INTERIM REPORT AND ACCOUNTS

FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

Scottish Water

Trusted to serve Scotland

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Please note: some photographs which appear within the Interim Report and Accounts for the six months to 30 September 2020 were taken before the Covid-19 pandemic.

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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
Iain Lanaghan
Ken Marnoch
Deirdre Michie, OBE
Matt Smith, OBE, DL
Paul Smith

Independent Auditors

KPMG LLP
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20 Castle Terrace
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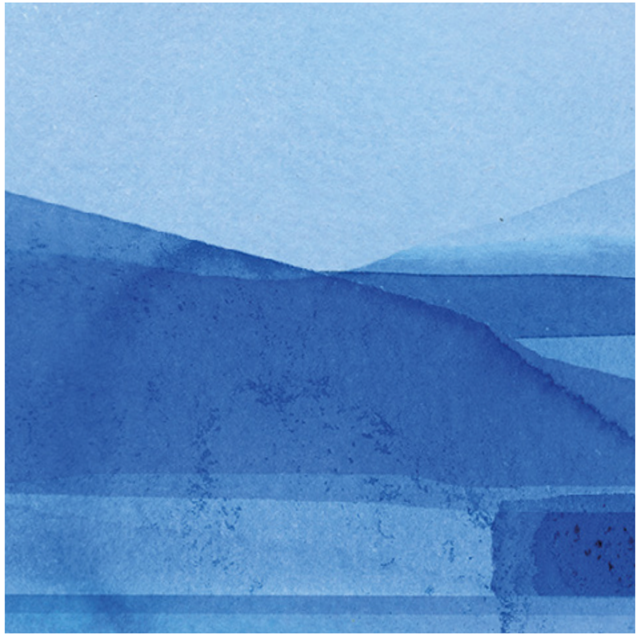

CHAIR'S STATEMENT
DAME SUSAN RICE

The first six months of the financial year 2020/21 have been as challenging as any in living memory, for people, communities and businesses. Scottish Water is no different and we have faced a number of challenges as a result of the Covid-19 pandemic and the steps taken by the Scottish and UK governments to support us at this time.

Throughout the crisis we have had a significant role to play in supporting public health, providing the clean water required for handwashing and hygiene and also delivering the waste water services so vital at this time. For example, at the height of lockdown, water consumption increased by around 30 litres per person per day.

The restrictions introduced by governments have also had a deep impact on how we work, most notably on the need for office-based employees to work from home and in shut-downs and restrictions at our capital investment project sites which meant we were unable to invest at the pace we had planned.

Business Stream, our retail subsidiary, has been significantly impacted by the pandemic. However, we have put in place a funding package to enable Scottish Water Business Stream Holdings Limited to provide Business Stream with the appropriate funds required to support its ongoing activities.

As ever, I am grateful to our employees, partners and suppliers for their efforts to ensure we continue to deliver our vital services in these extraordinary circumstances.

Despite the impacts of the pandemic there are many good things to report about our performance for the six months to the end of September 2020, with customer experience and drinking water quality, for example, increasing, albeit with restrictions to sampling in customers' properties.

We welcome the Water Industry Commission for Scotland's final determination of charges for 2021-27, including a 30% increase in capital investment funding from the current investment period. A consequence of increased investment will be a need to increase customer charges.

We fully understand the need to do this in a way that maintains the trust and confidence of our customers, communities and stakeholders, and particularly at this time when customers are challenged by the impacts of the pandemic.

While the final determination comes with very challenging efficiency targets at a level which have not been achieved anywhere in the UK water sector previously, increases in investment and customer charges are essential to replace ageing infrastructure, tackle climate change and deliver against strategic ambitions for the benefit of current and future generations. It creates the opportunity for us to achieve our strategic ambitions of service excellence, net zero emissions and great value.

So overall, it's been a highly challenging start to the year but one that we have managed well in the circumstances. It is difficult to predict what the rest of the year may bring but we are focused on continuing to deliver the essential services we all rely on through these tough times and investing for the future.

