
# INTERIM REPORT AND ACCOUNTS: PERFORMANCE AND PROSPECTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2021

Scottish Water

Trusted to serve Scotland

# CONTENTS



Please note: some photographs which appear within the Interim Report and Accounts for the six months to 30 September 2021 were taken before the Covid-19 pandemic.

# GOVERNANCE

# SCOTTISH WATER MEMBERS AND CORPORATE ADVISERS

## Executive Members

Douglas Millican, Chief Executive
Peter Farrer, Chief Operating Officer
Alan P Scott, Finance Director

## Non-executive Members

Dame Susan Rice, DBE, Chair
Samantha Barber
James Coyle
Steven Dickson
Iain Lanaghan
Ken Marnoch
Deirdre Michie, OBE
Catriona Schmolke (appointed 1 November 2021)
Paul Smith (resigned 29 June 2021)

## Independent Auditors

KPMG LLP
Saltire Court
20 Castle Terrace
Edinburgh
EH1 2EG

# CHAIR'S STATEMENT
## DAME SUSAN RICE

The first six months of this financial year were also the first six months of our new six-year regulatory period. The expectation for sectors regulated in this way is that the transition from one regulatory period to the next carries a number of risks and difficulties. So, I am delighted to report that the transition from the previous SR15 period to the new SR21 period has been relatively smooth, despite some significant changes to the way we operate.

Most pleasing for me has been our success in continuing to invest in the vital infrastructure that our customers and communities rely on. Despite bringing in new partners to work with us and undertaking important changes to our investment planning and decision making, we have managed to increase the rate of our capital investment. That is a truly remarkable achievement in the circumstances.

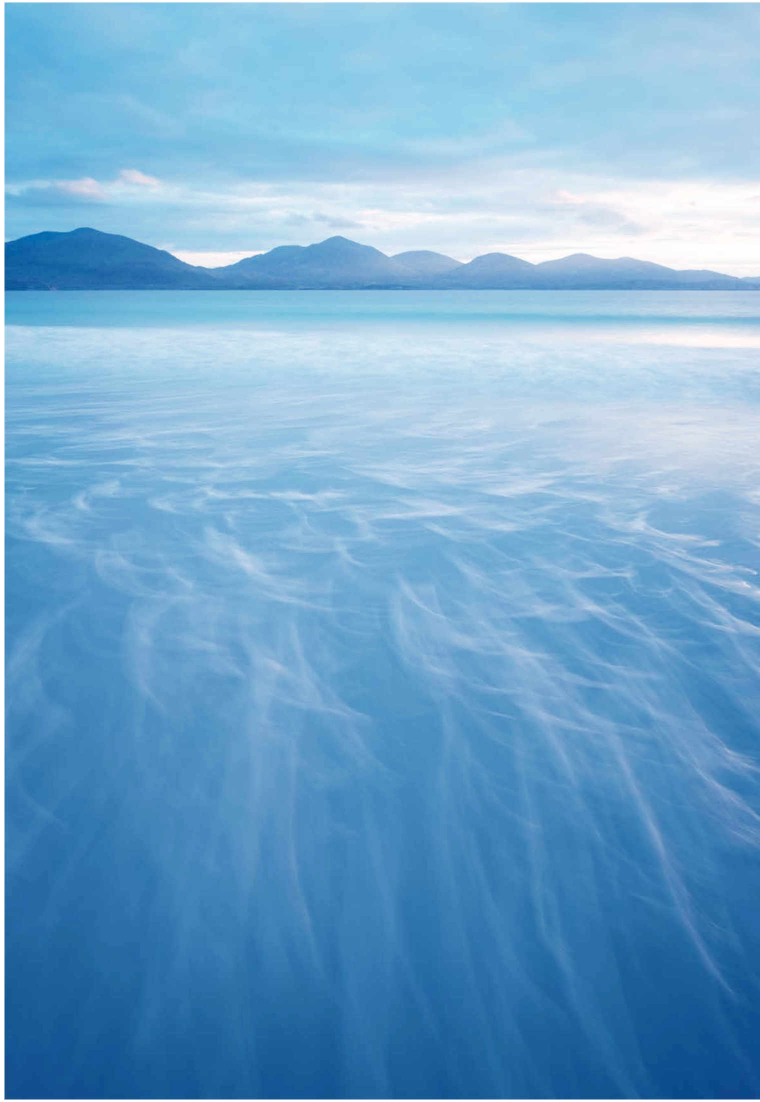
Placing that in a broader context, Scotland, like many other countries, intends to build back stronger and greener than before the Covid-19 pandemic. Our increased investment levels and smarter ways of investing, supporting our target of achieving Net Zero carbon emissions by 2040, are a significant part of Scotland's plan. Our contribution to Scotland's green recovery is well underway.

The challenges of the last six months, as our Chief Executive reports, have been largely caused by the weather, and recently we have also dealt with challenges caused by Storm Arwen. Again, looking to the broader context, we well understand that the impacts of climate change are only going to get more difficult for us and that is why we have plans in place to further increase investment to improve our resilience to our changing climate and maintain the level of service we provide to our customers.

As a Board, we have been struck by the dedication and commitment of the entire team at Scottish Water to dealing with the challenges of the last few months. We have worked with the senior team to ensure we have the strategy and plans needed for our continued success.

Finally I'd like to welcome Catriona Schmolke who joined our Board in autumn. I look forward to welcoming other new Board members in due course.

**Dame Susan Rice**
Chair, Scottish Water
December 2021



# CHIEF EXECUTIVE'S REPORT
## DOUGLAS MILLICAN

In the first six months of this financial year we have celebrated one of our greatest achievements while also encountering conditions that have been among the most difficult we have experienced at Scottish Water. With my 25 years of experience in the water sector, I can honestly say the last few months have been truly extraordinary.

While Covid-19 dominated our lives last year, and we're clearly still living with the impact of the pandemic, the dominant issue of the last six months for Scottish Water has been the weather.

It has been a period of record-breaking extremes that has severely tested our assets, networks and teams across the country. This has had an inevitable impact on our customers and the environment.

We have been faced with many challenges. These have included higher leakage levels resulting from the impact of past winter including early 2021 freezing conditions and higher levels of bursts on our water network in summer. The extended hot and dry weather led to significant increases in water consumption as well as our water resource levels and raw water quality being put under pressure. Additionally, there were intense summer storms that caused customer flooding and pollution events.

Looking ahead to the winter, we know the weather will bring many more challenges. This November, Storm Arwen struck the east and north-east with winds of up to 100 miles per hour, causing extensive damage and loss of power to many areas. This power outage impacted many of our sites and mobile communications with our field teams, and led to a loss of water supply for 17,500 homes and businesses. Our people worked round the clock to restore supplies as quickly as possible.


Around 800 properties were without water for four days and we ensured bottled water was available where needed. We kept customers and communities updated throughout and worked closely with partners including local councils and the electricity network company.

In summary, this has been a tough period for us but our people have handled the challenges robustly, working hard to maintain the trust of the customers and the communities we serve.

We pride ourselves on our excellent customer service – it's at the heart of everything we do. All our activity, decision-making and investment choices are anchored to doing what's right for customers. Nevertheless, we take very seriously, and seek to resolve, those rare circumstances where we do not deliver the service our customers expect.

In the middle of our summer challenges it was, therefore, particularly pleasing to receive strong external recognition for our work.

In July the Institute of Customer Service's latest UK Customer Satisfaction Index (UKCSI) announced Scottish Water was the highest rated organisation in the British utility sector for the first time ever - and the ninth highest rated in all sectors out of a total of more than 270 organisations in 13 different sectors. This success, coming during the Covid-19 pandemic, makes it an even more remarkable achievement.

Looking ahead, our planning for the transformation of Scottish Water, which I wrote about in our last Performance and Prospects report, is well-informed and comprehensive. Over the past few months we have launched our transformation plan and this will provide the framework through which we develop and deliver our vital services for decades to come.

In our Strategic Plan we set out the challenges we face and our three strategic ambitions that will enable us to fulfil our role in achieving Scotland's ambitious Water Sector Vision. These ambitions are: **Service Excellence**, **Beyond Net Zero Emissions** and **Great Value and Financial Sustainability**. In this report we provide insight into the challenges we have faced over the previous six months and we set out our performance. Additionally, we set out the future steps we are taking and how this links to the Delivery Plan we published in August 2021.

**Douglas Millican**
Chief Executive, Scottish Water
December 2021

# SERVICE EXCELLENCE
## THE CHALLENGES WE HAVE FACED

In the last six months, many parts of the country, notably in the north and west, experienced the driest April to September since records began 160 years ago. Overall Scotland's summer was the second driest on record. That placed real strain on our raw water sources and treatment and distribution systems. At the same time it also increased customer consumption, and at the height of summer up to 200 megalitres extra water was required each day to meet demand.

FACT

Scottish Water has 253 reservoirs or lochs it uses for drinking water supplies and a total of 400 sources, including rivers, boreholes and springs.

The performance of our waste water system has come under increased scrutiny from stakeholders, elected representatives, communities, and the media in recent months. This has been prompted in part by flooding events caused by extreme wet weather and also by an increase in the number of people spending time outdoors and on 'staycations' and the growing popularity of water sports such as paddle boarding and wild swimming.

We have experienced some economic impacts over the last few months, including the availability and cost of certain supplies. While there has been a significant increase in wholesale energy prices, our policy of buying energy well ahead of need means that we have been protected from significant energy price increases so far and will be protected for the rest of this financial year.

On our Capital programme the general construction market conditions are driving cost pressures and availability of materials, labour and commodities continue to present us challenges. Projections on market conditions vary with some indicating the market will be more stable in 2022 and others predicting longer periods of construction inflation circa 5%. We are working closely with our supply chain partners to understand and mitigate impacts but do expect some delays and cost increases.

On one Sunday in July, demand for water in the East Neuk of Fife, including the Anstruther, Pittenweem, Crail, and Elie areas, increased by about 40%, or one million litres per day, compared with normal water usage levels at that time of year.

## FACT

**Health and Safety Performance**

Looking at our performance to date this year, there have been 10 Scottish Water RIDDOR incidents, all involving contractors. This compares with seven, four involving contractors, at the same time last year. Each incident is subject to a Director Led Review with learning shared through contractor forums and via our Supply Chain Learning Hub. Investigations have majored on the human factors to understand better why those involved took certain decisions and what actions may prevent a reoccurrence.

There has been an increase in the number of hazards reports – 109 in the last 12 months. This is compared to 57 at the same time last year. This shows our people are reporting potential issues where appropriate action can then be taken, and so helping keep themselves and their colleagues safe.

