other provision relates primarily to onerous property rental costs.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

18. Other loans and borrowings

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Current				
Non-government loans	5.1	4.8	0.5	0.5
Obligations under finance leases	19.5	20.0	22.6	22.9
	24.6	**24.8**	**23.1**	**23.4**
Non current				
Non-government loans	35.8	40.9	–	0.5
Obligations under finance leases	217.0	236.5	256.6	279.2
	252.8	**277.4**	**256.6**	**279.7**
Total				
Non-government loans	40.9	45.7	0.5	1.0
Obligations under finance leases	236.5	256.5	279.2	302.1
	277.4	**302.2**	**279.7**	**303.1**

(i) Non-government loans

Other loans are repayable as follows:

	Note	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Total £m
Other loans - SW Company		0.5	–	–	–	0.5
Other loans - SW subsidiaries	20	4.6	5.0	17.1	13.7	40.4
At 31 March 2020		**5.1**	**5.0**	**17.1**	**13.7**	**40.9**
At 31 March 2019		4.8	5.0	10.2	25.7	45.7

Non-government loans of £40.4 million represent amounts borrowed by a subsidiary under a facility agreement with a consortium of banks which bear interest at a margin over LIBOR and are repayable in instalments over the period ending 31 March 2027. These are secured by fixed and floating charges over the undertaking, property, assets and rights of that and over the parent company's shares in that subsidiary. These loans have certain covenants attached.

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

	Book value 2020 £m	Book value 2019 £m	Fair value 2020 £m	Fair value 2019 £m
Non-government loans	40.9	45.7	45.5	51.2

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

18. Other loans and borrowings (continued)

(ii) Finance lease liabilities - PFI liabilities

Group

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts payable:				
Within one year	33.4	35.0	19.5	20.0
Between one and 5 years	130.7	131.4	108.2	106.5
After 5 years	163.9	196.6	108.8	130.0
Present value of minimum lease payments including finance charges	328.0	363.0		
Less future finance charges	(91.5)	(106.5)		
Present value of minimum lease payments	236.5	256.5	236.5	256.5

Company

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts payable:				
Within one year	39.2	40.8	22.6	22.9
Between one and 5 years	153.8	154.5	127.3	124.3
After 5 years	192.4	230.9	129.3	154.9
Present value of minimum lease payments including finance charges	385.4	426.2		
Less future finance charges	(106.2)	(124.1)		
Present value of minimum lease payments	279.2	302.1	279.2	302.1

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. On 19th December 2018, the companies operating the contract for Aberdeen were acquired by Scottish Water Horizons Holdings Limited, with Scottish Water remaining a client under the contract.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

18. Other loans and borrowings (continued)

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 for 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

19. Government loans

	Group and Company	
	2020 £m	2019 £m
Government loans	3,928.4	3,708.6

Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002.

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

Group and company	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	97.6	71.2	212.6	334.0	2,625.0	3,340.4
National Loans Fund	33.0	50.0	208.4	165.0	107.5	563.9
Public Works Loan Board	3.7	3.5	7.2	7.7	2.0	24.1
At 31 March 2020	**134.3**	**124.7**	**428.2**	**506.7**	**2,734.5**	**3,928.4**
At 31 March 2019	124.6	134.3	384.3	584.7	2,480.7	3,708.6

b. Fair values

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

	Book value		Fair value	
	2020 £m	2019 £m	2020 £m	2019 £m
Scottish Consolidated Fund	3,340.4	3,083.5	5,259.8	4,289.3
National Loans Fund	563.9	590.9	772.8	805.8
Public Works Loan Board	24.1	34.2	32.7	44.3
	3,928.4	3,708.6	6,065.3	5,139.4