Dame Susan Rice
Chair, Scottish Water
2 December 2020

CHIEF EXECUTIVE'S STATEMENT
DOUGLAS MILLICAN

In the first six months of financial year 2020/21, the scale and impact of the Covid-19 pandemic has continued to dominate our daily lives and is likely to do so for some time to come. With worlds turned upside down for customers and communities, our enduring priority has been to keep water and waste water services running smoothly in support of the national effort to protect public health. It is also our duty to keep our customers, employees and contracting partner colleagues safe during this time. To do so we have adapted how we work to adhere to the Scottish Government guidelines and will continue to do so as restrictions change across the country.

At this halfway point, I want to share an open and transparent view of our performance within this challenging and ever-changing environment, reporting our successes, challenges and the lessons we have learned to continue to drive improvement.

With many customers experiencing challenges at this time, we recognise the importance of reliably delivering our services and maintaining customer satisfaction. Between April and the end of September 2020, for both household and non-household customers, customer service was recorded at its highest ever level for this time of year.

Household Customer Experience (hCEM)

Year to date performance is 89.20, 1.47 points higher than same period in 2019/20.

Non-household Customer Experience (nhCEM)

Year to date performance is 88.64, 6.63 points higher than same period in 2019/20.

While this performance is positive, it is only right that I also share that I have personally received a small number of complaints, illustrating that there is still room for improvement in our customer service offering.

I have also welcomed a number of notes of thanks, with customers directly thanking me for the service they received from Scottish Water, often describing circumstances where our employees have delivered a level of service above and beyond expectations.

Receiving feedback from both ends of the customer experience spectrum serves as a welcome reminder that often what distinguishes the two forms of feedback is not the technical issue itself, but the manner in which we engage with our customers.

At Scottish Water, we care deeply about how we support customers and are committed to finding ways to continually improve. Now, more than ever, we recognise the need to treat customers and communities with great kindness and support them as best as we possibly can.

Water Quality

Year to date performance is 99.938%, increased from 99.922% reported in 2019.

Covid-19 impacted our ability to sample water at customers' taps, with testing in the normal way being halted on 15 March to ensure that we did not make unnecessary visits to customers' properties. Instead, we took additional samples in our water supply systems as well as maintaining the normal sampling programme of drinking water from treatment works and at storage reservoirs. When we examine the data available to us, we have recorded our best ever water quality performance, providing confidence that we are continuing to pursue excellence even in the middle of a pandemic.

Minimising leakage from our water network is an important priority. Unfortunately, the closure of business premises during the pandemic has impacted our ability to read water meters, gather accurate data on water consumption and therefore calculate the water lost from our system. However, the available data suggests that our leakage performance is broadly stable.

In terms of maintaining customers' water supplies, we have been working to keep interruptions to a minimum and, where necessary, restoring supply as quickly as possible, mindful of the need for handwashing and good hygiene.

While regulatory sampling at waste water treatment works was suspended until July, we maintained a strong focus on good waste water management and environmental performance throughout the period.

CASE STUDY
GLADHOUSE RESERVOIR

With holiday plans cancelled and an eagerness to get outside and enjoy periods of good weather, we experienced unprecedented numbers of visitors to our reservoirs in the summer.

At Gladhouse reservoir in Midlothian, we faced challenges including insufficient parking, toilet facilities and litter bins. The local community demanded we do more to manage the influx of visitors, particularly in response to antisocial behaviour.

While we are working with the community and other stakeholders to improve the situation, this is not an isolated incident and illustrates how we struggled to respond appropriately to the exceptional demand for access across our assets.

Our sewer systems were, however, particularly challenged in August as extreme rainfall caused severe flooding events for a small number of customers.

As we adapt to different ways of working during the rest of this year, our first priority remains delivering high quality supply and service to our customers across Scotland.

Among our biggest challenges to date this year have been the delivery of our capital programme and the impact of reduced customer income.

