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Scottish Water Annual Report and Accounts 2008/09

Record investment and performance across Scotland for our customers

Annual Report and Accounts 2008/09
scottishwater.co.uk



Contents

01 Highlights
02 Chair's statement
03 Chief Executive's statement
04 Our objectives to 2010
06 Our strategy
08 Value for money
09 Customer service
10 Investment overview
14 The environment
16 Innovation
17 Corporate responsibility
18 Social responsibility
20 Financial and business review
26 Executive Board Members
27 Non-executive Board Members
28 Members' report
29 Corporate governance
32 Members' remuneration report
37 Statement of Members' responsibilities
38 Independent auditors' report
40 Financial statements

Our vital role

Scottish Water provides a vital public service, essential to the health of the nation.

We provide good, clean, safe and high quality drinking water to 2.4 million households across Scotland. Every day we supply 883 million litres of safe, treated drinking water to our customers and take away 687 million litres of waste water, which we treat before returning safely to the environment.

We are delivering one of the largest investment programmes, per connected property, in Britain during 2006-2010. This at a time when household charges are lower than seven of the water companies in England and Wales. In 2009/10 the average household charge in Scotland is £18 lower per annum than the average household bill in England and Wales.

The quality of our drinking water remains high, investment is delivering the benefits Scotland needs and supporting over 5,000 construction jobs. Scottish Water is increasingly delivering a good value package to our customers.

Your charges go to maintaining and improving:

- 29,338 miles of water pipes
- 31,155 miles of sewer pipes
- more than 1,900 waste water treatment works
- 299 water treatment works
- delivering 883 million litres of safe drinking water to homes across Scotland every day.



How our industry is run

The Scottish Parliament

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

Scottish Ministers

Set the objectives for Scottish Water and appoint the Chair and Non-executive Directors.

Scottish Water

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

Water Industry Commission for Scotland

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

Drinking Water Quality Regulator

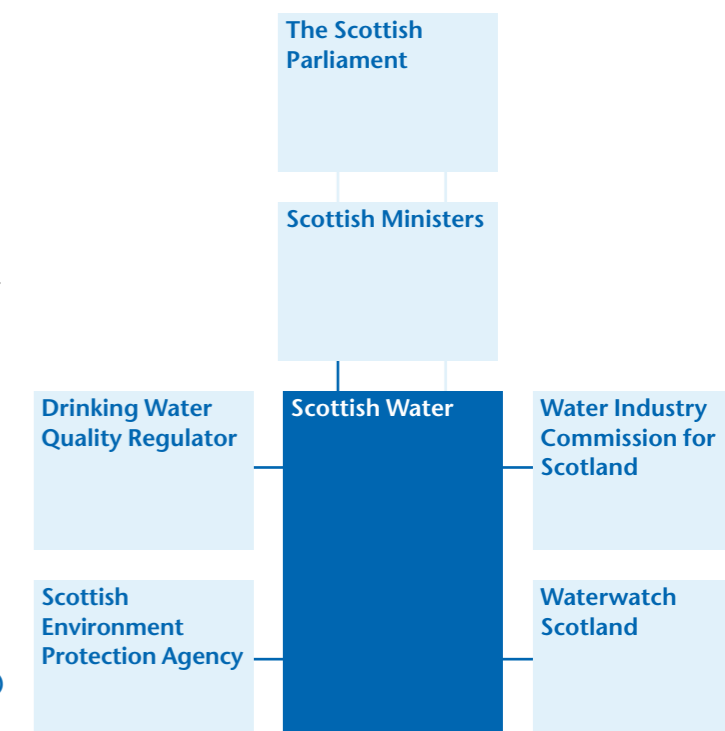
Responsible for protecting public health by ensuring compliance with drinking water quality regulations.

Scottish Environment Protection Agency (SEPA)

Responsible for environmental protection and improvement.

Waterwatch Scotland

Responsible for representing the interests of Scottish Water customers.



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Designed and produced by Tayburn.

Highest level of customer satisfaction

In 2008/09 our overall satisfaction figure of 80% represents an all time high in customers' satisfaction with the outcome of their contact with us.

Record investment across Scotland

Scottish Water delivered £687 million of Quality and Standards II/IIIa investment in 2008/09.

Highest ever water quality

In 2008/09 1.5 million of our customers are enjoying clearer, fresher drinking water straight from their taps.

Biggest ever leakage reduction

On average, over the year, leakage has been reduced by 122 million litres of water a day in Scotland.

Low bills

On average each Scottish household pays £324 a year for water and waste water services, the equivalent of less than £1 a day*.

Fastest improving water utility in the UK

Our Customer Overall Performance Assessment has improved by 53% in the period 2006-2009.

* The average household is between Council Tax Band B and Band C and has a combined bill of less than £1 a day. Individual water supply and waste water collection charges are less than £1 a day for all households (except for the individual water supply charges and waste water collection charges for Band H households).



Ronnie Mercer
Chair

“ We are continuing to deliver real benefits for our customers – always serving Scotland. ”

In this, the end of the third year of our regulatory period 2006-2010, we are at a crucial stage in the development of Scottish Water delivering the vital investment that Scotland needs, while supporting economic growth.

In 2008/09 the surplus from our regulated business was re-invested in delivery of the £687 million capital investment programme, one of the biggest investment programmes in the UK water industry, which is integral to our aim to deliver one of the best value packages to our customers.

The first seven years of Scottish Water from 2002-2009 has seen the company become more efficient, driving over 40% of the day to day running costs out of the business. This continued drive to become more efficient has helped keep charges steady, which is particularly important in this stringent economic climate as we help our customers keep their costs down. In 2009/10 the average household charge in Scotland is £18 lower per annum than the average household bill in England and Wales.

We share the Scottish Government's wish to keep charges steady in Scotland in the future. This is all while we continue to manage the effective and efficient delivery of one of the largest water industry investment programmes in the UK.

This year saw a number of developments at Scottish Water. We successfully launched a new wholly owned business, Scottish Water Horizons, to drive forward the green agenda and create new opportunities to help us meet carbon reduction targets which customers rank highly.

We fully support the aims of the Climate Change Bill presented to the Scottish Parliament and are confident that we can play our part in helping Scotland meet its ambitious targets for the reduction of greenhouse gases.

This is also the first full year of the separation of retail and wholesale divisions in the business market. Scottish Water supported the opening of the business customer market to retail competition, a first in the UK. We are actively engaged with all entrants to the market and will continue to provide a first class service as wholesale provider to Licensed Providers. We continue to supply all our household customers directly.

Since separating from Scottish Water, Business Stream has increased innovation, improved customer service and driven down costs.

Scottish Water's performance in 2008/09 is evidenced by an increasingly better delivery of a value for money package for our customers, closing the service gap between us and comparable companies in England and Wales. This will be a key priority in the next regulatory period 2010-2014 as we work towards becoming one of Scotland's most valued and trusted organisations, positioning Scottish Water as a business with high customer service and lower charges.

I am pleased to report the Executive Board appointment of Peter Farrer as the new Director of Customer Service Delivery, which will be integral to the development of our customer service strategy.

We have continued to support new development in Scotland, working closely with local authorities and developers to ensure we provide support and service through this difficult time for the construction industry, and to ensure we continue to play our part in helping communities grow across the country. Through a dedicated service by our teams we have connected around 18,000 new properties this year, and we look forward to this increasing as the market picks up.

Scottish Water is not immune from the current recession. But every person in the business is determined to continue the progress, which has been rapid, to ensure that our service to customers and the delivery of the vital investment Scotland needs is not hindered. A new business plan for 2010-2014 has now been submitted to our regulator for discussion. This is key to our aim of building a responsible and sustainable business for all our customers.

I would like to thank my Board, management team and staff for their continued commitment to the business and our customers.

Finally I must pay tribute to four of my Board Directors, Rita Theil, Ian McMillan, Graeme Crombie and Alistair Buchanan, who have stepped down this year.

I would also like to welcome the re-appointment of Pat Kelly as a Non-executive Director for a further term and the appointment of four new Non-executive Directors with a strong industrial background; James Spowart, Andrew Wyllie, Alan Bryce and Lynne Peacock.



Richard Ackroyd
Chief Executive

“ We have achieved major improvements in our service to our customers. Our commitment to the continuing improvement of our service remains undiminished. ”

I joined the fastest improving water company in the UK with one aim; to continue the rapid progress that has made Scottish Water the success it is today while managing an efficient well run business for the people of Scotland.

I have been at the helm of this business for a year now. Scottish Water has an impressive pedigree for such a young business. The achievements from 2002 have been impressive thanks to the dedication of every person who works in Scottish Water. We are now building a vision that lays out our aspirations to take Scottish Water on to the next level of achievement. I want Scottish Water to become an industry leader, delivering the best service to all our customers across Scotland.

I am pleased to report even more progress in 2008/09. The continued and sustained efficiency of the business has enabled customer charges to remain steady as we work to provide one of the best value for money water and waste services in the UK.

In 2008/09 we invested a massive £687 million to improve our asset base. We are now three quarters of the way through our second four year regulatory period 2006-2010 to deliver a £2.4 billion programme. By 2010 around £4 billion will have been invested to transform Scotland's water infrastructure. Our investment levels are higher than almost all water companies in England and Wales. It is also supporting over 5000 construction jobs across every corner of Scotland.

More than 4000 projects in this programme are delivering real benefits to communities across Scotland. We are building innovation into the water business to help drive efficiencies and customer service. Everyone in the business is being asked to look at how innovation can change or improve their role. I am pleased to report the appointment of Grant Nairn, as Director of technology and innovation who will help drive this step change.

In 2008 drinking water quality remained high at 99.81% compliance. We want our customers to enjoy the look and taste of their drinking water, with 1.5 million of our customers getting clearer, fresher drinking water as result of the investment in the last year.

Customers are seeing real improvements in the value they get for their charges; in 2008/09 180 properties were taken off the "at risk" register for internal sewer flooding and the number of properties with low water pressure reduced by 2,900.

In 2006 we agreed targets for improving customer service. The Overall Performance Assessment (OPA) score is based on a number of different elements of service, including drinking water quality, water pressure and sewer flooding. This year we raised our performance for the third year running to beat our regulatory target of 223 points. We actually reached 252 – beating our target by 13%. However we are committed to continuing to drive our customer focus to new heights.

I am also pleased to report that we have beaten our target to reduce leaking water from our pipes in 2008/09. We reduced leakage by 122 million litres of water a day, greater than the stretch target agreed with our regulator. Reducing leakage remains a top priority for Scottish Water. We are also working with customers to ensure that we all play our part in looking after this vital resource.

I am pleased with the progress that the business has made this year. There are many challenges ahead, not least the current economic climate and climate change. But we are not complacent. We are determined to build a business which Scotland can be proud of.