## CASE STUDY
### CRAIGLEITH STRATEGIC PLAN

Edinburgh has been hit with intense summer storms over the last three years. In response we are developing a strategic plan for the Craigleith area. Working with City of Edinburgh Council and Scottish Environment Protection Agency (SEPA) we will create a better understanding on how the water moves across the surface, how the current assets including sewers, road drains and gullies and watercourses work together. We will identify green space to use to store peak flow and look for interventions to keep surface water on the surface and reduce the amount of flow entering our sewers.

# OUR PERFORMANCE
## DELIVERING CONSISTENTLY EXCELLENT WATER QUALITY

The extended dry weather since April has given us many challenges, including reservoir levels dropping to historic lows, for the time of year, and water quality issues such as naturally-occurring manganese discolouring supplies at some customers' taps.

In July our regulatory sampling programme restarted as pandemic restrictions eased across the country. This allowed our samplers to visit customers at home – adhering to safety processes – to take samples for testing to ensure compliance with stringent water quality standards. To support the resumption of domestic sampling, public information and communication was undertaken online and in the media.

Our track record of year-on-year reduction in leakage from our network has come under pressure over the last few months, due to the after-effects of a harsh winter and a high number of burst pipes in the summer due to very dry ground conditions. This remains an area of focus for us and we know it will be a challenge to achieve year-on-year reductions in leakage but we are taking significant steps to bring leakage levels down again.

### FACT

The Drinking Quality Water Regulator for Scotland Annual Report published in August provided us with independent recognition for our work in planning, delivering, and maintaining water services despite change to water usage and staff working patterns during the Covid-19 pandemic, calling our work "exemplary."

### CASE STUDY
DAER

Discoloured water impacted on supplies to customers in Lanarkshire. The incident led to more than 11,800 contacts from customers across a number of channels. Naturally occurring manganese entered the water supply as water levels dropped to lowest recorded levels in our Daer and Camps reservoirs. Some areas saw the lowest storage levels this century – as low as 33%. We carried out extensive sampling and testing programmes working alongside the Drinking Water Quality Regulator (DWQR) and public health officials.

### FACT

At the height of the summer, water demand increased by 200 mega litres a day - the equivalent of 2.4 million baths.

# TRANSFORMING WASTE WATER SERVICES

Over the Spring and Summer we faced the double challenge of prolonged dry weather followed by short bursts of extremely wet weather. The impact of this on our waste water network was two-fold: firstly, the dry weather meant that our system was not being flushed out as it would normally be and so there was a significant amount of material in sewers waiting to cause blockages. When the extremely wet weather arrived those blockages were created and the sheer volume of water overwhelmed our system in certain places causing incidences of sewer flooding and an increase in the number of environmental pollution incidents.

In the last six months we have seen a significant rise in the number of complaints and enquiries we received from a range of stakeholders including customers, community action groups and politicians about flooding.

While we always attempt to clean up after such events as soon as possible, effective long-term solutions to these problems are challenging to develop and will require significant investment. We are starting phase 1 of our Intelligent Network implementation, which is a foundation of our Intelligent Asset Base. This will place sensors in three priority catchments which will provide information on how the networks are operating using machine learning and artificial intelligence to allow us to respond to issues ahead of them impacting customers or the environment.

Our waste water system includes thousands of essential safety valves that prevent flooding of homes and streets, called combined sewer overflows (CSOs), which release storm water at times of extreme rainfall. With climate change these safety valves are coming into use more often. We are currently developing a routemap to how we improve CSO performance and increase the monitoring of them.

We are working with SEPA to develop plans to substantially increase the coverage of monitoring of these overflows through our intelligent networks, provide near real-time alerts to water users and to design solutions for a small number of overflows that most impact the environment.

## CASE STUDY
### FLOOD PREVENTION INVESTMENT

We have made significant investment in flood prevention. In the last six months we saw the completion of a £3.2 million sewer upgrade in Eyemouth in the Borders and a £3.4 million investment in Tarbert, Argyll and Bute. However, the long-term sustainable solution is not building bigger sewers or storage tanks. As such we are taking part in an innovative multi-agency project in the St Mary's area of Dundee using the natural environment to improve the way storm water is managed and reduce flood risk.

# ENABLING SUSTAINABLE AND INCLUSIVE ECONOMIC GROWTH

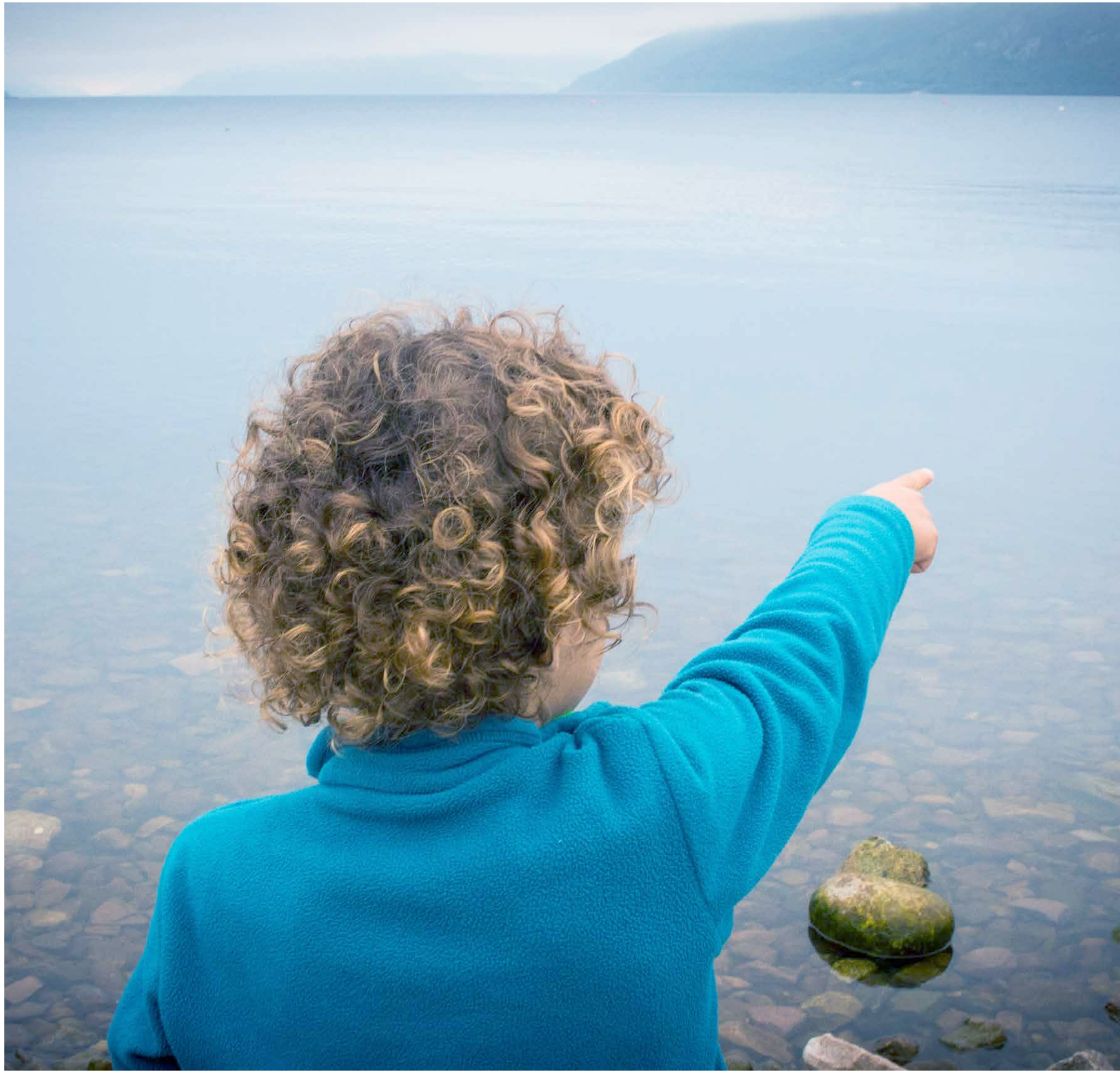
We will continue to work to support a flourishing Scotland. We have water and waste water assets with capacity for future development and we will invest to support new development to enable growth across the country.

We are already delivering connections to our assets in line with pre-pandemic levels. Between April and September 2021 we completed 12,086 water connections and 9,754 waste water connections – an increase from the same six-month period last year which was 8,429 and 8,567 respectively.

During the period

**WE INVESTED**
**£17.6 MILLION**

in building additional infrastructure capacity, particularly in additional waste water treatment capacity.



# EMPOWERING CUSTOMERS AND COMMUNITIES

We have seen a 36% increase in the number of customers contacting us about service issues, mostly due to weather impacts, which translated into a large increase in the volume of required work. In the last six months we had a 28% increase in cases where we had to attend a site to fix an issue, driven mainly by increased water leaks and sewer flooding contacts.

This increase in customer contacts about service issues has impacted our Household Customer Experience Measure (hCEM) score, which is below target at this half-way point. However, we are confident we can achieve increases in this score over the rest of the year. On our Non-household Customer Experience Measure (nhCEM) we are doing better – and have the potential to complete the year towards the top of our target range.

While these performance challenges are disappointing one thing is certain – it is due to the dedication of our teams across Scottish Water that we are still performing around our ambitious target zones, given the weather challenges we have faced.

As set out in Chief Executive's Report, we have continued to see good external recognition from the Institute of Customer Service's latest UK Customer Satisfaction Index (UKCSI) who announced that Scottish Water was the highest rated organisation in the British utility sector for the first time ever – and the ninth highest rated in all sectors.

As set out in our 2021-2023 Delivery Plan we have established a new Independent Customer Group to help ensure the expectations of customers and communities are identified, articulated, and advanced as we work to achieve the objectives set out in our Strategic Plan and the water sector Vision.

# FUTURE PROSPECTS

The weather extremes that we have experienced so far this year, as well as the most recent United Nations climate predictions, illustrate the ever more challenging future we face as the climate continues to change.

We are developing plans to address these impacts for both our water and waste water services so that we can continue to deliver high service levels to customers. This has led to an increased need for investment across both services, with managing flood risk to our customers the most substantial of these.

Our plans to develop smart networks, with real-time monitoring of our assets and networks will be key to mitigating the risks of sewer blockages, giving us the opportunity to take action to prevent incidents impacting customers.

We also plan to reduce sewer blockages, working with customers and government to take steps to reduce the number of wet wipes, the cause of most sewer blockages, from entering the sewer system.