The first national lockdown led to our capital programme being suspended for three months with all sites closed from 23 March 2020 to the end of May when we began a gradual ramp up in line with government guidance. Thanks to a huge effort from our people, our contracting partners and support from affected communities, we managed to get all capital projects back up and running by the end of July 2020. Our monthly capital investment rate has now also returned to pre-pandemic levels.

CASE STUDY
COMMUNITY ENGAGEMENT

Scottish Water has been served an enforcement notice for a breach in planning control relating to a sensitive project to expand the waste water treatment works in Ardersier.

While we have applied for retrospective permission, we exceeded the previously consented height of part of the infrastructure and missed both our formal duty and obligation to engage the local community appropriately. As a result, we have failed in our commitment to open and transparent engagement, however unintentionally.

We regret this failure and recognise it has damaged our relationship with the community. We are committed to doing all we can to resolve the issue.

Gross capital investment in the period, as measured on a regulatory accounting basis, was £234 million. For the same period in 2019 this was £317 million. The reduction was mainly because of the suspension of significant activities as a result of the Covid-19 restrictions. We estimate that the costs of lockdown, remobilisation and the productivity impacts of working in a Covid safe manner will add around £75 million to the cost of completing the current regulatory investment programme.

In the six months to 30 September 2020 the group surplus before tax reduced by £34.6 million to £17.4 million compared to £52.0 million for the same period in 2019. We estimate that the pandemic has reduced the surplus before tax by £47 million.

In our retail subsidiary, Business Stream, many customers suspended trading during the first national lockdown and others have required lower volumes of water because of the economic impacts from the pandemic. Consequently, and principally due to a £16 million increase in the provision for bad and doubtful debts, the operating loss in Business Stream for the period was £13.9 million. There is much uncertainty about the future short-term prospects for the UK economy and therefore the impacts on Business Stream and we have put in place an appropriate funding package to support its ongoing activities.

Even after recognising the impacts of Covid-19 on our revenue, overall revenue for the six months to September 2020 increased by £52.7 million to £811.8 million as a result of the acquisition by Business Stream of the non-household customer books of Yorkshire Water Business Services and Three-Sixty from Kelda in October 2019.

The consolidated cash balance as at 30 September 2020 was £439.4 million, compared to £320.7 million for the same period in 2019, and reflects the impact of the pandemic highlighted in the notes to the financial statements. The reduced demand for cash was partly offset by the measures introduced by the Water Industry Commission for Scotland to support business customers during the pandemic. This included the deferral of prepaid charges by Licensed Providers to Scottish Water which resulted in a net £22 million reduction in group cash. The delay to capital programme delivery, higher costs and lower income we are experiencing as a result of the pandemic, and the additional costs needed to complete safely the delivery of the regulatory capital programme, will increase the demand on our cash reserves to complete our commitments associated with this regulatory period.

The full financial impact of the pandemic is difficult to predict or forecast with any accuracy. Accordingly, financial projections for a range of plausible economic scenarios have been prepared and continue to be monitored. The key sensitivities being the level of volume reductions by business customers and the potential charges required for the provision for bad and doubtful debts.

However, we are fortunate that we opened 2020/21 with healthy cash balances due to strong financial performance each year between 2015 and 2020. While this means we are in a good position to weather the storm of the pandemic, we are not immune to its financial impact and must remain alert to minimising the financial impacts of the ongoing situation.

This year, more than ever before, safety, health and wellbeing has been of fundamental importance and a huge amount of effort has gone into supporting our employees and contracting partners to stay safe and well.

We now assess and internally report more hazards caught, beyond those required of us by the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR). In doing so our aim is to learn more about the risks we face, expanding our knowledge and ultimately become better prepared to mitigate them in the future.

In October 2019, together with our water sector regulators and stakeholders, we collectively committed to a shared water industry Vision; to support a flourishing Scotland in everything we do. Positioned firmly at the heart of our future planning, in February 2020 we launched our Strategic Plan sharing our long-term ambitions of Service Excellence; going beyond Net Zero Emissions; and delivering Great Value and Financial Sustainability.