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

20. Analysis of net debt

	Note	As at 1 April 2019 £m	Increase in cash £m	Movement in debt £m	As at 31 March 2020 £m
Group					
Cash and cash equivalents	14	434.8	96.8	–	531.6
Government loans	19	(3,708.6)	–	(219.8)	(3,928.4)
Other loans	18	(45.7)	–	4.8	(40.9)
Net debt		**(3,319.5)**	**96.8**	**(215.0)**	**(3,437.7)**
Company					
Cash and cash equivalents	14	310.9	80.5	–	391.4
Government loans	19	(3,708.6)	–	(219.8)	(3,928.4)
Other loans	18	(1.0)	–	0.5	(0.5)
Net debt		**(3,398.7)**	**80.5**	**(219.3)**	**(3,537.5)**

21. Retained earnings reserve

	Note	Retained earnings excluding actuarial gains £m	Actuarial gains/ (losses) on pension obligations £m	Retained earnings including actuarial gains/(losses) £m
Group				
At 1 April 2018		1,634.3	(115.3)	1,519.0
Retained surplus for the year		68.2	–	68.2
Actuarial loss net of deferred taxation	23	–	(43.5)	(43.5)
At 31 March 2019		**1,702.5**	**(158.8)**	**1,543.7**
Retained surplus for the year		20.6	–	20.6
Actuarial gain net of deferred taxation	23	–	49.7	49.7
At 31 March 2020		**1,723.1**	**(109.1)**	**1,614.0**
Company				
At 1 April 2018		1,460.3	(114.4)	1,345.9
Retained surplus for the year		67.2	–	67.2
Actuarial loss net of deferred taxation	23	–	(41.4)	(41.4)
At 31 March 2019		**1,527.5**	**(155.8)**	**1,371.7**
Retained surplus for the year		31.1	–	31.1
Actuarial gain net of deferred taxation	23	–	47.0	47.0
At 31 March 2020		**1,558.6**	**(108.8)**	**1,449.8**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

22. Results of Scottish Water (the Company)

Of the results for the financial year, a retained surplus of £31.1 million (2019: £67.2 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.

23. 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 Scottish Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively. The schemes provide defined benefits based on career average pensionable pay. Actual pension costs for the year for each fund, as a % of pensionable pay, were 18.5% (2019: 18.5%), 31.8% (2019: 31.8%) and 19.3% (2019: 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 2017 for all 3 funds and updated at 31 March 2020 by a qualified independent actuary, to take account of the requirements of IAS 19.

The major assumptions used by the actuaries were:

	2020 %	2019 %
Rate of increase in pensionable salaries	1.90	2.45
Rate of increase in pensions payment	1.90	2.45
Discount rate	2.30	2.40
CPI inflation rate	1.90	2.45

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

	North East Scotland Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2020			
Male	22.6	21.7	21.4
Female	24.8	24.3	23.7
Retiring at 31 March 2040			
Male	25.5	24.7	23.4
Female	27.8	27.5	25.8

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. 1.6%	Increase / decrease by c. £30m
Discount rate	+/- 0.5% per annum	Decrease / increase by c. 9.4%	Decrease / increase by c. £178m
CPI Inflation rate	+/- 0.5% per annum	Increase / decrease by c. 7.7%	Increase / decrease by c. £146m
Longevity	Increase life expectancy by 1 year	Increase by c. 4.0%	Increase by c. £76m

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

23. Pensions (continued)

Guaranteed Minimum Pension (GMP) equalisation

In considering the potential impact of GMP equalisation, the advice and responses provided by the 3 pension funds and Scottish Water's actuarial advisors has been as follows:

- the general expectation is that a 'trigger event' is yet to occur in the Scottish Local Government Pension Scheme and our default approach will be to ignore any GMP equalisation impact in the employer's 31 March 2020 IAS 19 reports.

This opinion is shared by CIPFA.

The McCloud Case

In considering the potential impact of the McCloud Case (age discrimination) on the gross pension liability, actuarial advice has been sought. In the case of the North East Scotland Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund the McCloud adjustment has been calculated at approximately 0.1% of active liabilities at 31 March 2020. This equates to a past service cost of £0.2 million, £0.3 million and £0.4 million respectively. This has been recognised in the gross pension liability at 31 March 2020.