Long-term our work will focus on keeping surface water from entering the sewer network, particularly during storms, by creating more innovative blue/green solutions, where environmental features hold more water in times of heavy rain and allow it to dissipate more slowly.

On the drinking water side, we are focused on increasing the resilience of our assets and networks to support increased demand for water in hot weather as well dealing with the increased stress on water availability and water quality due to dry weather. The changing water in our raw water sources, for example the elevated levels of manganese at Daer reservoir that we experienced in the summer, also require us to invest in our treatment processes to maintain drinking water quality standards.

We have an opportunity to engage more with customers to reduce their water consumption. At the height of the summer we believe we reduced peak consumption by around 50 Ml/d through customer engagement. Looking ahead, we must encourage changes in customer behaviours to reduce per person water consumptions levels, currently among the highest in the UK.

## COVID-19 RECOVERY

We have slowly started to reopen our offices to enable our staff who need or wish to return to them to do so. This is on a limited basis for now to ensure ongoing Scottish Government regulations are adhered to. As we adopt and adapt to hybrid working we will take this opportunity to continually learn and review the most efficient and effective way of working flexibly together.

We will ensure our people have the support and digital capacity to carry out their work and continue to build more collaborative relationships to better deliver our services. Additionally, we will do all we can to safeguard our digital systems from the threat of potential cyber-attacks.

# BEYOND NET ZERO

The extreme weather events we have seen happening with increasing frequency reinforce the importance of us doing all we can, as quickly as possible, to support the elimination of the emissions that contribute to climate change.

We marked the first anniversary of the launch of our Net Zero Emissions Routemap in September by announcing our progress to date. It included:

- Reducing our operational greenhouse emissions footprint by 2% year-on-year
- Installing 1GWh of solar energy
- Restored 45 hectares of peatland
- Assessed 450 of our sites for ability to host and use renewables
- Established our Carbon Academy providing training to our people and suppliers
- Established a new Benefits Framework, making finding the lowest carbon solution a central part of investment decision-making
- Finalising plans to change 800 of our diesel fleet vans to electric vehicles

Additionally, in the last six months we became a signatory of the Edinburgh Declaration – an international statement of intent led by the Scottish Government to ensure action is taken to protect global biodiversity. We also became a member of the Clyde Climate Forest network which will see 18 million trees planted in both urban and rural parts of Glasgow City Region over the next decade.

And looking at our investment emissions to date we are making progress – testing low carbon concrete, taking steel out of our designs and using recyclable material for roads to help ensure we do all we can to embrace a circular economy.

# OUR FUTURE PROSPECTS

In the next year we will continue to progress our routemap and look for learnings from our expert panel and supply chain partners. Among our most ambitious targets for the next 12 months are increasing further the rate of energy efficiency delivery and targeting an additional 3GWh of energy generation from bioresources. We will also be progressing a number of zero emission investment projects which we will announce in the coming months.

We are facing some timing challenges with important further peatland restoration and renewables schemes and know some parts of our plan may prove challenging to achieve. Where we anticipate any shortfall we will look to take corrective action to remain on track.

**Our first annual update is available here:**
**https://scottishwaternetzero.co.uk/annual-update/**

## CASE STUDY
### DENNY PILOT REACTOR

We have developed a design for the anaerobic treatment of waste water and have installed a pilot reactor at our Denny Waste Water Treatment Works. This technology offers the potential for a waste water treatment works to not only be low energy but also to generate all the energy it consumes. This will undergo a year-long trial to test its effectiveness under a range of operating conditions. If successful, we will look to scale up the technology.

# GREAT VALUE AND FINANCIAL SUSTAINABILITY
## MAKING SMARTER INVESTMENT CHOICES

We need to invest more – and more quickly – to replace our ageing infrastructure and make our assets more resilient to our changing climate.

In the last six months we have completed the refresh of our supply chain with the procurement of contractors for a new delivery vehicle in the area of repair and refurbishment work, one of the key early commitments we made in our Delivery Plan.

Despite safe Covid working practices and material challenges, the new investment planning framework we developed with our economic regulator and other stakeholders has enabled us to increase our investment to higher levels than any point over the last decade, with investment in the six months to September of £315 million.

In our Delivery Plan we set out our plan to invest between £570 million to £650 million and £610 million to £680 million in each of 2021/22 and 2022/23 respectively and we are currently on target to invest between £600 million to £650 million this year and now plan to invest between £620 million to £690 million in 2022/23.

This is a significant achievement when regulated utilities often have lower investment at the start of a new regulatory period as they adapt to the new ways of working and refresh their supply chains.

Looking further ahead we face significant demands for additional investment to replace our ageing assets, improve services, adapt to our changing climate and achieve net zero emissions. While investment will increase by 30% in this regulatory period, and need to increase further thereafter, there will be difficult choices to be made about the investment choices to prioritise and the implications for future customer charges. A key aspect of our transformation planning is to develop a framework to ensure that we prioritise investment decision making robustly in line with the agreed priorities of Scottish Ministers, regulators and our customers.

### CASE STUDY
### GLASGOW RESILIENCE PROJECT

The largest of our major capital investment projects under way, the Glasgow Resilience Project started on site in February 2021. This will upgrade the capacity and complete the two-way supply between the Glasgow and Ayrshire networks, increasing resilience and protecting water supplies for around one million customers. Works will involve the use of innovative construction materials and techniques to reduce carbon emissions and power requirements.

# TRANSFORMING HOW WE WORK

In our Delivery Plan for 2021/22 - 2022/23 we committed to key initiatives and change programmes (Appendix A). Where we have already delivered these, they are highlighted earlier in this report and the remainder are on track for delivery by March 2023.

Achieving all three ambitions from our Strategic Plan requires nothing short of a fundamental transformation.

We have a bold ambition to transform what we do to provide water and waste water services in a way that makes the broadest possible contribution to the life and wellbeing of people, businesses, communities and the environment across Scotland. And transforming how we deliver to achieve service excellence and go beyond net zero emissions while providing great value for our customers.

We recognise we will only achieve our ambitions by fundamentally transforming nearly all that we do, as we implement what we can see today and build the capabilities we'll need to seize future opportunities.

Our transformation is designed to deliver these ambitions and our broader commitments, working in a way that is fundamentally different to the way we have worked before:

- **Strategic** - so we can take well-evidenced decisions that balance across competing priorities even when they are difficult
- **Inclusive** - by empowering our people, customers, communities and stakeholders
- **Adaptive** - so we can react well and be on the front foot of the risks and opportunities changing circumstances and feedback bring
- **Efficient** - so we can move from decisions to action for our customers and communities quickly
- **Powered by digital technology** - that enable us to fix problems before they impact our customers and communities, in a way that predicts and prescribes solutions
- **Customer focused** – gaining insights that will help us take every decision as if the customer were in the room, allow us to involve and empower our customers and the communities we serve
- **Collaborative** - with our partners, stakeholders and other organisations so we create solutions and value together, with a relentless focus on learning and improving

Our transformation consists of many parts. None of these ideas will work in isolation; rather, they each play a vital role in contributing to something much larger than the sum of the parts.

Working with world leading advisors and learning from successful and leading worldwide companies we have developed a comprehensive Plan for Transformation that sets out the required changes to deliver our ambitions.

This plan will change and grow as we deliver and learn. We'll build on what we achieve, learning from our experiences, and look outside to learn from others.

We have identified important opportunities where we need to focus and prioritise. But our transformation is as much about building the capabilities and mindsets to keep adapting, as it is about delivering the initial plans we have laid out. We will need new skills to keep sensing what else we need to change and how our customers' needs are changing, and continually iterate what we do and how we do it.

The first two years of delivery of this plan will be critical in inspiring our people and instilling confidence in our customers, communities and stakeholders.

# FINANCIAL SUSTAINABILITY
## GROUP OVERVIEW

Our principal business activities include the supply of water and waste water services to homes and businesses across Scotland. Our subsidiary, Business Stream, operates as a Licensed Provider (LPs), competing with other LPs in the Scottish and English markets to supply water and waste water retail services to business customers.

The primary source of finance is revenue from customers, but Scottish Water also has access to 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 provide great value for its customers while Scottish Water itself is financially sustainable.

This report highlights the performance over the period 1 April 2021 to 30 September 2021 for Scottish Water's group of companies.

# FINANCIAL PERFORMANCE: GROUP

## Financial Summary

The group surplus before tax for the six months to 30 September 2021 increased by £26.0 million to £46.4 million (2020: £20.4 million). The increase reflects increased revenue, reflecting tariff increases effective from 1 April 2020, and increased consumption by businesses as they come out of restrictions caused by the Covid-19 pandemic.

The results for the period also reflect the initial implementation of the IFRS Interpretations Committee (IFRIC) final agenda decision on cloud computing arrangements.  Work continues in this complex arena to align our accounting policies but we have identified from the work to date, the need to expense c. £3.0m of cloud computing arrangement costs incurred in the interim period to 30 September 2021 (2020: £2.8 million) that would have previously been capitalised as IT software and depreciated over an economic life of three years. In addition, the income statements and the balance sheets as at 30 September 2020 and 31 March 2021 have been restated to reflect the IFRIC decision (see notes 1,2 4 and 5 to the financial statements). The group's implementation of the change is yet to be completed and additional adjustments may arise when preparing the annual financial statements for the year to 31 March 2022, which have not been reflected in these interim financial statements, however, we expect that these will not be material.

Consolidated revenue in the period increased by £53.2 million to £865 million (2020: £811.8 million) and associated cost of sales increased by £34.7 million to £644.1 million (2020: £609.4 million). The £6.4 million reduction in administrative expenses was driven by lower Covid-19 related costs including the provisioning for bad and doubtful debt.

We estimate that the pandemic has reduced the surplus before tax in the period by circa £17.0 million (2020: £47 million) driven by lower customer revenues of £32 million partially offset by reduced costs of £15 million. Further analysis is presented within note 2 to the financial statements.

Further coverage of the performance for the three main business areas covering regulated, non-regulated services and Business Stream is detailed on pages 23 to 29.

In the period, consolidated net debt increased by £60.3 million to £3,674.2 million. The increase was driven by a £90.7 million decrease in cash balances to £479.7 million partially offset by loan repayments of £30.4 million. The movement in cash is summarised below:

| | Scottish Water £m | Business Stream £m | Horizons Group £m | Group Total £m |
|---|---|---|---|---|
| Opening balance at 1 April 2021 | 428.7 | 94.9 | 46.8 | 570.4 |
| Cash generated/ (utilised) | (78.6) | (10.6) | (1.5) | (90.7) |
| **Closing balance at 30 September 2021** | **350.1** | **84.3** | **45.3** | **479.7** |

## Financial Summary (continued)

Cash balances within Scottish Water decreased by £78.6 million to £350.1 million due primarily to our increased investment programme. Any large infrastructure organisation that provides an essential service requires significant access to cash to maintain its activities and to respond to unforeseen events. Our cash balances each year are largely a function of when we borrow from the Scottish Government relative to when we invest and, unlike similar infrastructure businesses, we do not have access to any other form of credit facilities.