In December 2020, the proposed finance to support this plan over the next six years was set out in the Water Industry Commission for Scotland's' final determination of charges for 2021-2027.

The final determination highlighted our success in managing risks from our ageing assets to safely defer investment for as long as possible. While this is commended, the Commission also recognised that increasing asset replacement is inevitable to ensure that we meet our customers' service expectations.

As a result, the Commission has proposed to increase our investment allowance by 30% to £4.5 billion in the next regulatory period while requiring us to deliver unprecedented levels of efficiency improvement. We will need to clearly and transparently demonstrate how we continue to drive efficiency, improve risk management and deliver transformation that will ensure Scottish Water is fit for the future.

Some of this transformation work has already begun with changes to our approaches to planning and prioritising future investment, driving more consistent assessment of risk and delivering more robust appraisal of options. These are vital to help us make smarter investment choices in the future. We are also transforming our approach to future investment delivery, driving deeper integration across all parts of our delivery approach, reducing the time to get projects to site and generating greater efficiency. We continue to work more closely than ever with our customers and communities to involve them ever more in decision making and being increasingly transparent.

We also recognise the need to use technology in new ways, to equip people with the skills they need for the future, to support the need to work flexibly, and continue to build more collaborative relationships to better deliver our services.

Health and Safety Performance

Looking at our performance to date this year, there have been 3 Scottish Water RIDDOR incidents and 4 involving contractors.

For Lost Time Accidents (LTA), year to date, there have been 4 Scottish Water LTAs and 7 involving contractors.

CASE STUDY
MOBILE APP USAGE

The Electrical and Maintenance mobile app has enabled a transition in the way we raise mechanical, electrical, instrumentation, control and automation faults. Previously raised through a manual process which relied on Microsoft Excel and email, 95% of faults are now raised using the app, significantly streamlining the process and delivering a 20% improvement in first time fixes.

The ongoing challenges with technological developments such as this are the training and upskilling of people to use them effectively as well as site connectivity in some more rural locations. We are working to combat these issues with digital training tutorials and building in the ability to work offline. Covid-19 remains a barrier to providing more direct support to those who need it.

Beyond this we are currently developing a long-term plan for transforming how we operate.

While 2020 has brought some of the most challenging circumstances that any of us have experienced, we have faced them with focus, determination and, above all, kindness, valuing opportunities to adapt, learn and continually improve our services.

As we progress into the second half of the year, particularly as we move through the winter months, the safety, health and wellbeing of our customers, people and contracting partner colleagues will be more important than ever. Our priority remains delivering the vital services and associated investment to keep our customers and communities functioning through the continuing challenges and uncertainty of Covid-19. We will also continue to progress our transformation plans so we can deliver the essential change that is required to ensure Scottish Water is fit for the future.

Douglas Millican
Chief Executive, Scottish Water
2 December 2020

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INDEPENDENT REVIEW REPORT TO SCOTTISH WATER
FOR THE SIX MONTH PERIOD ENDED 30 SEPTEMBER 2020

Introduction

We have reviewed the accompanying condensed consolidated balance sheet of Scottish Water as at 30 September 2020, the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of cash flows for the six-month period then ended and the notes to the interim financial statements ('the condensed consolidated interim financial statements'). Management is responsible for the preparation and presentation of these condensed consolidated interim financial statements in accordance with IAS 34 Interim Financial Reporting. Our responsibility is to express a conclusion on these condensed consolidated interim financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial statements consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing 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 audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements as at and for the six months ended 30 September 2020 are not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting.