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

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Total fair value of assets		1,676.5	1,742.8	1,640.9	1,706.9
Present value of scheme liabilities		(1,897.0)	(1,991.1)	(1,858.0)	(1,950.2)
Gross pension liability		**(220.5)**	**(248.3)**	**(217.1)**	**(243.3)**
Related deferred tax asset	16	41.9	42.2	41.1	41.3
Net pension liability		(178.6)	(206.1)	(176.0)	(202.0)

Scheme assets are stated at their bid values.

Reconciliation of opening and closing retirement benefit liabilities and assets

		Group		Company	
	Note	2020 £m	2019 £m	2020 £m	2019 £m
Movements in liabilities during the year:					
Opening value of total liabilities		(1,991.1)	(1,798.1)	(1,950.2)	(1,764.2)
Total service cost	5	(63.0)	(54.1)	(60.5)	(52.0)
Interest on pension scheme liabilities	7	(48.0)	(46.9)	(47.0)	(46.0)
Contributions by members		(9.3)	(9.0)	(8.9)	(8.6)
Actuarial gain/(loss)		163.9	(131.4)	158.3	(127.6)
Benefits paid		50.5	48.4	50.3	48.2
Closing value of total liabilities		**(1,897.0)**	**(1,991.1)**	**(1,858.0)**	**(1,950.2)**
Movement in assets during the year:					
Opening fair value of total assets		1,742.8	1,622.8	1,706.9	1,590.5
Interest on pension scheme assets	7	41.6	41.8	40.7	40.9
Contributions by members		9.3	9.0	8.9	8.6
Contributions by the employer		39.0	38.6	37.9	37.4
Actuarial (loss)/gain		(105.7)	79.0	(103.2)	77.7
Benefits paid		(50.5)	(48.4)	(50.3)	(48.2)
Closing fair value of assets		**1,676.5**	**1,742.8**	**1,640.9**	**1,706.9**
Gross deficit in the schemes at 31 March		**(220.5)**	**(248.3)**	**(217.1)**	**(243.3)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

23. Pensions (continued)

Return on assets

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

	Note	Group 2020 £m	Group 2019 £m	Company 2020 £m	Company 2019 £m
Actual return on pension scheme assets		(64.1)	120.8	(62.5)	118.6
Actuarial gain/(loss) in other comprehensive income in the consolidated statement of comprehensive income					
Gross actuarial gain/(loss) recognised in the pension fund		58.2	(52.4)	55.1	(49.9)
Deferred tax movement	16	(8.5)	8.9	(8.1)	8.5
Net actuarial gain/(loss) recognised in other comprehensive income in the consolidated statement of comprehensive income	21	**49.7**	**(43.5)**	**47.0**	**(41.4)**

Amounts recognised in the consolidated income statement

	Note	2020 £m	2019 £m
Total service cost	5	63.0	54.1
Interest cost on pension scheme net liabilities (see above)	7	6.4	5.1
		69.4	59.2

The unpaid contributions outstanding at the year end included in other payables (note 15) was £0.5 million (2019: £0.9 million). It is estimated that Scottish Water will make contributions of £33 million to the pension funds in financial year 2020/21.

History of experienced gains and losses

	2020 £m	2019 £m
Group		
Difference between the expected and actual return on scheme assets:		
Amount	(105.7)	79.0
Fair value of assets	1,676.5	1,742.8
Experienced gains/(losses) on scheme liabilities:		
Amount	7.6	(3.6)
Present value of liabilities	1,897.0	1,991.1
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	156.3	(127.8)
Total variance between pension fund actuarial assumptions and actual experience	**58.2**	**(52.4)**
Gross deficit in the schemes at 31 March	(220.5)	(248.3)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

23. Pensions (continued)

	2020 £m	2019 £m
Company		
Difference between the expected and actual return on scheme assets:		
Amount	(103.2)	77.7
Fair value of assets	1,640.9	1,706.9
Experienced gains/(losses) on scheme liabilities:		
Amount	7.4	(3.6)
Present value of liabilities	1,858.0	1,950.2
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	150.9	(124.0)
Total variance between pension fund actuarial assumptions and actual experience	**55.1**	**(49.9)**
Gross deficit in the schemes at 31 March	(217.1)	(243.3)

24. Commitments

a. Capital commitments

Scottish Water has contracted capital commitments of £483.8 million (2019: £388.1 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

Scottish Water 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.