Before the pandemic our risk appetite determined that Scottish Water (regulated business) should always hold a minimum cash balance of £100 million. However, considering the increased risks faced, as a consequence of the pandemic, we increased this to holding a minimum £200 million cash balance for the time being, equivalent to approximately eight weeks expenditure.

Cash balances within the Business Stream group of companies reduced by £10.6 million in the period to £84.3 million reflecting the reinstatement of one month's wholesale charge prepayments in July 2021. Cash balances within the Horizons group of companies reduced by £1.5 million to £45.3 million.

## Taxation

Scottish Water was awarded the Fair Tax Mark for the second time in November 2021. 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 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 consolidated tax charge on the income statement to 30 September 2021 was £152.4 million (2020: £4.0 million), due primarily to a deferred tax charge of £148.4 million. The high deferred tax charge is a consequence of the revaluation of the deferred tax provision caused by the increase in the UK's main corporation tax rate from 19% to 25% effective from 1 April 2023. This was announced in the budget on 3 March 2021 and was substantively enacted on the 24 May 2021.
Further detail is included in note 8 to the financial statements. As a consequence, the effective tax rate was 350.3% (2020: 23.1%).

## 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 also a participating employer in the Strathclyde Pension Fund.

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.
As at 30 September 2021, the gross pension liability decreased by £12.7 million from £221.9 million at March 2021 to £209.2 million. The actuarial movements, net of deferred tax, are presented in the consolidated statement of comprehensive income with further detail in note 8 to the financial statements (on page 46).

Employees who joined Business Stream after December 2016 participate in a defined contribution scheme, administered by Standard Life. All Employees of the North-East Scotland Waste Water PFI also participate in a defined contribution scheme administered by Aviva.

# 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 cost and carbon efficiency improvements in operational and capital investment activities associated with regulated water and waste water services.

## Financial Framework for the 2021-27 regulatory period (SR21)

In our 2021 Delivery Plan we outlined how we would deliver great value and financial sustainability for our customers and presented our forecast income and expenditure for the 2021/22 and 2022/23 financial years. Our forecasts at the start of this year were that our investment will have to nearly double by 2040 with customer charges rising by an average of 2% above inflation each year to finance this. The WICS Final Determination provided flexibility as to how to phase these increases over the 2021-27 period.

For 2021/22 we increased charges by slightly less than 2% above inflation. The Consumer Price Index for October 2021, which provides the benchmark for our prices for the 2022/23 financial year, was 4.2%. While charges' proposals for 2022/23 are yet to be submitted to, and considered by, WICS, we expect that charge increases will be in line with WICS Final Determination expectations to finance the delivery of our services and our growing capital investment programme. Looking further ahead, to fulfil our investment requirements, we are planning for our annual charges to be consistent with the determination profile to achieve revenue of £8,024 million (in 2018/19 prices) over the 2021-27 period.

The performance against our Delivery Plan, including updates to our forecast income, expenditure and cash balances over the remainder of this year and next year, is detailed later in this report.

# Financial Performance Review for the six months to 30 September 2021

## 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 34-47), including cross-references to the relevant notes to the financial statements, have been provided.

## Revenue

Regulated revenue for the six months to 30 September 2021 totalled £641.0 million (2020: £621.5 million) and is analysed by category in the table opposite.

| Regulated revenue | Notes | September 2021 £m | September 2020 £m | Change £m |
|---|---|---|---|---|
| Household | | 468.9 | 458.2 | 10.7 |
| Wholesale | | 164.9 | 156.5 | 8.4 |
| Other | | 7.2 | 6.8 | 0.4 |
| **Total regulated revenue** | **2** | **641.0** | **621.5** | **19.5** |

## Operating Costs

Total operating costs increased £10.5 million or 2.1% to £515.6 million (2020: £505.1 million) reflecting higher IAS 19 pension charges of £12.7 million and a charge of £0.9 million for cloud computing arrangement costs associated with accounting policy changes required by the IFRIC final agenda decision referred to above (2020: £2.8 million). Higher depreciation and PFI charges being offset by reductions in regulatory operating costs.

Regulated operating and repair costs reduced by £5.3 million, or 1.9%, to £278.8 million (2020: £284.1 million) as last year's costs were significantly impacted by the pandemic. After adjusting for specific cost movements and the impact of CPI inflation, like-for-like operating and repair costs reduced in real terms by £4.5 million or 1.7% as listed in the table opposite.

The increase in incident and weather-related costs was due to the tail end impacts of severe winter weather experienced in January and February 2021 and the very dry warm summer which necessitated the need for increased road tankering of water and the delivery of bottled water supplies to customers to maintain supplies as well as additional leakage response action.

| | September 2021 £m | September 2020 £m | Inc/(dec) £m | Inc/(dec) % |
|---|---|---|---|---|
| **SW headline operating and repair costs** | **278.8** | **284.1** | **(5.3)** | **(1.9%)** |
| Covid -19 pandemic costs excluding bad debt charges | (1.5) | (3.7) | 2.2 | |
| Incident and weather-related costs | (2.5) | (0.4) | (2.1) | |
| Bad debt charges | (11.0) | (16.0) | 5.0 | |
| One-off refunds associated with previous years | 3.0 | | 3.0 | |
| New operating costs | (0.4) | – | (0.4) | |
| **Like-for-like controllable costs** | **266.4** | **264.0** | **2.4** | **0.9%** |
| Average CPI inflation at 2.61% | – | 6.9 | (6.9) | |
| **Like-for-like real costs reduction** | **266.4** | **270.9** | **(4.5)** | **(1.7%)** |

PFI operating costs increased £0.6 million or 0.8% to £76.9 million (2020: £76.3 million). Contract indexation for this year will be heavily impacted by increases in gas prices. However, to 30 September 2021 these increases were partially offset by one-off negotiated contractual changes for two of our PFI contracts.

Total depreciation and amortisation charges, net of the gain on sale from asset disposals, increased by £4.4 million to £138.9 million (2020: £134.5 million) due to the profile of capital investment and completed projects coming into beneficial use.

## Finance Costs

Net interest payable in the period to 30 September 2021 was £71.1 million (2020: £71.9 million) and finance costs associated with finance lease liabilities on PFI assets were £0.7 million lower at £7.6 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 £50.6 million to £3,770.3 million (being loans of £4,120.4 million less cash balances of £350.1 million). The increase was driven by a £78.6 million reduction in cash and a £28.0 million reduction in borrowing.

## Capital Investment

Scottish Water's capital investment in the six months to 30 September 2021 was £302.2 million, £144.4 million higher than the same period last year (2020: £157.8 million) which reflected the impact of the national lockdowns in the early months of 2020 because of the pandemic.

More information about Scottish Water's capital programme and projects is provided in Making Smarter Investment Choices on page 18.

## Scottish Water Regulatory Income and Expenditure

The new format Regulated Income & Expenditure Statement for the SR21 period is presented on the next page and presents the results of Scottish Water's regulated business activities, on the regulatory accounting basis. The total potential funding available for planned investment generated to 30 September 2021 (before reflecting adjustments for long-term normative charges (LTNC) associated with responsive repair & refurbishment, developer contributions and tax paid), was £13 million ahead of target at £209 million. After LTNC adjustments[3] the potential funding for planned investment reduces to c. £169 million, c. £10 million better than target.

The second table, Reconciliation to the consolidated group surplus before tax, provides the reconciliation of Scottish Water's (SW) regulated funding for planned investment to the consolidated surplus before tax as per the financial statements for the six months to 30 September 2021.

| SW's Regulated Income & Expenditure Statement | 30 September 2021 £m |
|---|---|
| **Total revenue** | **652.7** |
| Operating costs | (188.1) |
| Responsive repair & refurbishment costs | (81.1) |
| PFI operating costs | (86.9) |
| Developer contributions | (8.9) |
| **Total before interest charges & tax payments** | **(365.0)** |
| Interest charges | (71.1) |
| Tax paid | (7.6) |
| **Total expenditure (excluding investment)** | **(443.7)** |
| **Total available to support planned investment** | **209.0** |

| SW's Reconciliation to consolidated Group surplus before tax | 30 September 2021 £m |
|---|---|
| **Regulated funding for planned investment (per table above)** | **209.0** |
| Add back tax paid included in table above | 7.6 |
| Add non-core and subsidiaries surplus before tax | 3.7 |
| Less depreciation & amortisation charges | (143.6) |
| Less SW cloud computing arrangement costs associated with the IFRIC agenda decision | (0.9) |
| Add back developer contributions less infrastructure charge income awaiting investment | (0.1) |
| Planned maintenance costs less refurbishment costs capitalised | (9.6) |
| Group Retirement benefit obligation[1]: | |
| Operating costs | (21.1) |
| Finance costs | (2.4) |
| IFRIC 12 PFI finance lease costs adjustment | 3.8 |
| **Group Surplus Before Tax per statutory accounts** | **46.4** |

[1]These are non-cash adjustments required under International Accounting Standard 19 'Employee Benefits'.

## 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) to the extent permitted by the Governance Code.

## Financial Framework

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

Business Stream remains one of the largest retailers in the UK retail water market. Business Stream's main priority during the first half of this year has been providing on-going support to its customers and its people in response to Covid-19 and the restrictions that were in place.

To be able to continue to support its customers through the pandemic and its economic after effects, Business Stream secured temporary funding arrangements from SWBSH, provided on commercial arms-length terms, as a precautionary measure during 2020/21. Business Stream has had no requirement to access these facilities during the period to 30 September 2021.

## Financial Performance

Revenue from this business segment for the period to 30 September 2021 totalled £313.7 million (2020: £275.5 million) (per note 2 to the financial statements). This represents 32% (2020: 30%) of the group revenue, before intercompany eliminations. The operating surplus within this segment was £0.8 million (2020: £13.9 million loss) and reflects a charge of £2.1 million (2020: nil) associated with accounting policy changes required by the IFRIC final agenda decision on cloud computing arrangement costs referred to above. The loss for the same period last year was after recognising a £15.5 million charge for the provision of doubtful debts, £11.2 million of which related to the anticipated impact of the Covid-19 pandemic.