Hugh Harvie
for and on behalf of KPMG LLP
Chartered Accountants
Saltire Court
20 Castle Terrace
Edinburgh
EH1 2EG

18 December 2020

CONDENSED CONSOLIDATED INCOME STATEMENT
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2020

	Note	Half year to September 2020 Unaudited £m	Half year to September 2019 Unaudited £m	Year to March 2020 Audited £m
Revenue	2	**811.8**	**759.1**	**1,615.9**
Cost of sales		(612.4)	(543.4)	(1,185.2)
Gross surplus		**199.4**	**215.7**	**430.7**
Administrative expenses		(99.7)	(78.6)	(175.8)
Operating surplus	2	**99.7**	**137.1**	**254.9**
Finance income		0.4	1.2	2.6
Finance costs		(82.7)	(86.3)	(171.8)
Surplus before taxation		**17.4**	**52.0**	**85.7**
Taxation	3	(4.0)	(10.2)	(65.1)
Surplus for the period		**13.4**	**41.8**	**20.6**

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2020

	Note	Half year to September 2020 Unaudited £m	Half year to September 2019 Unaudited £m	Year to March 2020 Audited £m
Surplus for the period		13.4	41.8	20.6
Other comprehensive income for the period *Items which will not subsequently be reclassified to the income statement*				
Actuarial gain on post employment benefit obligations	8	–	–	58.2
Deferred tax on remeasurement of post employment benefit obligations		–	–	(8.5)
Effective portion of changes in fair value of cash flow hedge, net of deferred taxation		0.6	0.2	1.2
Total comprehensive income for the year		14.0	42.0	71.5

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

The notes on pages 19 to 25 form an integral part of the condensed consolidated interim financial information.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2020

	Cash flow hedging reserves £m	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2019	(8.5)	1,543.7	133.4	1,668.6
Surplus for the six months ended 30 September 2019	0.2	41.8	–	42.0
Total comprehensive income for the period	0.2	41.8	–	42.0
Balance at 30 September 2019	**(8.3)**	**1,585.5**	**133.4**	**1,710.6**
Balance at 1 April 2019	(8.5)	1,543.7	133.4	1,668.6
Surplus for the year ended 31 March 2020	–	20.6	–	20.6
Other comprehensive income:				
Actuarial gain on post employment benefit obligations, net of tax	–	49.7	–	49.7
Effective portion of changes in fair value of cash flow hedge, net of tax	1.2	–	–	1.2
Total comprehensive income for the year	1.2	70.3	–	71.5
Balance at 31 March 2020	**(7.3)**	**1,614.0**	**133.4**	**1,740.1**
Surplus for the six months ended 30 September 2020	–	13.4	–	13.4
Other comprehensive income:				
Effective portion of changes in fair value of cash flow hedge, net of tax	0.6	–	–	0.6
Total comprehensive income for the year	0.6	13.4	–	14.0
Balance at 30 September 2020	**(6.7)**	**1,627.4**	**133.4**	**1,754.1**

The 'Statement of changes in equity' above excludes Government loans which, in accordance with the Scottish Water Governance Directions 2009, are recorded on the balance sheet under Equity.

The notes on pages 19 to 25 form an integral part of the condensed consolidated interim financial information.

CONDENSED CONSOLIDATED BALANCE SHEET
AS AT 30 SEPTEMBER 2020

	Note	At 30 September 2020 Unaudited £m	At 30 September 2019 Unaudited £m	At 31 March 2020 Audited £m
Assets				
Non-current assets				
Property, plant and equipment		6,439.0	6,293.1	6,430.2
Intangible assets	5	12.8	9.2	14.0
Deferred tax asset		4.0	1.6	3.6
		6,455.8	6,303.9	6,447.8
Current assets				
Inventories		3.9	3.8	3.9
Trade and other receivables		704.8	666.5	246.8
Current tax asset		4.1	0.1	3.2
Cash and cash equivalents	7	439.4	320.7	531.6
		1,152.2	991.1	785.5
Total assets		**7,608.0**	**7,295.0**	**7,233.3**
Liabilities				
Current liabilities				
Trade and other payables		(898.8)	(913.0)	(532.6)
Other loans and borrowings		(24.4)	(24.3)	(24.6)
Provisions for liabilities		(14.6)	(10.2)	(12.9)
		(937.8)	(947.5)	(570.1)
Non-current liabilities				
Trade and other payables		(71.4)	(79.7)	(77.5)
Other loans and borrowings		(240.4)	(265.7)	(252.8)
Deferred tax liabilities		(433.0)	(374.4)	(432.7)
Retirement benefit obligations	8	(248.3)	(279.6)	(220.5)
Provisions for liabilities		(14.2)	(11.7)	(11.2)
		(1,007.3)	(1,011.1)	(994.7)
Total liabilities		**(1,945.1)**	**(1,958.6)**	**(1,564.8)**
Net assets		**5,662.9**	**5,336.4**	**5,668.5**
Equity				
Government loans	7	3,908.8	3,625.8	3,928.4
Retained earnings		1,627.4	1,585.5	1,614.0
Cash flow hedge reserve		(6.7)	(8.3)	(7.3)
Other reserves		133.4	133.4	133.4
		5,662.9	**5,336.4**	**5,668.5**