Scottish Water also leases vehicles under cancellable operating lease agreements. Scottish Water 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:

	2020 £m	2019 £m
Within one year	2.9	2.8
Between one and five years	7.5	8.6
After five years	15.8	16.0
	26.2	27.4

25. Contingent assets and liabilities

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 **(CONTINUED)**

25. Contingent assets and liabilities (continued)

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.

26. Related party transactions

Scottish Water has related party relationships with the Scottish Government, with its subsidiaries (note 11), 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 19.

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.

Subsidiaries

During the year Scottish Water entered into the following transactions with its subsidiaries (note 11):

	2020 £m	2019 £m
Wholesale water and waste water services to Business Stream	133.8	139.6
Sale of waste water services to other subsidiaries	0.5	0.5
Purchase of waste water services from other subsidiaries	23.7	7.8
Seconded staff costs charged to subsidiaries	4.1	4.5
Other operating costs charged to subsidiaries	0.6	0.9

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. Scottish Water'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 129 to 140. Scottish Water's non-executive members hold additional roles within other organisations (see Members on pages 113 to 116).

27. 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 14 to 111 and Corporate Governance report on pages 117 to 121.

a. Qualitative risk disclosures

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

27. Financial instruments and risks (continued)

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 Government borrowings are at fixed interest rates. Therefore Scottish Water is not deemed to bear any interest rate risk.

Other borrowings, following the acquisition of Aberdeen Environmental Services Limited (note 11), are linked to LIBOR and are therefore exposed to changes in LIBOR which could have a material effect on interest costs from year to year and over time. In order to manage the exposure to movements in LIBOR a floating interest rate to fixed rate swap exists. The fair values of these derivatives at the balance sheet date are determined by reference to their market values, which are provided by a third party (note 15).

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.

b. Categories of financial assets and liabilities and fair values

Scottish Water's financial assets and liabilities comprise trade and other receivables (note 13), cash and cash equivalents (note 14), borrowings (notes 18 and 19) and trade and other payables (note 15). No trading in derivative financial instruments was undertaken.

Basis of determining fair value

The financial assets of Scottish Water fall into the 'loans and receivables' category. The financial liabilities of Scottish Water 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 18 and 19.

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 2020 (CONTINUED)

27. 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	
	2020 £m	2019 £m	2020 £m	2019 £m
Trade receivables per note 13:				
Trade receivables	594.4	545.1	463.4	444.6
Less provision for impairment of trade receivables	(452.3)	(425.9)	(411.8)	(402.0)
Net trade receivables	142.1	119.2	51.6	42.6
Analysed between:				
Household receivables	450.2	435.5	450.2	435.5
Less provision for impairment	(408.8)	(399.0)	(408.8)	(399.0)
Net household receivables	41.4	36.5	41.4	36.5
Business customer receivables	144.2	109.6	13.2	9.1
Less provision for impairment	(43.5)	(26.9)	(3.0)	(3.0)
Net business customer receivables	100.7	82.7	10.2	6.1

Household water and waste water services are billed to customers by the 32 Councils as an element of the annual Council Tax bills. The Councils 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 by the Councils. Debt since the establishment of the former Water Authorities in 1996 continues to be collected. As at 31 March 2020 trade receivables in respect of household customers totalled £450.2 million with a provision of £408.8 million (2019: £435.5 million and £399.0 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 £m
Overall household collection rate	+/- 0.01%	Increase / decrease by c. £1.5m
In-year household bad debt provision charge	+/- 0.10%	Increase / decrease by c. £0.9m