The results reflect an increase in revenue for the period of £38.2 million (£313.7 million; 2020: £275.5 million) and the related operating costs. The increases are attributable to a recovery of consumption following the Covid-19 pandemic and related lockdowns in the prior year.

Despite this complex and challenging environment, Business Stream's balance sheet remains strong and debt free, with net assets of £88.7 million at the end of September 2021, including cash balances of £59.9 million. This position is helped in part by sector-wide financial support arrangements put in place to allow retailers to provide temporary support for their customers, but notwithstanding this, the underlying financial performance of the business has been better than planned for the period.

## 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.

Revenue from this business segment to 30 September 2021 totalled £25.9 million (2020: £22.7 million) (per note 2 to the financial statements). This represents 2.6% (2020: 2.5%) of the group revenue, before intercompany eliminations. The operating surplus within this segment to 30 September 2021 was £1.2 million higher than the same period last year at £3.2 million. This reflects £2.3 million operating profit (2020: £2.6 million) from North-East Scotland PFI waste water activities and operating profit from SWH of £0.8 million (2020: £0.5 million loss). 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 – Regulated Services Delivery Plan Review

We are committed to taking all possible steps to drive for further efficiency to reduce our expenditure and our target is to achieve, at least, a 1% year-on-year real reduction (CPI-1%) in line with the challenging target set in the Final Determination. We are also committed to driving further productivity and efficiency from our investment and are developing a framework to assess and report each year on our investment delivery value for money.

As highlighted above any large infrastructure organisation that provides an essential service requires significant access to cash to maintain its activities[2] and to respond to unforeseen events. Our cash balance at the start of 2021/22 was £428 million. However, c.£290 million of this was required to finance completion of the SR15/ IR18 investment programmes. Consequently, this left an effective residual notional cash balance from the 2015-21 period of around £138 million.

[2] Our investment and expenditure averages c. £250 million every two months

Table 1 below sets out our ranges for forecast investment and cash to 31 March 2022 and the 2022/23 financial year compared to our Delivery Plan. These reflect the revenue and expenditure ranges outlined in Table 2 on the next page and the associated key assumptions in Table 3. The re-forecast does not include any specific costs associated with storm Arwen which hit the country in late November.

| Forecast cash and investment | Re-forecast for 2021/22 £m | Delivery Plan 2021/22 £m | Re-forecast for 2022/23 £m | Delivery Plan 2022/23 £m |
|---|---|---|---|---|
| Investment (incl. SR15 completion) | 600 - 650 | 570 - 650 | 620 - 690 | 610 - 680 |
| Cash balances | 440 - 475 | 305 - 525 | 380 - 450 | 265 - 440 |

Table 1: Forecast Investment and Cash Balances

Investment during 2021-23 will be supported by net new borrowing from the Scottish Government of £180 million in 2021/22 and £170 million in 2022/23. Our forecast closing cash ranges are £440 million to £475 million for 2021/2022 and £380 million to £450 million for 2022/2023. These are towards the upper end of our ranges presented in our Delivery Plan, and reflect better-than-plan operating performance while delivering our planned investment programme. In addition, there may be requirement to lend up to £20 million to enable Business Stream to support its customers through and beyond the Covid-19 pandemic. Any such lending to Business Stream would be fully repayable within the 2021-27 period.

Table 2 opposite sets out our ranges for forecast income and expenditure for this year and 2022/23 compared to our Delivery Plan. The re-forecasts reflect the key assumptions in Table 3 on next page and the recently announced 1.25% increase in National Insurance rates effective from 1 April 2023.

The re-forecast plans highlight that the potential funds available to support investment over the two-year period could be in the range of £640 million to £745 million, an increase from the Delivery Plan.

| Forecast Income & Expenditure (excl. investment) | Re-forecast for 2021/22 £m | Delivery Plan for 2021/22 £m | Re-forecast for 2022/23 £m | Delivery Plan 2022/23 £m |
|---|---|---|---|---|
| Household Revenue | 935 - 940 | 930 - 940 | 1000 - 1005 | 965 - 980 |
| Wholesale Revenue | 325 - 340 | 310 - 340 | 350 - 360 | 320 - 355 |
| Other Revenue (incl. Infrastructure charges) | 30 - 35 | 25 - 35 | 25 - 35 | 25 - 35 |
| **Total revenue** | **1,290 - 1,315** | **1,265 - 1,315** | **1,375 - 1,400** | **1,310 - 1,370** |
| Operating and PFI costs | 550 - 565 | 575 - 605 | 590 - 620 | 580 - 610 |
| Interest costs | 140 - 145 | 140 - 145 | 135 - 145 | 135 - 145 |
| Responsive repair and refurbishment expenditure (including normative charge)[3] | 215 | 185 | 215 | 185 |
| Reasonable Cost Contributions (inc. normative charge)[3] | 30 | 30 | 30 | 30 |
| Taxation (including normative charge)[3] | 30 | 25 | 30 | 25 |
| **Total expenditure (excl investment)** | **965 - 985** | **955 - 990** | **1005 - 1040** | **955 - 995** |
| **Potentially available to support further investment** | **305 - 350** | **275 - 360** | **335 - 395** | **315 - 415** |

**Table 2: Analysis of revenue and expenditure in outturn prices**

The primary drivers of this improved position are:

- increased forecast revenue due to increased connections to our network reflecting increased construction activity as the sector recovers from the impacts of the pandemic;
- higher revenue as a consequence of higher CPI inflation and improved wholesale consumption levels (see Table 3 opposite); and
- lower operating and PFI costs reflecting our transformation programme and lower charges associated with the provision for bad and doubtful debts.

Uncertainties in our forecasts are the levels of new household connections, the timing and extent to which business consumption recovers to pre-pandemic levels, weather related incidents, the impact of Covid-19 and associated macro-economic factors that could influence the availability of materials and labour within our supply chains, bad debt related costs and inflation on our cost base.

| | Re-forecast for 2021/22 | Delivery Plan for 2021/22 | Re-forecast for 2022/23 | Delivery Plan 2022/23 |
|---|---|---|---|---|
| CPI inflation | 4.2% | 2.0% | 5.0% | 2.0% |
| Customer charges increase | 2.5% | 2.5% | 6.0% - 7.0% | 4.0% |
| Household growth | 0.9% | 0.5% | 0.5% - 1.0% | - |
| Wholesale consumption reduction caused by pandemic | 5% | 10% | - | - |

**Table 3: Key Assumptions**

[3] Responsive repair and refurbishment (R&R) expenditure is difficult to predict over a short-term time horizon as there can be significant variability in the annual level of expenditure associated with, for example, significant water main bursts or collapsed sewers. In the first six months of the 2021-27 period we have developed our processes to enhance cost capture. The change in process has resulted in an increase to our forecast overall responsive repair and refurbishment costs with the offset being in Operating and PFI costs. The rebased annual normative charge (£185 million to £215 million) has been applied. Over the 2021-27 period we expect the normative charge to balance with expenditure incurred. Developer contributions and taxation may also experience significant annual variability and we propose to adopt a similar normative charge approach in these areas for the same reason.

# SUMMARY

While the first six months of this financial year have been exceptionally challenging, Scottish Water has faced them with focus and determination. It's only because of the character and commitment of our people and partners that our performance is as good as it is.

As we progress into the second half of the year, we know the winter months will likely bring more challenges. We will do all we can to ensure our customers continue to receive the high quality service they have come to expect from us.

Looking ahead, we will continue to focus on delivering first class water and waste water services, transforming our activities, and addressing the key challenges of achieving Net Zero emissions and managing and replacing our ageing assets.

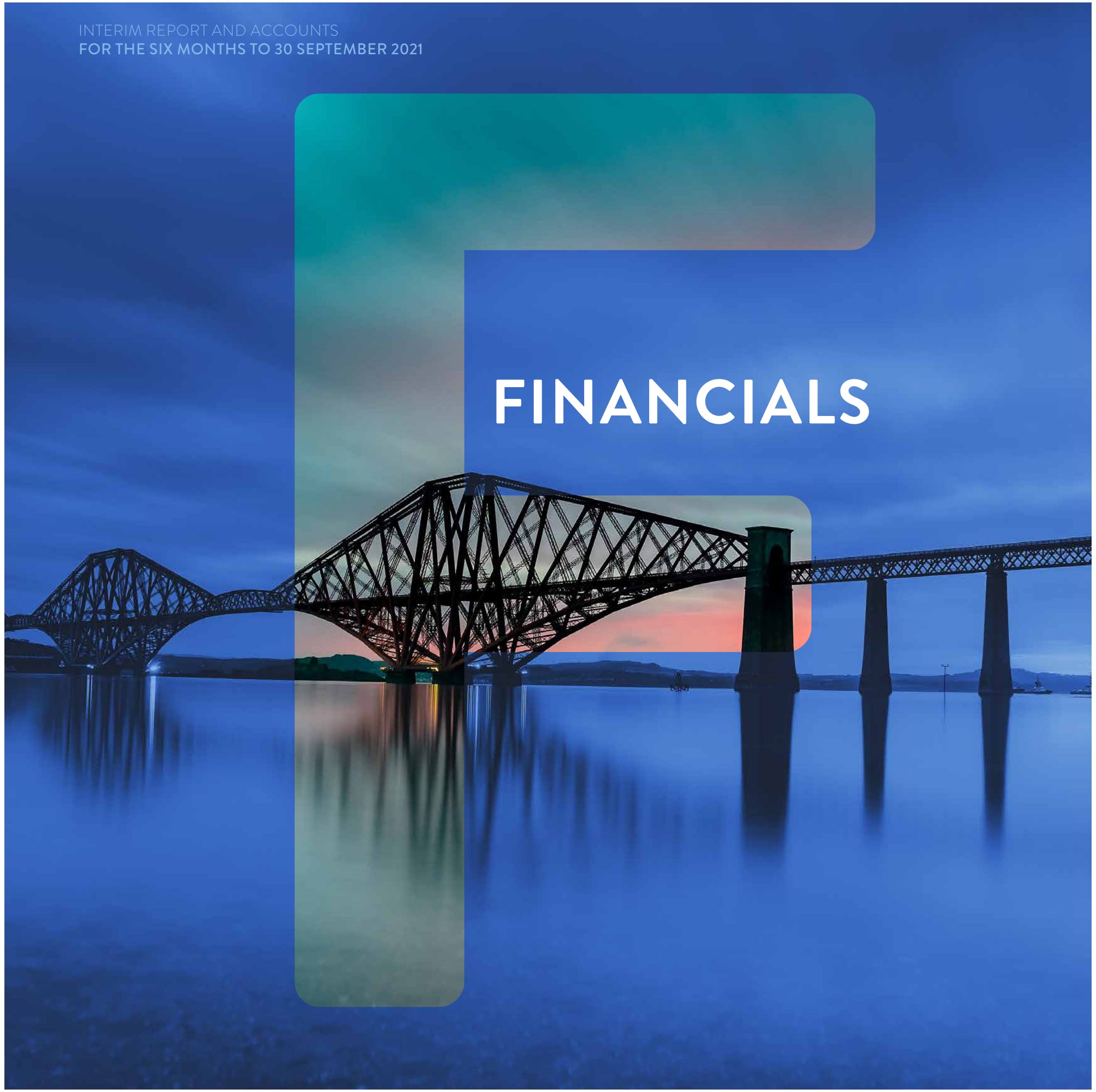
We are seeing shifts in the expectations of customers, communities and stakeholders that will require their continued support and time to fulfil.  In some instances, this will mean the help of communities including reducing their water consumption or working with us to protect our waste environment. It will also require their support for increased levels of investment and the impact this will have on customer charges.