The notes on pages 19 to 25 form an integral part of the condensed consolidated interim financial information.

The condensed set of financial statements on pages 15 to 25 were approved by the Board on 2 December 2020 and signed on its behalf by:

Douglas Millican
Chief Executive

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2020

	Note	Half year to September 2020 Unaudited £m	Half year to September 2019 Unaudited £m	Year to March 2020 Audited £m
Surplus before taxation		17.4	52.0	85.7
Depreciation charges		155.3	147.9	297.0
Amortisation of intangible asset	5	1.2	0.8	2.0
Amortisation of grants		(0.5)	(0.6)	(1.2)
Surplus on disposal of property, plant and equipment		(2.0)	(0.4)	(0.9)
Non cash adjustment for retirement benefit obligations		7.7	11.6	26.1
Finance costs - net		82.3	85.1	169.2
Operating cash flow before changes in working capital and provisions		**261.4**	**296.4**	**577.9**
Changes in working capital and provisions:				
Decrease/(increase) in receivables		6.0	(5.3)	(42.6)
Increase in inventories		–	(0.1)	(0.2)
(Decrease)/increase in payables		(60.3)	14.7	56.0
Increase/(decrease) in provisions		5.9	(2.4)	(2.8)
Cash flows from operating activities		**213.0**	**303.3**	**558.3**
Taxation paid		(5.2)	(1.3)	(11.4)
Net cash generated from operating activities		207.8	302.0	576.9
Cash flows from investing activities				
Purchase of property, plant and equipment		(195.9)	(249.4)	(525.4)
Sale of property, plant and equipment		2.0	0.4	1.4
Purchase of intangible asset		–	–	(6.0)
Government grant income received		–	0.6	0.6
Infrastructure income receipts		6.2	9.2	17.7
Net cash used in investing activities		(187.7)	(239.2)	(511.7)
Cash flows from financing activities				
Repayments of loans	7	(98.4)	(85.0)	(129.3)
Proceeds from borrowings	6	76.0	–	344.3
Interest received		0.4	1.2	2.7
Interest paid		(80.6)	(83.1)	(166.1)
Payment of finance lease liabilities		(9.7)	(10.0)	(20.0)
Net cash used in financing activities		(112.3)	(176.9)	31.6
Net (decrease)/increase in cash and cash equivalents		**(92.2)**	**(114.1)**	**96.8**
Cash and cash equivalents - opening balance	7	531.6	434.8	434.8
Cash and cash equivalents - closing balance	7	**439.4**	**320.7**	**531.6**

The notes on pages 19 to 25 form an integral part of the condensed consolidated interim financial information.

NOTES TO THE CONDENSED INTERIM STATEMENTS
FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

1. Accounting policies

1.1 General information

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

The condensed consolidated interim financial information was approved by the Board on 2 December 2020. The consolidated interim financial information is unaudited but has been reviewed by the auditor. The auditor's report is set out on page 14. 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 2020, were approved by the Board on 17 November 2020 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 2020 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 2020 which were prepared in accordance with EU adopted and endorsed International Financial Reporting Standards (IFRSs).

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 financial statements have been prepared on the going concern basis which the Members consider to be appropriate for the following reasons.