In this I must pay tribute and thanks to the dedication and commitment of everyone who works in Scottish Water. Our teams go out in all weathers and at all times and often go the extra mile to ensure our customers get a first class service.

Scottish Ministers set objectives for Scottish Water for the period 1 April 2006 to 31 March 2010. This annual report looks at the third year of the delivery period 2006-2010.

The Water Industry Commission for Scotland determines the financial limits within which these objectives must be achieved, including restricting the increases possible to household charges until 2010.

The Scottish Ministers' objectives are central to our delivery plan 2006-2010. We are improving the level of service to our customers and our delivery plan details the specific outputs required and agreed with the Drinking Water Quality Regulator (DWQR) and the Scottish Environment Protection Agency (SEPA) the environmental regulator.

These "outputs" deliver real benefits to our customers – clearer, fresher drinking water at their tap; a cleaner environment and improving service. To individual customers this means reducing the risk of sewer flooding in their homes, interruptions to their water supply and to low pressure which can affect their boilers, their showers and their washing machines.

We deliver these benefits to customers by improving operational practices, maintaining our existing assets and investing in new or enhanced assets.

To deliver our objectives for 2006-2010, Scottish Water shall:

- Improve the taste of drinking water for 4.31 million people, and improve the quality of drinking water for 1.5 million people with investment of almost £680 million by March 2010. More than £100 million will be invested in the Edinburgh area between 2006-2010 to provide better quality drinking water.
- By 2010, spend more than £800 million in maintaining our current assets and levels of service.
- Continue to service new development across Scotland by addressing water and waste water capacity to allow further growth.
- Further improve waste water treatment by reducing the effect of discharges on the water environment. By 2010 we will invest about £250 million enhancing the treatment processes at 44 works to meet new and existing consent standards and make improvements at more than 300 Unsatisfactory Intermittent Discharges, among other measures.
- Continue to reduce the effect on the environment from extracting water from lochs and rivers.
- Reduce odour issues at 14 waste water treatment works.
- Reduce the number of properties at risk of internal flooding from overloaded sewers.
- Reduce the number of properties that have problems with water pressure.
- Reduce the number of unplanned interruptions to water supplies.
- Delivering these objectives will continue to improve the water environment and water quality in Scotland and provide real value for money for our customers.



Our strategy – Always serving Scotland. Scottish Water delivers safe, clean drinking water and safely disposes of waste water across Scotland 365 days a year. We do this in an affordable and sustainable way while supporting economic growth in Scotland.

- We aim to deliver this service to the very highest standards of customer care ensuring our customers turn on their taps to the best quality drinking water Scotland has ever had and live in a country with cleaner rivers and beaches.
- We will do the right thing for our customers and take the right decisions for Scotland.
- We aim to deliver one of the leading value for money packages in the UK water industry.
- We will continue the transformation of the water industry in Scotland taking into account the new challenges of a changing climate. We will also continue to deliver the investment efficiently while building innovation into the business.

This annual report highlights our success in achieving these ambitions during 2008/09 and our plans to deliver more success in the future.



Always serving Scotland

Delivering the investment to bring clearer, fresher drinking water to millions of our customers' taps, protecting our environment, helping communities across Scotland grow and prosper and ensuring that we put the customer at the heart of everything we do.

Responsible

Always doing the right thing for Scotland. Our investment supports the Scottish economy, benefits customers, visitors and local communities the length and breadth of Scotland and protects public health. We will maintain our financial strength, deliver one of the best value for money packages in the UK water industry for our customers and protect Scottish Water for a sustainable future.

Improving service

Ensuring the customer is at the heart of our business. Since we were formed improving customer service has been a key priority and everything we do links to improving the service we provide to our customers. We are working towards being in the top quartile of water companies in the UK. Putting Scotland on the map for customer care.

People

Ensuring we have the right people, committed, trained and proud to deliver service 24/7 to our customers. Proud to work for Scottish Water and committed to improving the service for all our customers across Scotland. Ensuring we are a Scottish business that people respect.

Greener

At the forefront of a changing climate we will ensure that we tackle climate change, taking action to protect the environment for today's customers and future generations, while ensuring that our service to our customers is not affected.

Safer and Stronger

Putting the health and safety of our people, the thousands of contractors who work for us and our customers at the top of the agenda and built into the fabric of everything we do.

Value for money

<£1 a day

On average each Scottish household pays £324 a year for water and waste water services, the equivalent of less than £1 a day*.

Water and Sewerage companies	Average household bill for 2009/10
South West	£489
Wessex	£412
Welsh	£403
Anglian	£393
United Utilities	£377
Southern	£370
England & Wales average	£342
Yorkshire	£330
Scottish Water	£324
Severn Trent	£304
Northumbrian (North East)	£298
Thames	£295

Price comparison with English and Welsh companies based on OFWAT published average charge.

We are continually investing to ensure our customers have a quality supply of clear, fresh drinking water into the heart of their homes, and to help protect Scotland's natural environment. This is all for less than £1 a day* for the average home wherever our customers live in Scotland.

In 2009/10 charge increases for household customers are pegged at 3.7% – one of the lowest percentage increases in mainland UK. It means the average household water bill in Scotland is £18 lower per annum than the average in England and Wales.

The average water and waste water bill for households across Scotland in 2009/10 of £324 continues to be lower than the average bill in England and Wales of £342.

Scottish Water household customers pay less than customers of seven of the companies in England and Wales. Only three water and sewerage companies in England and Wales have a lower average household charge than Scottish Water.

This comes at a time when we are delivering one of the biggest investment programmes per household ever undertaken in the water industry in Britain. In 2008/09 we invested £687 million – the equivalent of £287 for every household in Scotland. During the four year regulatory period 2006-2010 we are investing the equivalent of more than £1000 for every home in Scotland improving drinking water, the environment and customer service.

We are continuing our drive to becoming a sustainable business in Scotland, serving Scotland, and delivering increasing value for money, and we aim to keep household charges stable through to 2014.



* The average household is between Council Tax Band B and Band C and has a combined bill of less than £1 a day. Individual water supply and waste water collection charges are less than £1 a day for all households (except for the individual water supply charges and waste water collection charges for Band H households).

Customer service

53%

Our Customer Overall Performance Assessment has improved by 53% in the period (2006-2009) from 165 points to 252 points.

We are committed to putting our customers at the heart of Scottish Water.

As part of the Ministerial requirement to improve customer service, we agreed with our regulator, the Water Industry Commission, challenging targets to improve service for our customers. These improvements are presented in the Overall Performance Assessment (OPA) score. In 2008/09 we achieved 252 points, beating our target by 13%.

In a report published in 2008 by the Water Industry Commission, they stated that "Scottish Water's customers are receiving an improved level of service. It is now within the range of that received by customers in England and Wales. We are certain these improvements will continue into the future."

The target for 2008/09 was to achieve a Customer OPA score of 223. Achievement of this target illustrates our focus on delivering real benefits to our customers in terms of better quality drinking water, a reduction in the number of homes experiencing sewer flooding, and more homes with better water pressure.

As well as improving our OPA score, we also place great importance on listening to our customers to find out if we are meeting their needs and how to improve our service.

Customer satisfaction is measured independently twice every year and in 2008/09 we once again saw improvements in the way we do business. Our overall satisfaction figure increased to 80% by the end of the year, this represents an all time high in customers' satisfaction with the outcome of their contact. Our focus on improving the quality of the experience included reviews of existing processes, improved customer communication and the establishment of a customer experience training programme. Increases were also recorded in our perception satisfaction tracker where 93% of a random sample of household customers said they were satisfied or very satisfied with the service they receive.

In relation to our service improvement programme we gained additional points in areas such as low pressure, where 2,900 properties benefited from increases in pressure; flooding, where 180 properties had the risk of flooding removed; and written complaints, where 100% of written complaints received a response within 10 days.

All of the improvements illustrate how our focus on improving customer service is making a real difference to the lives of our customers.

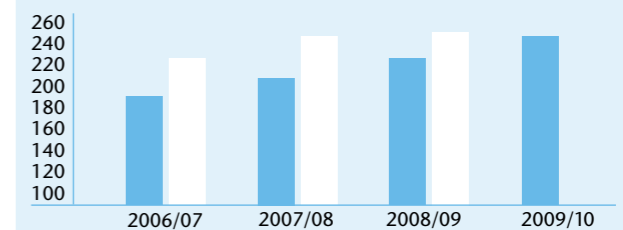
Guaranteed Standards of Service

Compliance from 2002/03 to 2008/09

2008/09	99.6%
2007/08	99.2%
2006/07	99.7%
2005/06	98%
2004/05	96%
2003/04	94%
2002/03	95%

Overall Performance Assessment

■ Commission's targets ■ Reported performance



The key successes in 2008/09 can be attributed to improvements in a wide range of the 12 OPA Indicators:

- We have improved the pressure to 2900 more properties. Less than 0.11% of all properties in Scotland are now affected by low pressure.
- We have reduced leakage by 122 million litres per day beating the target agreed with our regulator.
- We have removed the risk of internal flooding to 180 properties by putting in place permanent solutions.
- 100% of all written complaints are now replied to within 10 days.
- We have made an improvement in answering calls within 30 seconds to 97.41%.
- We continue to experience no hosepipe restrictions, by maintaining water supplies at all times.
- We have scored maximum points for sludge disposal by ensuring that all our sludge is treated according to regulations.
- Water Quality performance has been maintained at the highest quality it has ever been in Scotland with 99.81% compliance with stringent regulatory standards.

While we have seen big improvements across a number of key customer areas we plan to out-perform our targets and continue to improve the services that our customers receive in 2009/10.

Investment overview

In 2008/09 Scottish Water delivered £687 million of Quality and Standards II/IIIa (Q&S) investment to improve treatment works, water mains, sewers and networks across Scotland.

This was the third year in Scottish Water's four year regulatory period to March 2010. In this period hundreds of communities and millions of our customers will see the benefits delivered as a result of our £2.4 billion programme. In the next year 2009/10 we plan to invest more than £620 million to continue the transformation of the services we provide to customers across Scotland. We have already submitted our second draft business plan to our regulator for the next investment programme 2010-2014.

Enabling development and growth

We have continued to service all new development in Scotland, ensuring we continue our close links with developers and local authorities during this difficult time in the housing market to ensure that we play our part in helping communities across Scotland thrive.

We have invested £66 million improving water and waste water capacity, enhancing local water and waste water infrastructure and connecting customers to our waste water system for the first time to help protect the environment. A carefully managed programme of leakage reduction has also helped communities grow.