In closing, thank you to our customers for their patience and understanding when issues have arisen over the last few months. We know we are working with the country's most precious natural resource – and take seriously the trust placed in us.

# SUMMARY OF KEY INITIATIVES AND CHANGE PROGRAMMES

The key initiatives and change programmes we will deliver over 2020-21 to 2021-22, beyond our transformation planning, were set out in our Delivery Plan in the table below.

| Ambition | Service Excellence | | | | Beyond Net Zero Emissions | | Great Value and Financial Stability | | |
|---|---|---|---|---|---|---|---|---|---|
| Strategic Objective | **Delivering Consistently Excellent Water Supply** | **Transforming Waste Water Services** | **Enabling Sustainable and Inclusive Economic Growth** | **Empowering Customers and Communities** | **Transforming Our Emissions** | **Embracing the Circular Economy & Enhancing the Natural Environment** | **Making Smarter Investment Choices** | **Transforming How We Work** | **Financing Our Services** |
| What we are planning to deliver in 2021/22 - 2022/23 | – Deliver SR15 & IR18 investment milestones.<br>– Achieve accreditation for our water supply risk management system in 2023.<br>– Progress delivery of 4 priority system needs and bring forward appraisals for a minimum of a further 3 in 2021/22.<br>– Water Operational Systems Plans for all water treatment works. | – Deliver SR15 & IR18 investment milestones.<br>– Develop a further 3 drainage partnerships.<br>– Develop long-term plans for all waste water catchments by 2023.<br>– Expect to appraise UIDs in 23 catchments.<br>– Take ownership of Highland PFI assets in 2022 and finalise options for Daldowie PFI. | – Take the lead in delivering increased capacity in our existing network infrastructure.<br>– Improve our service to developers. | – Establish Independent Customer Group by Spring 2021 and develop a national engagement strategy.<br>– Transform wholesale service to Licensed Providers.<br>– Boost support to vulnerable customers and those most impacted by recurring issues. | – Appraise opportunities so we can continue the momentum in reducing our operational emissions in future years.<br>– Work with a partner to develop a 260GWh opportunity for new renewables in south-west Scotland on our land.<br>– Report on emissions driven by our investment and target opportunities.<br>– Commence pilots to improve our land to store carbon. | – Establish the biodiversity status of our land and identify projects to support.<br>– Pilot improving the community access to 6 popular Scottish Water reservoirs. | – Deliver our Asset Management Transformation Routemap.<br>– Implement (Summer 2022) portfolio reviews.<br>– Implement improvements to our project appraisals including community engagement.<br>– Procure contractor partners for a new delivery vehicle in the area of refurbishment and repair work. | – Roll out and embed our Scottish Water 'character'.<br>– Deliver research and innovation Routemap.<br>– Digital investment to continue cyber security focus while providing transformation opportunity. | – Target is to achieve, at least, a 1% year-on-year real reduction.<br>– Plan to invest between £570m to £650m and £620m to £690m in each of 2021/22 and 2022/23 respectively.<br>– Implement a framework to assess, drive improvements, and enable us to report on the delivery value for money achieved for customers. |
| We will invest in line with the policies we have set out, progressing larger projects through investment appraisals and learning from these experiences. | | | | | | | | | |



# FINANCIALS

# INDEPENDENT REVIEW REPORT TO SCOTTISH WATER
## FOR THE SIX MONTH PERIOD ENDED 30 SEPTEMBER 2021

### Conclusion
We have been engaged by the company to review the condensed set of financial statements in the half-yearly report for the six months ended 30 September 2021 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed balance sheet, the condensed consolidated statement of changes in equity, the condensed consolidated balance sheet and the condensed consolidated statement of cash flows and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly report for the six months ended 30 September 2021 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted for use in the UK.

### Scope of review
We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the half-yearly report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Directors' responsibilities
The half-yearly report is the responsibility of, and has been approved by, the directors.

As disclosed in note 1, the latest annual financial statements of the company were prepared in accordance with International Financial Reporting Standards (IFRSs), and as interpreted and adapted by the 2020/21 Government Financial Reporting Manual and the next annual financial statements will be prepared in accordance with International Financial Reporting Standards (IFRSs), and as interpreted and adapted by the 2021/22 Government Financial Reporting Manual. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly report in accordance with IAS 34 as adopted for use in the UK.

### Our responsibility
Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly report based on our review.

### The purpose of our review work and to whom we owe our responsibilities
This report is made solely to the company in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

**Hugh Harvie**
for and on behalf of KPMG LLP
Chartered Accountants
Saltire Court
20 Castle Terrace
Edinburgh
22 December 2021

# CONDENSED CONSOLIDATED INCOME STATEMENT
## FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2021

| | Note | Half year to September 2021 Unaudited £m | Half year to September 2020 Unaudited & Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|---|
| **Revenue** | 2 | **865.0** | **811.8** | **1,667.2** |
| Cost of sales | 1 | (644.1) | (609.4) | (1,275.4) |
| **Gross surplus** | | **220.9** | **202.4** | **391.8** |
| Administrative expenses | | (93.3) | (99.7) | (194.5) |
| **Operating surplus** | 2 | **127.6** | **102.7** | **197.3** |
| Finance income | | – | 0.4 | 0.4 |
| Finance costs | | (81.2) | (82.7) | (165.4) |
| **Surplus before taxation** | | **46.4** | **20.4** | **32.3** |
| Taxation | 3 | (152.4) | (4.0) | (7.9) |
| **(Loss)/surplus for the period** | | **(106.0)** | **16.4** | **24.4** |

The notes on pages 40 to 47 form an integral part of the condensed consolidated interim financial information.

# CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
## FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2021

| | Note | Half year to September 2021 Unaudited £m | Half year to September 2020 Unaudited & Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|---|
| (Loss)/surplus for the period | | (106.0) | 16.4 | 24.4 |
| Other comprehensive income for the period<br>*Items which will not subsequently be reclassified to the income statement* | | | | |
| Actuarial gain on post employment benefit obligations | 8 | 51.0 | - | 28.4 |
| Deferred tax on remeasurement of post employment benefit obligations | | (8.7) | - | (5.4) |
| Effective portion of changes in fair value of cash flow hedge, net of deferred taxation | | 1.4 | 0.6 | 1.8 |
| **Total comprehensive income for the period** | | **(62.3)** | **17.0** | **49.2** |

The loss for the period and total comprehensive income for the period are attributable to the owners of Scottish Water.
The notes on pages 40 to 47 form an integral part of the condensed consolidated interim financial information. The restated years are explained within note 1.

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

## FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2021

| | Cash flow hedging reserves £m | Retained earnings £m | Other reserves £m | Total reserves £m |
|---|---|---|---|---|
| Balance at 1 April 2020 | (7.3) | 1,614.0 | 133.4 | 1,740.1 |
| Restatement of retained earnings in relation to Cloud Accounting (Note 1) | - | (17.6) | - | (17.6) |
| Restated balance at 1 April 2020 | (7.3) | 1,596.4 | 133.4 | 1,722.5 |
| Surplus for the six months ended 30 September 2020 | 0.6 | 16.4 | - | 17.0 |
| Total comprehensive income for the period | 0.6 | 16.4 | - | 17.0 |
| **Balance at 30 September 2020** | **(6.7)** | **1,612.8** | **133.4** | **1,739.5** |
| Balance at 1 April 2020 | (7.3) | 1,614.0 | 133.4 | 1,740.1 |
| Restatement of retained earnings in relation to Cloud Accounting (Note 1) | - | (17.6) | - | (17.6) |
| Restated balance at 1 April 2020 | (7.3) | 1,596.4 | 133.4 | 1,722.5 |
| Surplus for the year ended 31 March 2021 | - | 24.4 | - | 24.4 |
| Other comprehensive income: | | | | |
| Actuarial gain on post employment benefit obligations, net of tax | - | 23.0 | - | 23.0 |
| Effective portion of changes in fair value of cash flow hedge, net of tax | 1.8 | - | - | 1.8 |
| Total comprehensive income for the year | 1.8 | 47.4 | - | 49.2 |
| **Balance at 31 March 2021** | **(5.5)** | **1,643.8** | **133.4** | **1,771.7** |
| Loss for the six months ended 30 September 2021 | - | (106.0) | - | (106.0) |
| Other comprehensive income: | | | | |
| Actuarial gain on post employment benefit obligations, net of tax | - | 42.3 | - | 42.3 |
| Effective portion of changes in fair value of cash flow hedge, net of tax | 1.4 | - | - | 1.4 |
| Total comprehensive income for the period | 1.4 | (63.7) | - | (62.3) |
| **Balance at 30 September 2021** | **(4.1)** | **1,580.1** | **133.4** | **1,709.4** |

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

The notes on pages 40 to 47 form an integral part of the condensed consolidated interim financial information. The restated years are explained within note 1.