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

Consequently, the Members are confident that Scottish Water will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of these financial statements. 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 2020 and the related costs, as calculated under IAS 19 'Employee Benefits', have been calculated using the valuation report from 31 March 2020 (see note 8).

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020 **(CONTINUED)**

1. Accounting policies (continued)

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 2021. The accounting policies, as set out in the Annual Report and Accounts for the year ended 31 March 2020, 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) on the 19 March 2020 to 1 April 2021. 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.

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 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Revenue			
Scottish Water regulated water and waste water services	621.5	630.6	1,254.4
Business Stream	275.5	189.0	477.7
Scottish Water non-regulated activities	22.7	22.4	49.1
	919.7	842.0	1,781.2
Less Intercompany elimination	(107.9)	(82.9)	(165.3)
	811.8	**759.1**	**1,615.9**

	Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Operating surplus			
Scottish Water regulated water and waste water services	113.4	137.7	267.5
Business Stream	(13.9)	0.1	(14.0)
Scottish Water non-regulated activities	2.0	1.1	5.0
Reversal of IFRIC 12 adjustments on consolidation	(1.8)	(1.8)	(3.6)
	99.7	**137.1**	**254.9**

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

2. Segmental analysis (continued)

	Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Total assets			
Scottish Water regulated water and waste water services	7,279.9	7,004.4	6,880.1
Business Stream	243.1	205.6	262.9
Scottish Water non-regulated activities	115.7	117.9	122.1
Reversal of IFRIC 12 adjustments on consolidation	(30.7)	(32.9)	(31.8)
	7,608.0	**7,295.0**	**7,233.3**

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

	Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Revenue			
United Kingdom	811.7	758.8	1,615.3
Rest of the World	0.1	0.3	0.6
	811.8	**759.1**	**1,615.9**

The Covid-19 pandemic has had a significant adverse impact across the Scottish Water group of companies in the six months to 30 September 2020. A summary of this is provided below.

Estimated impact on the operating surplus:

	Scottish Water £m	Business Stream £m	Other £m	Elimination £m	Total £m
Reduction in revenues	16	48	4	(9)	59
Net increase/(reduction) in cost of sales and administration expenses	4	(45)	(3)	9	(35)
Increase in the provision for bad and doubtful debts	7	16	–	–	23
Net impact on operating cost	**11**	**(29)**	**(3)**	**9**	**(12)**
Impact on operating surplus	**27**	**19**	**1**	**–**	**47**

The estimated impact of the pandemic on the operating surplus to 30 September 2020 is £47 million, being an estimated £59 million reduction in revenue partially offset by a net reduction of £12 million in operating costs. The estimated reduction in revenue reflects lower actual and anticipated consumption by business customers because of them stopping or reducing trading. The £12 million reduction in operating costs reflects lower cost of sales of £45 million, cost increases of £10 million, mainly for additional personal protective equipment and cleaning costs, and additional charges of £23 million for the provision of bad and doubtful debt.

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

3. Taxation

The tax charge for the 6 months to September 2020 has been determined using the current rate of corporation tax in the UK of 19%. The effective rate of tax was 23.1% (2019: 19.5%). Analysis of the tax charge recognised in the income statement is as follows:

		Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Current Tax:	UK corporation tax	4.2	3.8	8.8
	Adjustment in respect of prior years	–	–	2.1
		4.2	3.8	10.9
Deferred tax:	Origination and reversal of timing differences			
	- Current year	(0.2)	6.4	10.2
	- Prior year	–	–	(1.1)
		(0.2)	6.4	9.1
Effect of rate change		–	–	45.1
		(0.2)	6.4	54.2
Total taxation charge		**4.0**	**10.2**	**65.1**

4. Property, plant and equipment

During the period, additions to property, plant and equipment totalled £164.1 million (September 2019: £226.3 million). The reduction was mainly because of the suspension of significant activities as a result of Covid-19 restrictions. The investment figure includes estimated Covid-19 related costs of £16 million which are associated with closing and making safe capital works.