Service improvements

A total of £38 million has been invested in improving malodour at eight waste water treatment works, reducing the number of homes on the sewer flooding register, decreasing the number of unplanned interruptions to the water supply and reducing the number of people on the low pressure register.

Retail competition

We invested £4 million to support the first year of retail competition in Scotland. Scottish Water's drive in the first year was to ensure we provide a first class service as the wholesale provider and actively support all new entrants. Scottish Water supported the market opening in Scotland, a first in the UK, and look forward to continuing to work with our retail partners to provide an excellent service.

Drinking water quality and standards

A total of £248 million has been invested improving the quality of drinking water to 1.5 million customers across Scotland, managing water resources and planning resources for the future. Water quality remains at an all time high. Scotland has some of the best quality tap water which is rigorously tested to ensure it complies with the strictest standards. Our investment ensures that the quality remains good for all our customers.

In July 2008 Her Majesty Queen Elizabeth II and HRH the Duke of Edinburgh officially opened the new Milngavie Water Treatment Works which is delivering clearer, fresher drinking water to over 700,000 people in Greater Glasgow. Then in August 2008 work started on the new water treatment works for Edinburgh at Glencorse, near Penicuik. The tiny island of Fair Isle and Foula also saw improvements to the quality of their drinking water.

Environmental quality enhancements

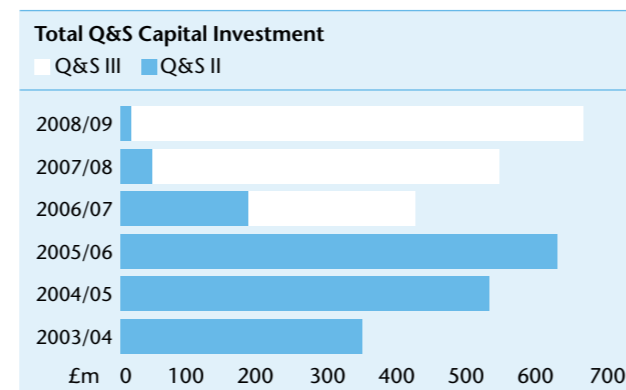
A total of £71 million has been invested in protecting the environment. We continue to improve unsatisfactory intermittent discharges and significant work was completed at waste water treatment works across mainland Scotland and the Islands to help ensure a cleaner, fresher environment.

Capital maintenance

A total of £234 million has been invested to ensure that we are maintaining current levels of service across Scotland.

Q&S II investment

In 2008/09 we invested £25 million on projects from the Q&S II period (2002-2006). We have now delivered more than 99.55% of Q&S II outputs, and the remaining projects still being completed are the result of delays such as land purchase and obtaining planning permission and consent.



Targets specified in Ministerial Objectives	Actual 2008/09	Cumulative 2006-09	Planned Q&S IIIa
Customer service (Cumulative measure)			
Number of works where odour problem is addressed	2	10	14
Water quality (Cumulative measure)			
Improve drinking water quality for 1.5 million people	1.66m	2.50m	3.00m
Improve disinfection control for 4 million people. We plan to improve the quality of drinking water to 4.31 million customers before March 2010.	1.67m	2.54m	4.31m
Number of water resource zones with reduced abstraction. By March 2010 the volume of water being abstracted from 78 water sources will be reduced in agreement with SEPA.	24	45	78
Number of water sources provided with flow monitoring and recording	234	521	521
Number of flood studies undertaken	0	23	30
Number of backflow prevention devices installed	71	235	235
Number of cross-connections made redundant	2,126	4,937	5,500
Number of sites with increased security	307	901	1,016
% of population covered by water safety plans	22%	47.5%	50%
Waste water quality (Cumulative measure)			
Number of unsatisfactory intermittent discharges improved	108	162	304
Number of waste water treatment works' discharges improved to meet new consent requirements	7	18	27
Number of First Time Provision projects to meet environmental objectives in the Directions (cumulative)	4	5	9
Number of waste water treatment works upgraded to meet existing consent requirements	8	14	18
Number of management and monitoring systems at works to meet IPPC Regulations	0	1	1
Number of landfill sites contained, monitored and decommissioned	5	15	17
Relieving development constraints (Cumulative measure)			
Provide strategic capacity at waste water treatment works (PE)	34,495	55,505	42,094
Provide strategic capacity at water treatment works (PE)	84,507	114,364	174,693

£248m

A total of £248 million has been invested to bring clearer, fresher drinking water to 1.5 million customers across Scotland.



£71m

A total of £71 million has been invested to help protect and enhance rivers and beaches across Scotland.



Investment overview

Green electricity

01 From the clouds dusting the Perthshire hills, Scottish Water's investment at the Turret Water Treatment Works peeks through. Improving the country's highest water treatment works provides its own challenges as workers battle through winds of up to 60 mph to deliver this massive investment which will benefit our customers from Crieff to Stirling. Rock and soil taken from the ground will be used on site, reducing the number of lorry journeys needed in the construction of the works. Gravity replaces the need for energy-sapping pumps as Turret feeds Perthshire and Stirlingshire. Our new modern hydro turbine will generate enough 'green' electricity to export energy back to the national grid.

Conversion success

02 In the far south east of Scotland 80,000 customers in the Scottish Borders will receive clearer, fresher drinking water with the completion of three key water treatment projects. A beautiful summer's day helped launch the investment programme, with the region's rugby stars launching the conversion to clearer, fresher drinking water.

Delivering results

03 Across the rolling Borders hills to Dumfries and Galloway, 10 water treatment works are being improved, delivering clearer, fresher drinking water to around 120,000 customers across the south west.

Full service package

04 The multi-million pounds package of improvements at Invercarnie and Mannofield will deliver improved quality drinking water to 200,000 customers in Aberdeenshire and the Granite City itself. In a centre of innovation, even the treasured aquaduct linking the two works will receive a facelift.

Keeping up standards

05 Scottish Water delivered improvements to the remote Fair Isle, battered by the waves and wind of the Atlantic. Investment is delivering clearer, fresher drinking water for the 70 inhabitants of this remote island community and ensuring they get the same standard of service as every other person in Scotland.

Essential support

06 Splicing through the North Atlantic is St Kilda, the remotest part of the UK, an outpost for 30 workers from the National Trust and the Ministry of Defence. Scottish Water Commercial Operations acted swiftly, installing a desalination plant, when the natural spring began to run dry in the summer. Their work will ensure a year round supply of drinking water to this essential group of workers.

Refreshing news

07 In the shadow of Ben Nevis, in Scotland's outdoor capital, 10,000 residents, tourists, hillwalkers and mountain bikers are enjoying clearer, fresher drinking water. Investment in Fort William, the Highland's biggest town, will keep extreme sports fans refreshed.

Cleaning up the River Eden

08 While delivering £10 million investment to upgrade four waste water treatment works at Cupar, Springfield, Bowhouse and Guardbridge in Fife, we worked closely with local groups such as the Eden Anglers Association. Improving the natural environment and ecosystem of the River Eden, one of Scotland's most significant salmon fishing rivers, will mean it can not only be enjoyed by anglers but by all sections of the community for many years to come.

Boost for whisky heartland

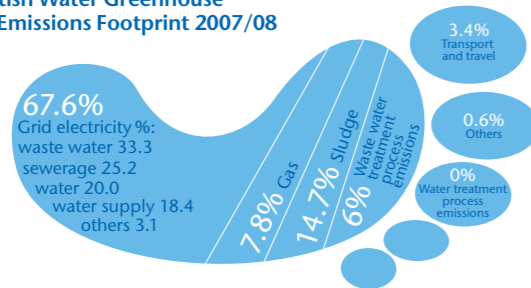
09 Our investment at the Keith waste water treatment works is ensuring that we operate to a high standard to help protect the natural environment of Scotland's whisky heartland. The final product from the works, which handles high strength effluent from distilleries can safely be dispersed into the River Isla, a popular angling water, with minimal impact on the local environment.



The environment

We are working hard to adapt to the changing climate and reduce our carbon emissions. We know it's an issue our customers take seriously, and so do we. By taking action now we can reduce the chances of droughts and floods disrupting the service we provide, and play a key part in Scotland's effort to tackle greenhouse gases.

Scottish Water Greenhouse Gas Emissions Footprint 2007/08



Climate Change

Over the past year we've made significant progress with our dual strategy for adapting to the changing climate and mitigating our carbon emissions. It's an issue which our customers rank highly and which we must tackle in order to protect the service we provide to the nation.

We are fully supportive of the aims of the Climate Change Bill presented to the Scottish Parliament and are confident that we can play a major role in helping Scotland meet its ambitious targets for the reduction of greenhouse gases.

Carbon attainment plan

A major achievement during 2008/09 was the development of Scottish Water's Carbon Attainment Plan, which shows what each area of the business can do and is doing to mitigate its emissions.

Due to our ongoing investment in modern infrastructure our most up to date carbon footprint – the equivalent of 475,000 tonnes of carbon dioxide – has shown a 1.5% increase on the previous year, a rise in line with expectations.

Generating green power

We are confident of slowing and halting the growth of our carbon footprint, in part by generating more of our own green energy. For example, the new water treatment works at Glencorse, under construction, will have a hydro turbine built into the main supply pipe. Meanwhile our new commercial business Horizons has invested in anaerobic digestion facilities to convert methane into green energy and has launched a project in which Scottish Water will work with private sector developers to identify and develop a number of Scottish Water sites where wind energy could be generated.

Adapting to a changing climate

During 2008 we carried out risk assessments at critical assets to better understand their vulnerability to flooding, and these have informed our investment plans for the 2010-2014 investment period. Our 25 year water resource plan that was consulted on during 2008 considered the impact of climate change and we are committed to ensuring that the latest models and predictions are used to inform its future development.

Scottish Water is at the forefront of the climate change issue and is confident of making the right decisions to support a more sustainable Scotland.

Leakage – a continuing focus

Scottish Water has achieved a record real volume leakage reduction during 2008/09, outperforming the target reductions agreed with the Water Industry Commission.

On average, over the year, leakage has been reduced by 122 million litres of water a day in Scotland – a figure as good as or better than the top reductions in leakage ever reported from England and Wales. As a result water treatment works across Scotland are now producing 127 million litres of water a day less than for the same period last year. This means we are using less energy and fewer chemicals, while also helping communities to prosper and grow.

We have a clear and robust picture of leakage across Scotland. The installation of District Meter Areas (DMAs) across most of Scotland (95% of all properties covered by DMAs) has allowed us to target leakage reduction where it will benefit Scotland most, help communities grow, and help us on our road to becoming a more sustainable business.

Our dedicated leakage response teams are able to respond to leaks at three times the level of the same time last year. We are also fixing in excess of 80% of customer reported leaks within three working days.