# CONDENSED CONSOLIDATED BALANCE SHEET
## AS AT 30 SEPTEMBER 2021

| | Note | Half year to September 2021 Unaudited £m | Half year to September 2020 Unaudited & Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|---|
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | | 6,694.6 | 6,421.6 | 6,543.3 |
| Intangible asset | 5 | 15.0 | 12.8 | 13.3 |
| Deferred tax asset | | 6.5 | 4.0 | 5.8 |
| | | 6,716.1 | 6,438.4 | 6,562.4 |
| **Current assets** | | | | |
| Inventories | | 4.6 | 3.9 | 3.9 |
| Trade and other receivables | | 719.9 | 704.8 | 240.9 |
| Current tax asset | | 10.3 | 6.0 | 6.3 |
| Cash and cash equivalents | 7 | 479.7 | 439.4 | 570.4 |
| | | 1,214.5 | 1,154.1 | 821.5 |
| **Total assets** | | **7,930.6** | **7,592.5** | **7,383.9** |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Trade and other payables | | (961.8) | (898.8) | (445.4) |
| Other loans and borrowings | | (25.6) | (24.4) | (24.9) |
| Current tax liabilities | | (1.1) | - | - |
| Provisions for liabilities | | (9.4) | (14.6) | (9.0) |
| | | **(997.9)** | **(937.8)** | **(479.3)** |
| **Non-current liabilities** | | | | |
| Trade and other payables | | (71.7) | (71.4) | (87.0) |
| Other loans and borrowings | | (214.8) | (240.4) | (228.0) |
| Deferred tax liabilities | | (598.4) | (432.1) | (440.4) |
| Retirement benefit obligations | | (209.2) | (248.3) | (221.9) |
| Provisions for liabilities | | (8.8) | (14.2) | (7.2) |
| | | (1,102.9) | (1,006.4) | (984.5) |
| **Total liabilities** | | **(2,100.8)** | **(1,944.2)** | **(1,463.8)** |
| **Net assets** | | **5,829.8** | **5,648.3** | **5,920.1** |
| **Equity** | | | | |
| Government loans | 7 | 4,120.4 | 3,908.8 | 4,148.4 |
| Retained earnings | | 1,580.1 | 1,612.8 | 1,643.8 |
| Cash flow hedge reserve | | (4.1) | (6.7) | (5.5) |
| Other reserves | | 133.4 | 133.4 | 133.4 |
| | | **5,829.8** | **5,648.3** | **5,920.1** |

The notes on pages 40 to 47 form an integral part of the condensed consolidated interim financial information. The restated years are explained within note 1.

The condensed set of financial statements on pages 36 to 47 were approved by the Board on 1 December 2021 and signed on its behalf by:
**Douglas Millican,**
Chief Executive.

# CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2021

| | Note | Half year to September 2021 Unaudited £m | Half year to September 2020 Unaudited & Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|---|
| Surplus before taxation | | 46.4 | 20.4 | 32.3 |
| Depreciation charges | | 154.4 | 149.5 | 296.7 |
| Amortisation of intangible asset | 5 | 1.6 | 1.2 | 2.4 |
| Amortisation of grants | | (1.2) | (0.5) | (1.4) |
| Surplus on disposal of property, plant and equipment | | (2.6) | (2.0) | (2.2) |
| Non cash adjustment for retirement benefit obligations | | 21.1 | 7.7 | 24.7 |
| Finance costs - net | | 81.2 | 82.3 | 165.0 |
| **Operating cash flow before changes in working capital and provisions** | | **300.9** | **258.6** | **517.5** |
| Changes in working capital and provisions: | | | | |
| Decrease in receivables | | 8.8 | 6.0 | 8.1 |
| (Increase) in inventories | | (0.7) | – | – |
| Increase/(decrease) in payables | | 30.9 | (60.3) | (60.1) |
| Increase/(decrease) in provisions | | 3.1 | 5.9 | (9.5) |
| **Cash flows from operating activities** | | **343.0** | **210.2** | **456.0** |
| Taxation paid | | (7.1) | (5.2) | (8.4) |
| Net cash generated from operating activities | | 335.9 | 205.0 | 447.6 |
| **Cash flows from investing activities** | | | | |
| Purchase of property, plant and equipment | | (322.5) | (193.1) | (470.2) |
| Sale of property, plant and equipment | | 2.6 | 2.0 | 2.4 |
| Purchase of intangible asset | | (0.7) | – | – |
| Government grant income received | | 0.2 | – | 7.1 |
| Infrastructure income receipts | | 12.6 | 6.2 | 16.8 |
| Net cash used in investing activities | | (307.8) | (184.9) | (443.9) |
| **Cash flows from financing activities** | | | | |
| Repayments of loans | 7 | (30.5) | (98.4) | (139.4) |
| Proceeds from borrowings | 6 | – | 76.0 | 354.3 |
| Interest received | | – | 0.4 | 0.4 |
| Interest paid | | (78.3) | (80.6) | (160.7) |
| Payment of finance lease liabilities | | (10.0) | (9.7) | (19.5) |
| Net cash used in financing activities | | (118.8) | (112.3) | 35.1 |
| **Net (decrease)/increase in cash and cash equivalents** | | **(90.7)** | **(92.2)** | **38.8** |
| Cash and cash equivalents - opening balance | 7 | 570.4 | 531.6 | 531.6 |
| **Cash and cash equivalents - closing balance** | 7 | **479.7** | **439.4** | **570.4** |

The notes on pages 40 to 47 form an integral part of the condensed consolidated interim financial information. The restated years are explained within note 1.

# NOTES TO THE CONDENSED INTERIM STATEMENTS
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2021

## 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 condensed consolidated interim financial information was approved by the Board on 1 December 2021. The consolidated interim financial information is unaudited but has been reviewed by the auditor. The auditor's report is set out on page 35. These consolidated financial statements do not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2021, were approved by the Board on 29 June 2021 and laid before the Scottish Parliament. The report of the auditor on those accounts was unqualified.

### 1.2 Basis of preparation
The condensed consolidated interim financial information for the six months ended 30 September 2021 has been prepared in accordance with IAS 34 'Interim Financial Reporting'. The consolidated interim financial information is presented on a condensed basis as permitted by IAS 34 and therefore does not include all disclosures that would otherwise be required in a full set of financial statements. Consequently, this report should be read in conjunction with Scottish Water's annual financial statements for the year ended 31 March 2021 which were prepared in accordance with International Financial Reporting Standards (IFRSs), as interpreted and adapted by the 2020/21 Government Financial Reporting Manual (FReM). Scottish Water's annual financial statements for the year ending 31 March 2022 will be prepared in accordance with IFRSs, as interpreted and adapted by the 2021/22 FReM.

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

### 1.3 Going concern
The Members, taking all relevant factors into account, including the downside impacts of the Covid-19 pandemic, at the time of approving the consolidated interim financial information, 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. The consolidated interim financial information has therefore been prepared on the going concern basis under the historical cost convention, in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002.

### 1.4 Accounting estimates and judgements
The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

The employee benefit obligation as at 30 September 2021 and the related costs, as calculated under IAS 19 'Employee Benefits', have been calculated using the valuation report from 31 March 2021 (see note 8).

### 1.5 Significant accounting policies
These financial statements have been prepared in accordance with accounting policies expected to be followed for the year ending 31 March 2022. The accounting policies, as set out in the Annual Report and Accounts for the year ended 31 March 2021, have been applied consistently to all the periods presented.

### 1.6 New standards and interpretations
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 implementation for public sector was deferred by the Financial Reporting Advisory Board (FRAB) in December 2020 to 1 April 2022. Early adoption was not an option for Scottish Water as the relevant criteria, based on the size of relevant subsidiary companies, were not met. IFRS 16 is not expected to have a material impact on the results and net assets of Scottish Water.

**NOTES TO THE CONDENSED INTERIM STATEMENTS** FOR THE SIX MONTHS ENDED SEPTEMBER 2021 **(CONTINUED)**

## 1. ACCOUNTING POLICIES (continued)

In August 2020 the International Accounting Standards Board issued interest rate benchmark reform. The proposed amendments impact on our subsidiary, Aberdeen Environmental Services Limited and relate to the London Interbank Offered Rate (LIBOR) used in the valuation of the interest rate swap. The amendment is effective for periods beginning on or after the 1 January 2021.

In April 2021 the IFRS Interpretations Committee (IFRIC) published an agenda decision in relation to the application of IAS 38 Intangible Assets to configuration or customisation costs in a cloud computing arrangement. The agenda decision provides new guidance specific to cloud computing arrangements and provides a framework for the accounting treatment of 'implementation costs'.

To date Scottish Water has accounted for all implementation costs as Property, plant and equipment and are subject to depreciation on a straight-line basis over the useful lives of the assets. The new guidance states that implementation costs should be recognised as an intangible asset if costs incurred meet the definition of an intangible asset under IAS 38. If it is not possible to identify an asset the costs should be expensed in the year in which they occur if the costs incurred are distinct and over the life of the contract with the supplier if not distinct.

Application of the agenda decision is a complex process involving engagement with multiple digital partners to identify and classify transactions relating to projects involving key systems and processes. Significant complexity also exists in understanding the tax effect of this change including adjustments to capital allowances. Work continues in this arena to align our accounting policies but we have identified from the work to date, the requirement to expense c. £3.0 million of cloud software arrangement costs incurred in the interim period to September 2021 that previously would have been capitalised as IT software and depreciated over an economic life of 3 years. In addition the income statements and the balance sheets as at 30 September 2020 and 31 March 2021 have been restated to reflect the IFRIC decision (see notes 2, 4 and 5 below). The group's implementation of the change is ongoing and additional adjustments may arise when preparing the annual financial statements for the year to 31 March 2022, which have not been reflected in these interim financial statements, however, we expect that these will not be material.