Additional productivity related costs, because of new ways of working, will also be borne within the investment programme, which totalled £9 million in the six months to 30 September 2020. These productivity related costs are projected to be an ongoing additional cost element within the investment programme for the foreseeable future.

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 intangible asset is treated as having a finite life and is being amortised on a straight-line basis over its expected useful life, currently set at 8 years. The cost, additions, amortisation charge and carrying value are shown in the table below.

	As at 1 April 2020 £m	Amortisation charge £m	Year at 30 September 2020 £m
Acquisition cost	22.7	–	22.7
Amortisation total	(8.7)	(1.2)	(9.9)
Net book value	**14.0**	**(1.2)**	**12.8**

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

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.

Loans of £76.0 million were drawn down from the Scottish Government during the six months to 30 September 2020. Repayments over the period, in line with repayment terms, were £95.6 million.

7. Analysis of net debt

	As at 1 April 2020 £m	Decrease in cash £m	Decrease in debt £m	As at 30 September 2020 £m
Cash and cash equivalents	531.6	(92.2)	–	439.4
Government loans	(3,928.4)	–	19.6	(3,908.8)
Other loans (exc PFI lease liabilities)	(40.9)	–	2.8	(38.1)
Net debt	**(3,437.7)**	**(92.2)**	**22.4**	**(3,507.5)**

The movement in cash is summarised below:

	Scottish Water £m	Business Stream group £m	Non Regulated group £m	Total £m
Balance at 1 April 2020	391.4	92.7	47.5	531.6
Cash utilised	(80.4)	(9.0)	(2.8)	(92.2)
Balance at 30 September 2020	**311.0**	**83.7**	**44.7**	**439.4**

The consolidated cash balance as at 30 September 2020 was £439.4 million (2019: £320.7 million) and reflects the Covid-19 related issues as highlighted in Notes 2 and 4 above, in particular the lower level of capital investment. The reduced demand for cash was partly offset by the Covid-19 measures introduced by the Water Industry Commission for Scotland to support business customers. This included the deferral of prepaid charges by Licensed Providers to Scottish Water which resulted in a net £22 million reduction in group cash. Further demands on cash were caused by the slower rate of cash collections from household customers and the fast-track payment of supplier invoices to support Scottish Water's supply chain during the pandemic.

8. Retirement benefit obligations

	Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Movement in pension liability in the period			
At start of period	(220.5)	(248.3)	(248.3)
Current service cost	(26.7)	(30.0)	(63.0)
Employer contributions	1.3	1.8	39.0
Net finance cost	(2.4)	(3.1)	(6.4)
Remeasurement - actuarial gains recognised	–	–	58.2
At end of period	**(248.3)**	**(279.6)**	**(220.5)**

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

8. Retirement benefit obligations (continued)

The pension liability has not been revalued as at 30 September 2020 as there have been no plan amendments, curtailments or settlements since 31 March 2020. The actuarial revaluation will be calculated at 31 March 2021 by actuarial advisers. Any updated measurement of the pension liability is a snapshot in time. The following table is an extract from the 2019/20 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. 1.6%	Increase / decrease by c. £30m
Discount rate	+/- 0.5% per annum	Decrease / increase by c. 9.4%	Decrease / increase by c. £178m
CPI Inflation rate	+/- 0.5% per annum	Increase / decrease by c. 7.7%	Increase / decrease by c. £146m
Longevity	Increase life expectancy by 1 year	Increase by c. 4.0%	Increase by c. £76m

9. Capital commitments

The Group has contracted capital commitments of £537 million (30 September 2019: £453 million; 31 March 2020: £484 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 2020, 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 2020, Scottish Water had the following material transactions with the Scottish Government.

	Half year to September 2020 £m	Half year to September 2019 £m	Year to March 2020 £m
Loans repaid	95.6	82.8	125.0
Loans drawndown	(76.0)	–	(344.3)
Interest paid	71.4	73.3	145.6

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.

NOTES TO THE CONDENSED INTERIM STATEMENTS FOR THE SIX MONTHS TO 30 SEPTEMBER 2020

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