Scottish Water's main focus is to keep working towards the Economic Level of Leakage (ELL), to be achieved by 2014 as agreed with our regulator. This is the point where it is more costly to repair a leak than the cost saving due to the value of the water leaking from the system. By 2010 we will reach in excess of half way towards the ELL.

This is an historic problem. Scottish Water is putting in place all the resources needed to reduce the amount of water leaking from our pipes. We are always working with our customers to ensure that everyone plays their part in looking after this quality, natural resource.



Innovation

In autumn 2008, as Minister for Transport, Infrastructure and Climate Change, Stewart Stevenson, officially launched the construction of the new Glencorse Water Treatment Works (WTW) the fruits of Scottish Water's innovative thinking were beginning to take shape.

As part of this project in Seafield Mill, Midlothian Scottish Water is teaming up with Scandinavian pipeline company KWH, delivering a world first. A mobile production factory is rolling the new trunk mains almost straight into the ground to bring the clearer, fresher drinking water to Edinburgh, reducing lorry journeys by 75%.

A new onsite hydro turbine will deliver a third of Glencorse's energy needs, while water will be delivered directly to the capital using gravity, rather than energy-sapping pumps.

From the Pentland Hills, to the foot of Ben Chonzie where the Turret Water Treatment Works ageing hydro turbine is being replaced by a modern, more efficient equivalent. This will generate power not only for the treatment works, but will also export energy back to the national grid.

'Green' energy will also be produced through a pioneering new project, generating electricity from wind turbines at the sites of water and waste water treatment works.

Just outside Cumbernauld, food waste will be used to produce a sustainable biogas that will generate electricity and heat. This state-of-the-art Anaerobic Digestion facility will allow the Deerdykes site to be self sufficient, with surplus electricity exported to the grid. Additional heat energy produced can also be exported to the neighbouring industrial estate. Construction of the facility began in May 2008, and planning permission has been achieved for a further two sites with future potential.

Below ground in Dundee information is flowing. In partnership with i3, Scotland's first Fibrecity has recently been announced, using a proportion of Scottish Water's waste water network to extend high-speed telecommunications to thousands of homes and businesses across the city. This pioneering approach provides a secure network, which is quick and easy to install, reducing disruption in the city streets.

Across Scotland from the cities to rural communities our engineers are using the latest scheduling software. This ensures that each job has the right person, at the right place and at the right time, reducing travel time and costs. We will be able to focus more on the service given to each customer, with the pressures of prioritising work dealt with by this innovative software.



Corporate responsibility

Flooding

Flooding is an issue of increasing concern to the public. A changing climate and the highlighted cost to people's lives and properties in flooding events has brought the issue to the forefront.

Scottish Water has a role to play in dealing with flooding, along with other public bodies.

The Flood Risk Management (Scotland) Bill, introduced to Parliament in Autumn 2008, deals with all types of flooding. The complex nature of flooding – with many agencies responsible for different aspects of the sewer and drainage systems in communities – means that a partnership approach is needed to tackle this serious problem.

Scottish Water is actively engaged with local authorities across Scotland to look to the future. We are starting to develop Surface Water Management Plans for urban areas in partnership with a number of agencies including local authorities, the environment agency SEPA, and the Scottish Government. These take a holistic view of how to manage rainfall in the urban environment.

Glasgow has led the way in this innovative approach. The Metropolitan Glasgow Strategic Drainage Partnership (MSGDP) is a National Planning Framework priority encompassing seven local authorities.

At the core of this partnership approach is Scottish Water, SEPA, Glasgow City Council and Scottish Enterprise. The MSGDP has undertaken a considerable amount of work to evaluate Glasgow's complex drainage infrastructure. Computer modelling is revealing how rivers, sewers and watercourses work and interact during normal and storm conditions. This helps us better understand the problems and identify the most effective integrated solutions.

It has already led to informed and innovative decisions which ensure that the MSGDP plays its part in the success of the Clyde Gateway – the redevelopment of the River Clyde artery – and the Commonwealth Games in 2014.

We are seeing more extremes of weather and rainfall. Our customers can be assured that we take the issues of flooding extremely seriously. We look forward to playing our part in the Flood Risk Management (Scotland) Bill.

Waste water treatment

In 2008/09 our waste water treatment works compliance improved. This is part of a continual improving trend as a result of investment in maintenance and better operational procedures. This plays a part in improving the quality of water in our rivers, seas and lochs.

One of the wettest summers on record impacted on bathing waters compliance. The designation of an additional 20 bathing waters also provided a challenge to our assets but continued investment in waste water enhancements and improved operational procedures ensured that our overall compliance improved.

Heavy rain can overload our sewer system but bathing waters can also be affected by farmland run off and general surface water. Our continued investment in waste water treatment works will ensure that the aquatic environment continues to improve.

In 2008/09 we began work at unsatisfactory intermittent discharges in the major catchment area at Meadowhead and Stevenston in Ayrshire and in Glasgow. This investment over the next two years will further improve the natural environment in those areas.

Drinking water quality

The quality of drinking water in Scotland remains consistently high. In 2008, Scottish Water conducted more than 340,000 laboratory analysis on regulatory samples taken at treatment works, service reservoirs and customers' taps.

Of these, 99.81% were compliant with stringent microbiological and chemical regulatory standards. This continues the improving trend that has seen standards rise for more than a decade.

In this regulatory period (2006-2010) we will replace, refurbish or improve 187 water treatment works. Much of the work will improve the look and taste of our customers' drinking water.

Clearer, fresher drinking water – water quality
Overall compliance with microbiological and chemical standards

2008	99.81%
2007	99.81%
2006	99.76%
2005	99.64%
2004	99.57%
2003	99.44%
2002	99.36%

Social responsibility

Scottish Water is committed to take action and improve the quality of life for our customers, their families and local communities across Scotland.

The Orchard Project

01 Four primary schools from the Glasgow area and our staff planted fruit trees at the orchard site next to Garthamlock Water Towers as part of a Commonwealth Orchard project. Scottish Water donated 12 apple trees and compost for the orchard which will bear fruit in time for the Commonwealth Games in 2014. The Orchard is very much part of the community in Garthamlock and we are keen to support The Children's Orchard's efforts to help local children in a way which will leave a positive legacy of the 2014 Commonwealth Games.

Water Aid

02 Scottish Water supports employees across the business who give up their time to different fundraising ventures – particularly our supported charity, WaterAid.

Claire Chapman organises the WaterAid speakers network across Scotland, with a number of delegates addressing local groups on water issues in the developing world. Claire, Scottish Water's Asset Management Technical Leader, visited Uganda, where the charity has already helped nearly a million people to access a sustainable, safe water and effective sanitation supply.

Uganda is one of 17 countries around the world where WaterAid has been working to save the lives of millions of men, women and children.

The environment

03 A new pipeline for the Touch Water Treatment Works (WTW) in Stirling was moved several metres to avoid the sensitive habitat of the rare Yellow Speckled Moth.

As well as delivering clearer, fresher drinking water to the people of Stirlingshire, the project will also help protect this delicate eco-system for a number of other species including newts and beetles.

We carry out studies ahead of projects to identify any significant habitats and this year we have also helped to protect the habitation of seals, otters, bats and swallows.

Recycling

04 Scottish Water is reducing its own energy consumption and carbon footprint through a number of initiatives. We are helping to reduce our energy needs by using energy saving devices such as motion sensitive lighting and encouraging employees to turn off PCs and laptops when not in use. Teleconferencing, car sharing and cycle2work schemes, along with locally sourcing supplies are all helping us to reduce our carbon footprint.

We encourage employees to recycle where possible, with paper, plastic and aluminium recycling points in all office buildings.

We also encourage our customers to use water wisely in and around their home, helping them to not only save water but also save energy, which will help reduce their carbon footprint and their energy bills.

Glencorse

05 Scottish Water works with schools, colleges and universities throughout Scotland. As part of our flagship Glencorse WTW project we are working with four primary schools in the Penicuik area. Local children will receive lessons on site safety, construction, water treatment and the environment.

Youngsters from Mauricewood Primary helped Stewart Stevenson, Minister for Transport, Infrastructure and Climate Change, officially launch construction of the new works which will deliver clearer, fresher drinking water to around 450,000 customers throughout Edinburgh and parts of Midlothian.

In the community

06 Scottish Water is keen to get involved in our customers' lifestyle choices. We run a range of awareness campaigns throughout the year to provide information and tips which will benefit them. This ranges from protecting against burst pipes to bogus callers.

Our annual Warm Pipes campaign encouraged everyone to wrap up their homes as well as their presents for Christmas. It highlighted the importance of preparing your home for winter temperatures and provided simple tips for homeowners to enjoy a freeze-free festive season. During winter 2008 we continued to put information out through local press and provided information packs to MSP's, Councillors, libraries and Housing Associations to help this message get out to all customers across Scotland.

Advising our customers on the dangers of bogus callers is also a priority for Scottish Water. Our campaign focuses on advising people to follow the three C's rule – Chain, Check, Call. This year we teamed up with Lothian and Borders Police to support the inclusion of our bogus caller theme into their Aladdin pantomime at the King's Theatre, Edinburgh which is aimed at helping older people throughout the Lothian and Borders area protect themselves against bogus callers.



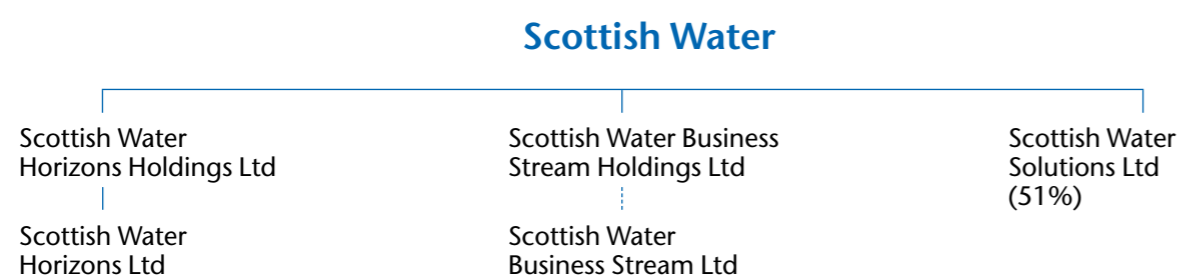
Group Overview

The overarching strategy for the Scottish Water group of businesses is to deliver more for customers through enhancing our service and financial performance and ensuring our financial sustainability in the regulated and non-regulated parts of the Scottish Water group.