**NOTES TO THE CONDENSED INTERIM STATEMENTS** FOR THE SIX MONTHS ENDED SEPTEMBER 2021 **(CONTINUED)**

## 2. SEGMENTAL ANALYSIS

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

Scottish Water's reportable segments are the provision of regulated water and waste water services, Business Stream (a Licensed Provider in the supply of water and waste water services to business customers in Scotland and England) and non-regulated businesses. These operating segments reflect the internal management reporting regularly reviewed by the Board in order to allocate resources to and assess the performance of the segments.

| | Half year to September 2021 £m | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|---|
| **Revenue** | | | |
| Scottish Water regulated water and waste water services | 641.0 | 621.5 | 1,266.2 |
| Business Stream | 313.7 | 275.5 | 574.4 |
| Scottish Water non-regulated activities | 25.9 | 22.7 | 49.8 |
| | 980.6 | 919.7 | 1,890.4 |
| Less Intercompany elimination | (115.6) | (107.9) | (223.2) |
| | **865.0** | **811.8** | **1,667.2** |

| | Half year to September 2021 £m | Half year to September 2020 Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|
| **Operating surplus / (loss)** | | | |
| Scottish Water regulated water and waste water services | 125.4 | 116.4 | 212.4 |
| Business Stream | 0.8 | (13.9) | (18.6) |
| Scottish Water non-regulated activities | 3.2 | 2.0 | 7.1 |
| Reversal of IFRIC 12 adjustments on consolidation | (1.8) | (1.8) | (3.6) |
| | **127.6** | **102.7** | **197.3** |

| | Half year to September 2021 £m | Half year to September 2020 Restated £m | Year to March 2021 Restated £m |
|---|---|---|---|
| **Total assets** | | | |
| Scottish Water regulated water and waste water services | 7,584.4 | 7,264.4 | 7,045.9 |
| Business Stream | 253.6 | 243.1 | 244.4 |
| Scottish Water non-regulated activities | 121.1 | 115.7 | 123.2 |
| Reversal of IFRIC 12 adjustments on consolidation | (28.5) | (30.7) | (29.6) |
| | **7,930.6** | **7,592.5** | **7,383.9** |

**NOTES TO THE CONDENSED INTERIM STATEMENTS** FOR THE SIX MONTHS ENDED SEPTEMBER 2021 **(CONTINUED)**

## 2. SEGMENTAL ANALYSIS (continued)

An analysis of revenue by geographical location of customers is provided below:

| | Half year to September 2021 £m | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|---|
| **Revenue** | | | |
| United Kingdom | 864.9 | 811.7 | 1,666.9 |
| Rest of the World | 0.1 | 0.1 | 0.3 |
| | **865.0** | **811.8** | **1,667.2** |

### Estimated impact on the operating surplus:

The estimated impact of the pandemic on the operating surplus to 30 September 2021 was £17 million (2020: £47 million), being an estimated £32 million (2020: £59 million) reduction in revenue partially offset by a net reduction of £15 million (2020: £12 million) in operating costs. The estimated reduction in revenue reflects lower consumption as a consequence of Covid-19 restrictions. The £15 million (2020: £12 million) reduction in operating costs reflects lower cost of sales of £20 million (2020: £45 million), cost increases of £2 million (2020: £10 million), mainly relating to additional contractor costs to comply with Covid-19 operating procedures, and additional charges of £3 million (2020: £23 million) for the provision of bad and doubtful debt.

### Impact of IFRIC Agenda Decision on cloud computing arrangements:

The IFRIC agenda decision published in April 2021 has been applied under IAS 8 as a restatement to opening reserves at 1 April 2020 of £20.4 million with an equal reduction to property, plant and equipment. The associated tax adjustment to reserves equates to £2.8 million. The table below summarises the restatement adjustments that have been made to September 2020 and March 2021 comparatives:

| | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|
| Opening adjustment to retained earnings and Property, Plant & Equipment | (20.4) | (20.4) |
| Effect of tax on opening adjustment to retained earnings: | | |
| - Current tax asset | 1.9 | 1.9 |
| - Deferred tax liabilities | 0.9 | 0.9 |
| | 2.8 | 2.8 |
| Reversal of depreciation charges | 5.8 | 12.1 |
| Additional expenditure incurred | (2.8) | (13.8) |
| Adjustment to operating surplus | 3.0 | (1.7) |
| **Adjustment to Total Assets** | **(15.5)** | **(20.2)** |

**NOTES TO THE CONDENSED INTERIM STATEMENTS** FOR THE SIX MONTHS ENDED SEPTEMBER 2021 **(CONTINUED)**

## 3. TAXATION

The high deferred tax charge is a consequence of the revaluation of the deferred tax provision caused by the increase in the UK's main corporation tax rate from 19% to 25% effective from 1 April 2023. This was announced in the budget on 3 March 2021 and was substantively enacted on the 24 May 2021. As a consequence, the effective tax rate was 350.3% (2020: 23.1%). Analysis of the tax charge recognised in the income statement is as follows:

| | | Half year to September 2021 £m | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|---|---|
| Current Tax: | UK corporation tax | 4.0 | 4.2 | 6.5 |
| | Overseas corporation tax | – | – | – |
| | Adjustment in respect of prior years | – | – | 0.8 |
| | | 4.0 | 4.2 | 7.3 |
| Deferred tax: | Origination and reversal of timing differences | | | |
| | - Current year | 7.1 | (0.2) | 1.2 |
| | - Prior year | – | – | (0.6) |
| | | 7.1 | (0.2) | 0.6 |
| Effect of rate change | | 141.3 | – | – |
| | | 148.4 | (0.2) | 0.6 |
| **Total taxation charge** | | **152.4** | **4.0** | **7.9** |

## 4. PROPERTY, PLANT AND EQUIPMENT

During the period, additions to property, plant and equipment totalled £309.7 million (September 2020: £161.3 million). Investment to 30 September 2020 was significantly impacted by the suspension of activities as a result of Covid-19 restrictions. To 30 September 2021, the capital programme has incurred an additional £2 million (2020: £9 million) in relation to productivity impacts of Covid-19.

## 5. INTANGIBLE ASSET

The intangible asset relates to the acquisitions of the non-household customer base of Southern Water Services Limited in April 2017 and the non-household customer bases of Yorkshire Water Business Services and Three-Sixty, both part of the Kelda Group, in October 2019 by Business Stream. The associated 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. The cost, additions, amortisation charge and carrying value are shown in the table below.

As a result of an accounting policy change in respect of cloud accounting, the table below discloses the adjustments to reflect the IFRIC agenda decision on cloud computing. The adjustment specifically relates to integration software for a cloud-based billing application.

| | Total £m |
|---|---|
| **Cost** | |
| At 31 March 2021 | 22.7 |
| Effect of prior period adjustment (note 1) | 1.7 |
| Cost as restated at 31 March 2021 | 24.4 |
| Additions in the year | 3.3 |
| At 30 September 2021 | 27.7 |

**NOTES TO THE CONDENSED INTERIM STATEMENTS** FOR THE SIX MONTHS ENDED SEPTEMBER 2021 **(CONTINUED)**

## 5. INTANGIBLE ASSET (continued)

| | Total £m |
|---|---|
| **Accumulated Amortisation** | |
| At 31 March 2021 | 11.1 |
| Effect of prior period adjustment (note 1) | - |
| Amortisation as restated at 31 March 2021 | 11.1 |
| Amortisation charge | 1.6 |
| At 30 September 2021 | 12.7 |
| **Net book value** | |
| **At 30 September 2021** | **15.0** |
| At 31 March 2021 | 13.3 |

## 6. GOVERNMENT BORROWING

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

No loans were drawn down from the Scottish Government during the six months to 30 September 2021. Repayments over the period, in line with repayment terms, were £28.0 million.

## 7. ANALYSIS OF NET DEBT

| | As at 1 April 2021 £m | Decrease in cash £m | Decrease in debt £m | As at 30 September 2021 £m |
|---|---|---|---|---|
| Cash and cash equivalents | 570.4 | (90.7) | – | 479.7 |
| Government loans | (4.148.4) | – | 28.0 | (4,120.4) |
| Other loans (exc PFI lease liabilities) | (35.9) | – | 2.4 | (33.5) |
| **Net debt** | **(3,613.9)** | **(90.7)** | **30.4** | **(3,674.2)** |

The movement in cash is summarised below:

| | Scottish Water £m | Business Stream group £m | Non Regulated group £m | Total £m |
|---|---|---|---|---|
| Balance at 1 April 2021 | 428.7 | 94.9 | 46.8 | 570.4 |
| Government loans repaid | (28.0) | – | – | (28.0) |
| Cash utilised | (50.6) | (10.6) | (1.5) | (62.7) |
| Intercompany dividends | – | – | – | – |
| **Balance at 30 September 2021** | **350.1** | **84.3** | **45.3** | **479.7** |

The consolidated cash balance as at 30 September 2021 was £479.7 million (2020: £439.4 million) and continues to reflect the Covid-19 measures introduced by the Water Industry Commission for Scotland to support business customers and continued support of our supply chain. The estimated reduction to cash at 30 September 2021 of these measures was £12 million (September 2020: £22 million).

## 8. RETIREMENT BENEFIT OBLIGATIONS

| | Half year to September 2021 £m | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|---|
| **Movement in pension liability in the period** | | | |
| At start of period | (221.9) | (220.5) | (220.5) |
| Current service cost | (37.1) | (26.7) | (62.7) |
| Employer contributions | 1.3 | 1.3 | 38.8 |
| Net finance cost | (2.5) | (2.4) | (5.9) |
| Remeasurement - actuarial gains recognised | 51.0 | – | 28.4 |
| **At end of period** | **(209.2)** | **(248.3)** | **(221.9)** |

An actuarial gain of £51.0 million has been reflected in the closing pension liability. This is a result of higher than forecast asset returns to 30 September 2021 offset by a higher expectation of future CPI growth than originally forecast at 31 March 2021. Any updated measurement of the pension liability is a snapshot in time. The following table is an extract from the 2020/21 Annual Report and Accounts (note 23) and illustrates the potential impact of changes in the assumptions:

| 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. 1.3% | Increase / decrease by c. £30m |
| Discount rate | +/- 0.5% per annum | Decrease / increase by c. 9.0% | Decrease / increase by c. £205m |
| CPI Inflation rate | +/- 0.5% per annum | Increase / decrease by c. 7.6% | Increase / decrease by c. £173m |
| Longevity | Increase life expectancy by 1 year | Increase by c. 3.0% | Increase by c. £68m |

## 9. CAPITAL COMMITMENTS

The Group has contracted capital commitments of £496.2 million (30 September 2020: £537 million; 31 March 2021: £541 million) relating to property, plant and equipment at the balance sheet date.

## 10. RELATED PARTY TRANSACTIONS

As disclosed in the annual report for the year ended 31 March 2021, the Scottish Water group has related party relationships with the Scottish Government and with its Members and Executive Management.

**Scottish Government**
During the six months to 30 September 2021, Scottish Water had the following material transactions with the Scottish Government.

| | Half year to September 2021 £m | Half year to September 2020 £m | Year to March 2021 £m |
|---|---|---|---|
| Loans repaid | 28.0 | 95.5 | 134.3 |
| Loans drawndown | – | (76.0) | (354.3) |
| Interest paid | 70.9 | 71.4 | 142.2 |

Scottish Water had various material transactions with entities for which the Scottish Government is regarded as the parent. However, under IAS 24 'Related Party Disclosures' paragraph 25, Scottish Water is exempt from the disclosure requirements of IAS 24 paragraph 18 in respect of other government related entities.

## 11. FINANCIAL INSTRUMENTS

Scottish Water's financial assets and liabilities comprise trade and other receivables, cash and cash equivalents, borrowings and trade and other payables.

Other borrowings, following the acquisition of Aberdeen Environmental Services Limited in December 2018, are linked to LIBOR and are therefore exposed to changes in LIBOR which could have a material impact 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.

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.

Scottish Water
Trusted to serve Scotland