As at 31 March 2020 trade receivables from business customers totalled £144.2 million (2019: £109.6 million). The ageing analysis of trade receivables from business customers and the related provisioning is as follows and includes an in year charge of £13.2 million in relation to the potential consequences of the Covid-19 pandemic:

Group	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Gross receivable	144.2	84.8	40.8	13.6	5.0
Provision	(43.5)	–	(27.7)	(10.8)	(5.0)
Net trade receivable as at 31 March 2020	100.7	84.8	13.1	2.8	–
Gross receivable	109.6	55.8	37.0	12.4	4.4
Provision	(26.9)	–	(12.5)	(10.0)	(4.4)
Net trade receivable as at 31 March 2019	82.7	55.8	24.5	2.4	–

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2020 (CONTINUED)

27. Financial instruments and risks (continued)

	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Company					
Gross receivable	13.2	9.3	2.3	0.5	1.1
Provision	(3.0)	–	(1.4)	(0.5)	(1.1)
Net trade receivable as at 31 March 2020	10.2	9.3	0.9	–	–
Gross receivable	9.1	4.6	1.7	1.1	1.7
Provision	(3.0)	–	(0.2)	(1.1)	(1.7)
Net trade receivable as at 31 March 2019	6.1	4.6	1.5	–	–

Group

Other financial Liabilities - Interest rate swap

As at the acquisition of Aberdeen Environmental Services Limited on 19 December 2018, the floating interest rate to fixed rate interest swap liability had a carrying value of £10.9 million. Any gains or losses on the effective portion of the hedging instruments are recognised within the Consolidated statement of comprehensive income or as an expense within the Consolidated income statement. The maturity of the interest rate swap coincides with the maturity of the loan (31 March 2027).

Interest rate swap - financial liability	Note	2020 £m
Balance at 31 March 2019		(10.3)
Effective portion of changes in fair value of cash flow hedge		1.3
Balance at 31 March 2020	15	**(9.0)**

The fair values of these derivatives at the balance sheet date are determined by reference to their market values, which are provided by a third party.

The cash flow hedge reserve in the balance sheet, and the corresponding change in fair value recognised in the Consolidated statement of comprehensive income, reflect the movement in the interest rate swap liability net of deferred taxation.

	Cash flow hedging reserve		
	Gross reserve £m	Deferred tax £m	Net reserve £m
Balance at 31 March 2019	10.3	(1.8)	8.5
Effective portion of changes in fair value of cash flow hedge	(1.3)	0.1	(1.2)
Balance at 31 March 2020	**9.0**	**(1.7)**	**7.3**

28. 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.

29. Regulatory information

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

The WICS monitors Scottish Water's performance on efficiency and customer service and approves the code of practice. Each year the WICS publishes reports on the exercise of its functions. In preparing these reports, the WICS 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 WICS 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 & Accounts 2019/20: Performance and Prospects.
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	Burncrooks Water Treatment Works Quality Trihalomethanes (TMH) Compliance	£15 million
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	Scottish Amateur Swimming Association*	£165,000
Gifts	£100	None	–

*Funded by Scottish Water Horizons Holdings Limited from the profits of non-regulated activities.

THE WATER INDUSTRY IN SCOTLAND

The Scottish Parliament
www.parliament.scot

The Scottish Government
www.gov.scot

dwqr
www.dwqr.scot

SEPA
www.sepa.org.uk

Scottish Water
Trusted to serve Scotland
www.scottishwater.co.uk

water industry commission for scotland
www.watercommission.co.uk

customer forum
The best water service for the fairest price
www.customerforum.org.uk

citizens advice scotland
www.cas.org.uk

SCOTTISH PUBLIC SERVICES OMBUDSMAN
www.spso.org.uk

Scottish Water

Trusted to serve Scotland