The operating environment for the Scottish Water group has changed significantly since March 2008:

- A global economic downturn presents a turbulent operating environment and is already impacting on the growth in our customer base and the number of new connections in Scotland.
- The water retail market opened on 1 April 2008. The core regulated business is now operationally separated from Scottish Water Business Stream Ltd, our retail subsidiary, and we now operate with new licensed providers in the water retail to non-household market.
- On 1 April 2008, we transferred the commercial, non regulated activities into separate legal entities. For this purpose two wholly owned subsidiary companies were set-up – Scottish Water Horizons Holdings Ltd (SWHH) and Scottish Water Horizons Ltd (SWH). SWHH owns 100% of the shares in SWH which is the operating company. Both subsidiaries commenced trading on 1 April 2008 providing waste management, contracting and other business services.
- For the remainder of this regulatory period (2006-2010) and the 2010-2014 review period, our strategy is founded on ensuring that we continue to improve our service to customers while decreasing customer charges in real terms. The detail of our strategy was set out in our second draft business plan which was submitted to the Water Industry Commission in March 2009, to inform the Strategic Review of Charges 2010-14.

The Scottish Water group structure is summarised below:



The three main trading businesses of the Scottish Water group are Scottish Water, that supplies households and wholesale licensed providers with regulated water and waste water services, Scottish Water Business Stream Ltd (Business Stream), our licensed retail subsidiary which supplies water and waste water services to business customers, and Scottish Water Horizons Ltd (Horizons) that provides the bulk of non core services to customers. Business Stream is operated and managed independently of Scottish Water in accordance with the Governance Code, which sets out the terms of separation to enable the operation of the licensed retail market for business customers.

The following table summarises turnover, profit before tax, net assets and net debt, as at 31 March 2009, for the Scottish Water group of businesses.

Group Financial Summary as at 31 March 2009

	Scottish Water £m	Business Stream & SWBSH £m	Horizons £m	Inter company* £m	Total £m
Turnover	1,034.4	355.4	26.8	-322.0	1,094.6
Surplus before tax	195.2	12.7	2.9	-2.0	208.8
Net assets	3,577.6	118.2	5.2	-50.8	3,650.2
Borrowing	2,794.5	58.5			2,853.0
Cash	15.9	49.2	10.1		75.2
Net debt/(cash)	2,778.6	9.3	-10.1		2,777.8

*Intercompany adjustments relate to the elimination of intercompany turnover and profit between Scottish Water and Business Stream.

Consolidated turnover in the year increased by 4.1% to £1,094.6 million (2008: £1,051.7 million) but the surplus for the year to 31 March 2009 was 11.8% lower at £208.8 million (2008: £236.8 million). In the year consolidated net debt increased by £224.8 million to £2,777.8 million (2008: £2,553.0 million). The increase in net debt was driven by a £219.8 million increase in borrowings from the Scottish Government and a £5.0 million reduction in cash balances. Individual business performance is reviewed below.

Taxation

The consolidated tax charge on the income and expenditure account was £63.9 million, (2008: £41.4 million). The effective rate was 30.6%, (2008: 17.5%) in respect of deferred taxation. The effective rate for the year was impacted by the requirement to revisit changes introduced by the Finance Act 2007 in relation to assets classed as industrial buildings. This required a cumulative catch-up in the 2008/09 deferred tax computation.

In 2007/08, as a result of the change in the UK corporation tax rate from 30% to 28% which was effective from 1 April 2008, deferred tax balances were re-measured as at 31 March 2008. Deferred tax expected to reverse in the future was measured using the effective rate of 28%. This, and the abolition of balancing adjustments for industrial buildings allowances, resulted in the lower deferred tax charge and the associated effective tax rate in 2008.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £219.8 million for 2008/09. Actual net new borrowings in 2008/09 were £219.8 million, being £161.3 million for Scottish Water and £58.5 million for SWBSH.

Scottish Water

– Financial Framework

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

The Commission carries out four year price reviews and caps the prices that Scottish Water charge for water and waste water services. The combination of regulated price caps and firm constraints on borrowing from the Scottish Government creates a clearly defined limit on the financing available to Scottish Water.

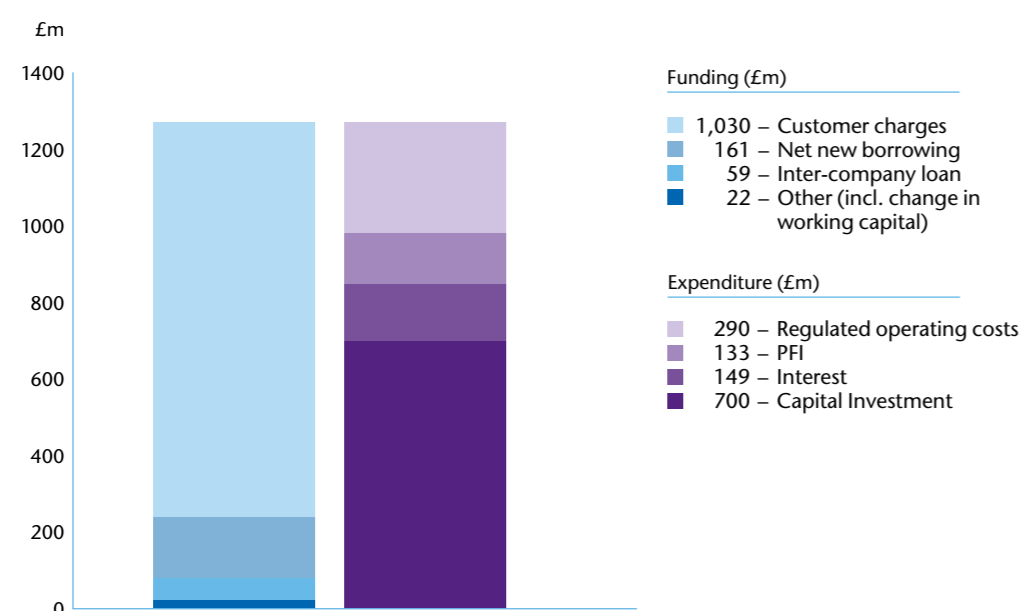
Within this financial framework Scottish Water has an agreed Delivery Plan with Scottish Ministers that sets out Scottish Water's planned level of investment to deliver the required improvements and the expenditure to run its operation. Scottish Water's aim is to out-perform the targets set out in the Delivery Plan, and thereby out-perform the regulatory contract. The current Regulatory Period runs from 1 April 2006 until 31 March 2010.

An integral part of this Regulatory Contract was that annual out-performance would be transferred to a financial reserve. At the end of the regulatory period, once the final assessment of out-performance has occurred, the financial reserve that has built up, together with any necessary adjustments, will be formalised as the financial buffer. However, no transfers to the financial reserve have been made because all available financing will be required to finance delivery of the capital investment programme in 2009/10.

– Financial Performance

The surplus before tax in the year for Scottish Water was £195.2 million, £27.0 million lower than in 2007/08 (2008: £222.2 million). The regulated surplus before tax was £24.8 million lower at £194.4 million (2008: £219.2 million). The surplus for non regulated activities was £2.2 million lower at £0.8 million. This was due to many of the non regulated activities now being carried out by Horizons. The surplus made by Scottish Water on core service provision is required to finance our capital investment programme as is demonstrated in the chart below:

Scottish Water Funding



– Regulated turnover

Regulated turnover for the year totalled £1,029.7 million (2008: £986.7 million) and is analysed by category in the table below:

	2008/09 £m	2007/08 £m	Change £m
Household	704.7	673.7	31.0
Wholesale	319.9	305.5	14.4
Other	5.1	7.5	-2.4
Total regulated turnover	1,029.7	986.7	43.0

Turnover from services supplied to household customers increased by £31.0 million or 4.6% to £704.7 million driven mainly by the tariff increase effective from 1 April 2008. Turnover from wholesale services supplied to Licensed Providers increased by £14.4 million or 4.7% to £319.9 million. Turnover from other sales reduced by £2.4 million to £5.1 million reflecting the transfer of building water services to Business Stream during 2008/09.

– Operating costs

Operating costs of £286.9 million, including FRS 17 pension charges, (2008: £262.7 million) were 9.2% or £24.2 million higher than in 2007/08. The main cost increases were due to higher levels of network maintenance in order to improve customer service and reduce leakage of £12.5 million, higher bad debt charges of £9.1 million, new operating costs associated with new assets coming into operation of £3.0 million and increased local authority rates and SEPA charges of £4.9 million. However, these increases were partially offset by a £7.0 million reduction in FRS 17 pension costs.

The cost of the PFI schemes in the year was £132.6 million, £5.1 million higher than in 2007/08 due primarily to contract indexation which on one scheme was impacted significantly by increases in gas prices.

Depreciation, including infrastructure depreciation, increased by £14.9 million to £266.5 million. The main reason for the increase was a higher Infrastructure Maintenance Charge to reflect the level of underlying and long term forecast infrastructure investment. The gain on sale from asset disposals was £7.8 million lower than in 2007/08 at £1.5 million.

– Finance costs

As at 31 March 2009, the weighted average interest cost of the £2,794.5 million outstanding debt was 5.50% (2008: 5.83%). Net interest payable during the year was £149.5 million, £9.2 million higher than in 2007/08.

Other finance costs, being the expected return on pension scheme assets less interest on pension scheme liabilities, increased by £6.6 million to £1.3 million (2008: an income of £5.3 million).

During the year, net debt increased by £175.3 million to £2,778.6 million (being loans of £2,794.5 million less cash balances of £15.9 million). The increase was driven by a £161.3 million increase in borrowings from the Scottish Government and a £14.0 million reduction in cash balances.

Business Stream

2008/09 was Business Stream's first year operating in a competitive retail market. Despite prudent assumptions for revenue and gross profit, Business Stream have completed the year having retained the majority of its customers.

The first 12 months of competition have delivered increased innovation, improved customer satisfaction and better value for money for customers, with over 25% now paying less than they would have in a non-competitive market.

The results below reflect alignment with Scottish Water group accounting policies. In addition, for comparative purposes, the results for 2007/08 have been aligned to include those of Business Solutions which was acquired by Business Stream from Scottish Water in March 2008.

Profit before tax for Business Stream in the year was £11.3 million, a reduction of £2.5 million from 2007/08.

Like-for-like turnover for the year increased by £3.8 million or 1.1%, to £355.4 million. Costs increased year-on-year by £5.1 million but this was after absorbing £2.4 million of new regulation costs.

Consequently, operating profit reduced by £1.3 million from 2007/08 to £13.5 million as a result of margin compression and a reduction in the overall size of the customer base.

Net interest payable increased by £1.2 million to £2.2 million reflecting the full year impact of the commercial cost of debt and a reduction in interest received on deposits.

Operationally Business Stream delivered the following:

- Aged debt is at an all time low, and reflects the significant focus placed on managing customer payments.
- Staff engagement at 62% is at top quartile levels for a UK service company and reflects the efforts to improve training, development and communication.
- Awareness of the Business Stream brand has gone from zero in November 2007 to 46% by April 2009 reflecting the significant efforts of the marketing team to produce targeted customer campaigns.

Horizons

On 1 April 2008 Horizons commenced operations and the assets and liabilities of the non-core business units of Scottish Water were effectively transferred into the new Horizons' group of companies.

Horizons' working capital requirements and investment plan will be financed by organic cash flow, grant funding and future disposals. Horizons does not receive debt finance from Scottish Water or the Scottish Government.

Horizons contributed £2.9 million to the Group's surplus before tax of £208.8 million from a turnover of £26.8 million.

Group Pension arrangements

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

The administering authority for each scheme is required to conduct a triennial valuation of the assets and liabilities of the scheme in line with LGPS regulations. This must be conducted by a qualified actuary. The purpose of the valuation is to review the financial position of the fund and specify the employer contribution rates for the next 3 year period. The last valuation was carried out as at 31 March 2008.

The actuarial funding position at 31 March 2008 of the Group's share of each pension fund is shown in the table below.

Fund	Value of assets £m	Total Accrued Liabilities £m	Deficit £m	Funding Level (%)
Strathclyde	361.6	365.7	4.1	99%
Aberdeen	197.2	220.3	23.1	90%
Lothian	214.3	256.1	41.8	84%

From 1 April 2009, under Regulation 4(2) (b) of the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulation 2008, employee pension contributions are no longer levied on a flat rate basis (e.g. 5% or 6% of pensionable pay), but are determined according to the level of an employee's full time equivalent pensionable pay. A key feature of the new pension arrangements is that contribution rates are applied in tiers ranging from 5.5% to 12% depending on the employee's rate of pensionable pay on 31 March. Using these tiers average contribution rates will range from 5.5% up to 10.9% for employees. It is anticipated that this new approach to employees' contribution rates will ultimately result in a 2:1 ratio between Scottish Water's contributions and employees' contributions in a fully funded scheme.

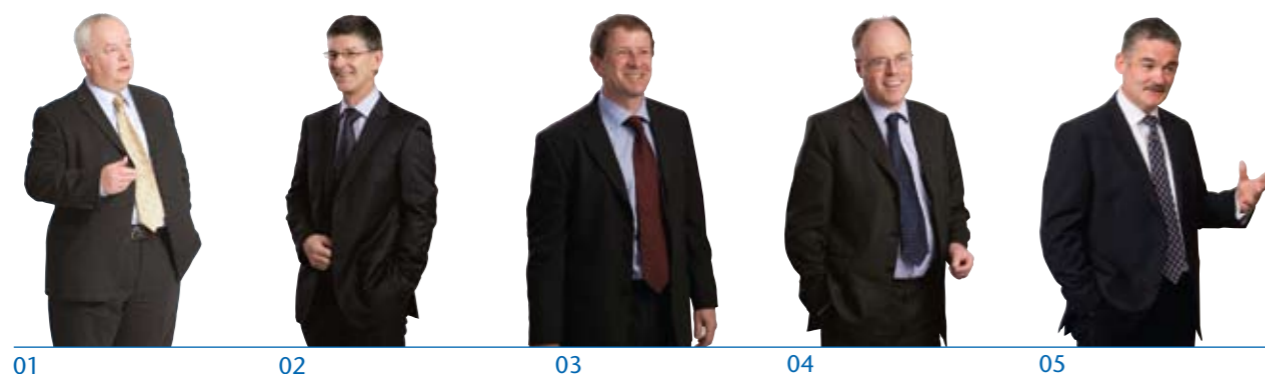
Under FRS 17, Retirement Benefits, a snapshot is taken of pension fund assets and liabilities at a specific point in time. Movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities.

At 31 March 2009, after taking account of deferred taxation, there was a shortfall of assets over respective liabilities of £160.9 million (2008: £34.2 million). This was an increase in the net pension liability of £126.7 million from 31 March 2008 and was due mainly to the actuarial loss of £183.0 million, reflecting the lower than expected return on scheme assets.

International Accounting Standards

All European Union listed companies were required to adopt International Accounting Standards (IAS) for their financial statements from 2005. Following the UK 2008 budget statement adoption of IAS within the public sector and Central Government will now apply to the accounting period ending 31 March 2010.

The main areas of impact will be: the abolition of renewals accounting currently permitted under Financial Reporting Standard 15 Tangible Fixed Assets, which will impact on depreciation charges for infrastructure assets and presentation of, and accounting for, PFI contracts and taxation.



Executive Members

01 Richard Ackroyd Chief Executive

Richard Ackroyd was appointed as Chief Executive in March 2008 and has twenty years experience in the water industry. Prior to joining Scottish Water Richard had been a Director of Yorkshire Water since 1996, latterly as Director of Regulation and Investment. Richard was also Chairman of Water UK from 2006 to 2008.

He is a solicitor by profession and has previously been Head of Legal Services for Yorkshire Water following a period in private practice.

02 Geoff Aitkenhead Asset Management Director

Geoff was formerly General Manager, Customer Services and Networks at East of Scotland Water (ESW) where he led the Asset Management Group.

Previously, he was Strategic Development Manager, Operations at ESW and Capital Planning Manager at Borders Regional Council. He is a Chartered Civil Engineer, a graduate of Newcastle University, and a member of the Chartered Institute of Water and Environmental Management. Geoff is Chairman of WaterAid (Scotland), an organisation dedicated to the provision of clean water and sanitation in the developing world, and Chairman of Scottish Water Solutions.

03 Chris Banks Commercial Director

Chris was formerly Business Development Director with Ennstone plc. Previously, he was Commercial Director at Scottish Coal and Celtic Energy, following his earlier career in minerals, shipping and construction products. He gained an MA in History at Oxford University and an MBA at Cranfield School of Management. Chris is also a Fellow of Chartered Institute of Marketing and a Member of Chartered Institute of Purchasing and Supply and Institute of Quarrying. Chris is a Non-executive Director of Sgoiltean Ura LLP.

04 Douglas Millican Finance and Regulation Director

Douglas was formerly with East of Scotland Water, initially as Financial Controller and latterly as Commercial Director. Prior to this, he worked with Price Waterhouse in Edinburgh and New Zealand and with Tyco International in Australia. He is a Chartered Accountant with a BCom from the University of Edinburgh and is an Associate Member of the Association of Corporate Treasurers.

05 Peter Farrer Customer Service Delivery Director

Peter, prior to his recent appointment as Customer Service Delivery Director, was general manager of Tactical Planning and Performance within Scottish Water's asset management team.

Peter has 25 years experience in the water industry in Scotland since graduating from Heriot Watt University as a civil engineer in 1984. He later gained an MBA at the Edinburgh Business School in 2001, and is a Director of Scottish Water Solutions.

Non-executive Members

06 Ronnie Mercer

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

07 David Gray

David, a chartered accountant, is also a Non-executive Director of Romag Holdings plc and Composite Energy Ltd. Previously he was Managing Director of Caledonian Paper plc, Finance Director of Scottish Hydro-Electric plc, Business Development Director of Scottish and Southern Energy plc, Director of DTZ Holdings plc and a Non-executive Director of F&C Asset Management plc.

08 Pat Kelly

Pat was formerly Scottish Secretary of the Public and Commercial Services Union and President of the STUC. He was educated at Glasgow University and is a chartered civil engineer. Pat has held Non-executive Director positions in Scottish Enterprise, Edinburgh and Lothian, and in NHS 24, and was a member of the Civil Service Appeal Board.



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09 Donald Emslie

Donald Emslie was a Main Board Director at SMG PLC for 7 years and was Acting Chief Executive from June 2006 to March 2007. Donald is a former Chair of ITV Network and GMTV. He is currently Chair of CHMC, Chair of Queuebay Ltd, Chair of the Royal Lyceum Theatre, Chair of Royal Zoological Society of Scotland and a Non Executive Director of Scottish Rugby PLC and sits on the Board of Scottish Arts Council and Scottish Screen.

10 James Spowart

Jim Spowart was the founder and Chief Executive of Direct Line Financial Services, Standard Life Bank and Intelligent Finance. Jim has considerable corporate experience and retired from Intelligent Finance in 2002. He was awarded an honorary doctorate from Edinburgh Napier University for his contribution to banking and also to the economic development of the central belt of Scotland where he created over 5000 banking jobs.

Since he retired he has been involved in various consultancy projects and assisted many companies including providing advice to Banks in Poland.

11 Alan Bryce

Alan is Managing Director of Energy Networks at ScottishPower. He joined the company in 1981 after graduating from the University of Strathclyde as an electrical engineer. He has gained a broad experience of regulated utilities, including electricity and water, and managed the initial public offering of ScottishPower's telecoms subsidiary in 1999. Prior to his current post, he was responsible for ScottishPower's Generation business and for the group's UK strategy. He is a Fellow of the Institution of Engineering and Technology and a director of the Energy Networks Association.

12 Andrew Wyllie

Andrew is Chief Executive of Costain Group PLC, the worldwide construction and engineering group. Prior to taking up this role in 2005, he worked for Taylor Woodrow where he was Managing Director of the construction business and was a member of the Group Executive Committee.

He is a graduate of the University of Strathclyde, has an MBA from London Business School and is a Fellow of the Institution of Civil Engineers. He is also a member of the CBI Construction Council and a Companion of the Chartered Management Institute.

Lynne Peacock (not pictured)

Lynne Peacock has been Chief Executive of Clydesdale and Yorkshire Banks since October 2004. She is also a Member of National Australia Bank's Group Executive Committee. Lynne joined the Group in September 2003 as an Executive Director but spent most of 2004 in Australia where she held the position of Executive General Manager, People & Culture for National Australia Bank Group, based at the company's head office in Melbourne.

She started her career in banking in 1983 with The Woolwich. She was appointed to the Woolwich plc Board in 1996 as Group Operations Director and was appointed Chief Executive in 2000 (when Woolwich became part of the Barclays Group).

Before joining the Woolwich in 1983, Lynne held a number of marketing roles with Tate and Lyle and Unilever.

The Members present their annual report together with the audited financial statements for the year ended 31 March 2009.

Accounting requirements

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

Principal activities

Scottish Water group principal activities during the year were the supply of water and waste water services to around 5 million customers in homes and businesses across Scotland covering an area of 30,410 square miles.

On 1 April 2008, the commercial, non regulated activities were transferred into Scottish Water Horizons Ltd (SWH), a wholly owned subsidiary. SWH is a commercial business enterprise which provides waste management, contracting and other business services.

Scottish Water Business Stream Ltd (Business Stream), our licensed retail subsidiary, supplies water and waste water services to business customers in the competitive retail market within Scotland which opened to competition on 1 April 2008.

A review of the business and future developments for Scottish Water are presented in the Chair's Statement on page 02 and in the Financial and Business Review on pages 20 to 25.

Members

The Chair and other Non-executive Members are appointed by Scottish Ministers. Executive Members are appointed by Scottish Water after receiving consent to their appointment from Scottish Ministers. The Members as at the date of the Annual Report and their biographies are set out on pages 26 to 27.

Members and their interests

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

Results

The surplus for the year after taxation amounted to £144.9 million. Details of the financial results and associated accounting policies are set out on pages 40 to 62.

Research and development

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

Political and charitable contributions

No political or charitable contributions were made during the year. However, Scottish Water supports WaterAid, a charity founded by the UK water industry which raises funds for water related projects overseas. Employees represent Scottish Water on regional fundraising committees, which are periodically provided with facilities and other support.

Employee relations and involvement

The Scottish Water group of businesses employed an average of 3,737 staff during the year. Details of the costs incurred in relation to these staff can be found in note 4 to the financial statements on page 47. Scottish Water is committed to a policy of equal opportunities for all employees irrespective of race, religion, sex, disability or age and uses a number of forums to encourage employee involvement. Employees are kept involved through a process of regular team meetings, employee newsletters and representation on consultative forums.

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

Payment of suppliers

Scottish Water agrees terms and conditions with suppliers before business takes place. Provided that all trading terms and conditions have been complied with, it is Scottish Water's policy and practice to pay agreed invoices in accordance with the terms of payment. At 31 March 2009, the amount owed to trade creditors was equivalent to 28 days of purchases from suppliers.

Auditors

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

Scottish Water is committed to the principles of good governance and the code of best practice with regard to corporate governance.

The Members of Scottish Water are accountable to the Scottish Government through the Scottish Water (Corporate Governance) etc. Directions 2002, the Scottish Water Governance Directions 2008 and the Scottish Water Governance Directions 2009. This statement describes how the Members comply with the requirements of the above Directions and the provisions set out in the revised Combined Code (section 1) of the listing rules of the Financial Services Authority introduced in July 2003 and updated in June 2006.

Compliance

The Members confirm that throughout the year and up to the date of approval of the Annual Report and Accounts Scottish Water complied with:

- The relevant sections of the Combined Code of Corporate Governance as set out in the listing rules of the Financial Services Authority; and
- The Scottish Water (Corporate Governance) etc. Directions 2002, the Scottish Water Governance Directions 2008 and the Scottish Water Governance Directions 2009 (for the periods respectively for which they were in force) and other Directions, requirements and guidance issued by Scottish Ministers in so far as such matters relate to the functions of Scottish Water.

The Members of the Board

For the period under review the Board of Scottish Water comprised 13 members, 8 Non-executive Board Members and 5 Executive Board Members.

The Board has a formal schedule of matters specifically reserved to it for decision making. Reporting to the Board are the Chief Executive and the Executive Members, who have responsibility for the management of Scottish Water, and the Board Committees detailed below.

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

During the year, the Board met on 12 occasions to review Scottish Water's operational and financial performance, business strategy and risk management.

Board committees

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

Name	Board		Audit		Remuneration	
	Held	Attended	Held	Attended	Held	Attended
Ronnie Mercer (Chair)	12	12	–	–	–	–
Richard Ackroyd	12	12	–	–	–	–
Geoff Aitkenhead	12	11 [†]	–	–	–	–
Chris Banks	12	10 [†]	–	–	–	–
Alistair Buchanan	12	11	4	4	–	–
Graeme Crombie	12	12	–	–	5	5
Donald Emslie	12	12	–	–	5	5*
Peter Farrer (from 24 September 2008)	6	6	–	–	–	–
David Gray	12	12	4	4	–	–
Pat Kelly	12	11	–	–	5	4
Ian McMillan	12	11	4	4	–	–
Douglas Millican	12	11	–	–	–	–
Rita Theil	12	8*	–	–	5	4**

*denotes a meeting attended by telephone conference

†non-attendance relates to Special Board Meetings

Remuneration Committee

The Remuneration Committee, chaired by a Non-executive Member, Graeme Crombie, comprised three other Non-executive Members: Donald Emslie, Pat Kelly and Rita Theil. On 31 March 2009, Graeme Crombie and Rita Theil left the Committee at the expiry of their term as Board Members. With effect from 1 April 2009 Alan Bryce joined the Committee on his appointment to the Board, and Donald Emslie was appointed as Chair of the Committee.

The Committee, in accordance with requirements of the Corporate Governance Direction, monitors the contract terms, remuneration and other benefits for each of the Executive Members including performance related incentive schemes. The Committee met on 5 occasions during the year.

The Committee has access to external independent advice as it sees fit.

Audit Committee

The Audit Committee, which is chaired by a Non-executive Member with a financial background, David Gray, comprised two other Non-executive Members: Alistair Buchanan and Ian McMillan. Ian McMillan left the Committee at the expiry of his term as a Board Member on 31 March 2009, and Alistair Buchanan left the Committee on his resignation as a Board Member on 19 April 2009.

With effect from 1 April 2009 James Spowart and Andrew Wyllie joined the Committee on their appointments to the Board.

The Committee reviews the financial reports of Scottish Water and considers the results of the Auditors examination and review of the financial statements. It meets with management and with internal and external auditors to review the effectiveness of internal controls and business risk management. The Chair of the Audit Committee reports to the Board on internal control and risk management matters following each Audit Committee meeting. The Committee adheres to the requirements of the Audit Committee Handbook.

The Committee met on 4 occasions during the year.

Executive Management

The Chief Executive is responsible for the management and operation of Scottish Water within the strategy determined by the Board and is supported by a Business Management Team which he chairs. The Executive Members of it are:

Richard Ackroyd	Chief Executive
Geoff Aitkenhead	Asset Management Director
Chris Banks	Commercial Director
Peter Farrer	Customer Service Delivery Director
Douglas Millican	Finance and Regulation Director

Internal control

Scottish Water operates within a broad strategic framework set by Scottish Ministers. The targets and milestones that Scottish Water has agreed to meet are set out in its Delivery Plan for the 2006-2010 period. The Delivery Plan also sets out the resources required and proposals for meeting and out-performing the regulatory targets.

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

The systems of internal control are compliant with the relevant sections of the Combined Code, the Scottish Water (Corporate Governance) etc. Directions 2002 and the Scottish Water Governance Directions 2008 and 2009 for the periods respectively they were in force. They are based on an ongoing process designed to identify those risks material to the achievement of Scottish Water's policies, aims and objectives, to evaluate those risks and to manage them effectively in accordance with good risk management practices. The risk management process has been in place for the full year under review and up to the date of approval of the Annual Report and financial statements.

Risk management

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

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

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

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

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

Control activities

Scottish Water's Internal Control Framework incorporates:

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

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

Control effectiveness review

Reviewing control effectiveness is a continuous process throughout the year. The Board gains assurance as to the effectiveness of internal control through a collaborative approach, based on the work of internal and external audit, other internal and external review agencies, and Executive Members' reports. In addition the Board reviews annually its assurance need and considers an Annual Report from the Audit Committee. The controls assurance process is co-ordinated by internal audit and incorporates self-assessment by management, independent assessment by audit, and annual statements of assurance from senior management.

Sustainable development

Scottish Water recognises the importance of fulfilling its social responsibilities. To this aim the Board has a Sustainable Development Policy that includes social, economic and environmental aspects and has set up a Sustainable Development Advisory Group who report directly to the Board. This is led by a member of the Board (Geoff Aitkenhead), and is attended by a range of external advisers. The group provides a forum for discussion on sustainable development issues relating to the water industry, and as well as advising the Board, challenges the implementation of the sustainable development policy and strategy.

The Board is committed to providing an active but appropriate level of support to community projects. This is detailed further in the Social Responsibility section on pages 18 to 19.

Information and communication

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

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

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

Board and Committee performance

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

Independence of Auditors

The Auditor General for Scotland is responsible to the Scottish Parliament for securing the audit of the financial statements of Scottish Water. For 2006/07 to 2010/11, the Auditor General appointed PricewaterhouseCoopers LLP as the auditors of Scottish Water.

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

Going concern

Scottish Water operates under an annual external financing limit (EFL) set by the Scottish Government. The annual EFL controls the amount by which Scottish Water can increase its externally sourced finance, including borrowings. In addition, Scottish Water's charging structure is reviewed through a regulatory process and charges are approved annually by the Water Industry Commission for Scotland.

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

Quoted companies are required to include in their Annual Report a Directors' Remuneration Report with specified contents. Even though Scottish Water is not a quoted company, the report follows the format and content required of quoted companies; where that is not possible, it is explicitly noted.

1. Remuneration Committee

a. Remit

The Remuneration Committee meets regularly to consider issues, in particular Executive Members terms and conditions, and makes recommendations to the Board. In respect of levels of Executive Members remuneration and incentive arrangements, its proposals have formed the basis of recommendations to the Scottish Government. No Executive Members are involved in deciding their own remuneration.

b. Membership

For the financial year under review, the Remuneration Committee has consisted of the following Non-executive Members:

Mr Graeme Crombie	(Chair of the Committee to 31 March 2009)
Mr Donald Emslie	(Chair of the Committee from 1 April 2009)
Mr Pat Kelly	
Mrs Rita Theil	(until 31 March 2009)
Mr Alan Bryce	(from 1 April 2009)

During the year external independent advice has been provided by Hay Group Management Consultants. In addition, Hay Group Management Consultants provided Scottish Water with remuneration survey data. Internal advice was provided by the Chair of Scottish Water, the Chief Executive, and the Director of Human Resources & Development and Health and Safety. No Executive Member was present during discussions about their own remuneration.

c. Meetings

There were five meetings of the Committee in 2008/09. At each meeting a quorum of independent, Non-executive Members was present.

2. General Remuneration Policy

Scottish Water must continue to build on the progress made since its inception to be a successful water services company that provides the levels of service and value for money expected by its customers, regulators, the Scottish Government and benchmarked against the performance of the water companies in the United Kingdom.

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

Scottish Water's overall remuneration policy aims are to:

- Attract, develop, motivate and keep highly talented people at all levels of the organisation.
- Pay competitive salaries and benefits to all Scottish Water's people. When pay levels are set, account is taken of the work an employee does, what is paid in other organisations for similar work and how well Scottish Water is performing.
- Incentivise and reward good individual and corporate performance.

3. Policy on Executive Members' Remuneration

a. Comparator Organisations

Scottish Water is publicly owned and accountable to the Scottish Parliament and Scottish Ministers. Within the context of public sector ownership, Scottish Water seeks to attract, retain and motivate leadership talent in competition not just with other utilities and other organisations in the public sector, but with organisations across the economy.

Scottish Water uses the remuneration database of Hay Group Management Ltd to ascertain the remuneration practices of industry in general. This is the largest remuneration database in the UK with each job subjected to the same method of job sizing.

b. Remuneration Elements

Scottish Water's Remuneration Policy for Executive Members consists of five principal elements:

- Base Salary;
- Annual Incentive Scheme;
- Long Term Incentive Plan (LTIP);
- Pension; and
- Allowances (for business needs, car, relocation, etc.).

c. Relative Importance of Performance Related Elements to Base Pay

Scottish Water is a performance-orientated organisation. It believes that Executive Members' remuneration should be closely related to both corporate performance and individual performance.

The aim is to pay a base salary that is as competitive as possible within public sector ownership and provide the opportunity for extra discretionary pay to be earned for out-performance of demanding targets.

The potential maximum annual incentives attainable by the Executive Members are 40% of base salary and are non-pensionable.

d. Performance Conditions for Annual Incentives and Awards Made – 2008/09

Scottish Water has an annual out-performance incentive plan (AOIP) that is designed to incentivise and reward the out-performance of targets agreed with regulators. Scottish Water out-performed the stretch targets on all measures, apart from the profit before tax measure where performance was between target and stretch target. The targets, stretch targets and actual performance in 2008/09 for each measure are set out below.

Measure	Target	Stretch target	Actual performance
– Profit before Tax excluding depreciation in comparison with the targets in the Final Determination	£446.1m	£461.1m	£458.9m
– Out-performing the Final Determination OPA target of 223	223	251	252
– Investment			
– outputs delivered	85%	110%	114%
– Q&S II/IIIa investment	£650m	£670m	£687m
– Leakage reduction (mega-litres per day)	70	100	122

This performance generates the following awards, based on the criteria set at the start of the year:

Measure	% allocated	% awarded
– Profit before Tax excluding depreciation	30%	25.6%
– OPA score	40%	40%
– Investment out-turn	15%	15%
– Leakage	15%	15%

Overall AOIP awards in 2008/09 were 38% of annualised salary.

Non-executive Members are not eligible for incentive payments.

e. Long Term Incentive Plans for 2006-2010

The Long Term Incentive Plan (LTIP) has been agreed with the Scottish Government and provides clear targets for out-performance of the Water Industry Commission's Final Determination. Payments under the scheme will only be made to Executive Members remaining in employment with Scottish Water on 1st January 2011 if there is overall financial out-performance of the Final Determination.

The plan is based on:

- 50% for performance against financial targets, being the extent to which net debt is lower in March 2010 than was assumed in the Final Determination. Maximum bonus would be payable for at least £100m out-performance.
- 50% for out-performance of OPA targets above those set out in the Final Determination. Maximum LTIP will be payable for an OPA score of at least 271, 30 points higher than the Final Determination target of 241.
- The LTIP will be funded by 15% of annual salary being accumulated each year for ultimately vesting if earned after four years by eligible Executive Members. Any LTIP payment will only be funded from financial out-performance after payment of any incentive awards to staff.

4. Service Contracts

Details of Executive Members' contracts are set out below.

Executive Member	Name	Date of Contract	Unexpired Term	Notice Period
Chief Executive	Richard Ackroyd	25 March 2008	All Members have Permanent contracts	All Members are required to give six months' notice of resignation. Scottish Water is required to give Members twelve months' notice of termination.
Asset Management Director	Geoff Aitkenhead	1 April 2002		
Finance & Regulation Director	Douglas Millican	1 April 2002		
Commercial Director	Chris Banks	1 April 2002		
Customer Service Delivery Director	Peter Farrer	13 October 2008		

Non-executive Board Member Appointments

The Non-executive Members do not have service contracts. Non-executive Members are expected to work four days per month for Scottish Water with the exception of the Chair, Ronnie Mercer, who works 2 days per week. No compensation is payable to any Non-executive Member if their appointment is terminated early. The expiry dates of Non-executive appointments are as follows:

Graeme Crombie	term of office expired on 31 March 2009
Ian McMillan	term of office expired on 31 March 2009
Rita Theil	term of office expired on 31 March 2009
Alistair Buchanan	resigned 19 April 2009
Ronnie Mercer	30 September 2011
Donald Emslie	31 March 2012
David Gray	31 March 2012
Alan Bryce	31 March 2013*
Pat Kelly	31 March 2013*
Lynne Peacock	31 March 2013*
James Spowart	31 March 2013*
Andrew Wyllie	31 March 2013*

*Alan Bryce, James Spowart and Andrew Wyllie joined the Board with effect from 1 April 2009 and Pat Kelly was reappointed with effect from 1 April 2009. Lynne Peacock joined the Board on 6 May 2009.

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

5. Members' Remuneration

Details of Members' Remuneration, as defined in the Accounts Direction for 2008/09 by Scottish Ministers, are set out below for the year.

	Salary/ Fees £000	AOIP £000	Benefits £000	Total 2008/09 £000	Total 2007/08 £000
Executive Members					
Richard Ackroyd (i)	263	101	9	373	7
Geoff Aitkenhead	167	64	6	237	243
Chris Banks	155	59	9	223	229
Peter Farrer (ii)	70	44	4	118	–
Douglas Millican	168	65	8	241	261
Non-Executive Members					
Ronnie Mercer (Chair)	90	–	9	99	98
Alistair Buchanan	20	–	–	20	–
Graeme Crombie	20	–	–	20	20
Donald Emslie	20	–	–	20	–
David Gray	20	–	–	20	20
Pat Kelly	20	–	–	20	20
Ian McMillan	20	–	–	20	20
Rita Theil	20	–	–	20	20
Total Members' remuneration	1,053	333	45	1,431	938
Former Members					
Jon Hargreaves (iii)					198
Professor Paul Jowitt (iv)					20
Total	1,053	333	45	1,431	1,156

- (i) The total for 2007/08 is from the date of appointment to the Board on 25 March 2008.
- (ii) Salary was from date of appointment to the Board on 13 October 2008: Mr Farrer's AOIP was in respect of his employment for the full year.
- (iii) To date of resignation from the Board on 30 November 2007.
- (iv) To date of resignation from the Board on 31 March 2008.
- (v) A car or car allowance is provided to all Executive Members and the Chair for business needs. The associated benefit is included in the benefits section of the table above. The benefits section also includes the value of any holiday sale backs.
- (vi) The AOIP criteria are explained in section '3d' of the Members' Remuneration Report.
- (vii) Costs of £96,183 have been charged relating to the permanent relocation by Mr Ackroyd to Scotland to take up his appointment.

6. Pension

The Executive Members, other than Richard Ackroyd, participate in the Lothian Pension Fund – a defined benefit scheme. Details of their benefits under this scheme are set out below. Richard Ackroyd does not participate in this pension scheme but Scottish Water contributed £92,050 (2008: £1,732) to his pension arrangements during the year.

	Increase in accrued benefits during the year net of inflation			Accumulated total accrued benefits at 31 March 2009		Transfer Values (note 5)		
	Years in Scheme	Pension £000	Lump sum £000	Pension (note 4) £000	Lump sum (note 4) £000	At 31 March 2009 £000	At 31 March 2008 £000	Increase in 2008/09 net of Members' own contributions and inflation £000
Geoff Aitkenhead	30.4	2	6	63	190	1,363	1,040	304
Chris Banks	14.7	2	6	28	85	521	388	120
Peter Farrer	24.7	n/a	n/a	40	121	694	n/a	n/a
Douglas Millican	14.1	0	1	30	90	470	375	82

Notes:

- Members of the pension scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.
- The normal retirement age of Executive Members is 65.
- The pension entitlement shown is that which would be paid annually on retirement along with the lump sum, based on service to the end of the year.
- The increase in accrued pension, lump sum and transfer value during the year excludes any increase for inflation.
- The transfer value of accrued pension is calculated in a manner consistent with Actuarial Guidance Note GN11.
- On death, a spouse's pension is payable equal to one half of the Member's pension, and children's pension may also be payable.

This report was approved by the Board on 3 June 2009 and signed on its behalf by Mr Donald Emslie, Chair of the Remuneration Committee.

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

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

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

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

We have audited the financial statements of Scottish Water for the year ended 31 March 2009 under the Water Industry (Scotland) Act 2002. These comprise the Income and Expenditure Account, Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement, and the related notes. These financial statements have been prepared under the accounting policies set out within them. We have also audited the information in the Remuneration Report that is described in that report as having been audited.

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Board Members, Chief Executive and auditor

The Board Members and Chief Executive are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers and for ensuring the regularity of expenditure and income. These responsibilities are set out in the Statement of Members' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers. We report to you whether, in our opinion, the information which comprises the Financial and Business Review included in the Annual Report, is consistent with the financial statements. We also report whether in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

In addition, we report to you if, in our opinion, the body has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the body's compliance with those provisions in the Combined Code specified for our review in the Accounts Requirements, and we report if, in our opinion, it does not. We are not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the body's corporate governance procedures or its risk and control procedures.

We read certain of the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Financial and Business Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. Our audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Board Members and Chief Executive in preparation of the financial statements, and of whether the accounting policies are most appropriate to the body's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinion

Financial statements

In our opinion

- the financial statements give a true and fair view, in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers, of the state of affairs of the body as at 31 March 2009 and of its surplus, total recognised gains and losses and cash flows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers; and
- information which comprises the Financial and Business Review included with the Annual Report is consistent with the financial statements.

Regularity

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

PricewaterhouseCoopers LLP
Edinburgh
3 June 2009

Notes:

- a. The maintenance and integrity of the Scottish Water website is the responsibility of the Members; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- b. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

	Notes	2009 £m	2008 £m
Turnover	2	1,094.6	1,051.7
Cost of sales		(632.7)	(579.5)
Gross surplus		461.9	472.2
Administrative expenses		(101.8)	(100.2)
Surplus on ordinary activities before interest	2, 3	360.1	372.0
Net interest payable	6	(149.9)	(140.5)
Other finance (costs)/income	7	(1.4)	5.3
Surplus on ordinary activities before taxation		208.8	236.8
Taxation	8	(63.9)	(41.4)
Retained surplus for the financial year		144.9	195.4

Statement of total recognised gains and losses

	Notes	2009 £m	2008 £m
Surplus for the financial year		144.9	195.4
Actuarial (loss)/gain recognised in respect of pension funds	21	(134.7)	64.0
Total gains and losses recognised since last Annual Report		10.2	259.4

	Notes	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Fixed assets					
Tangible fixed assets	9	4,253.8	3,820.1	4,249.2	3,819.4
Investments	10	–	–	37.6	34.6
Current assets					
Stocks	11	3.2	3.9	2.9	3.9
Debtors	12	168.6	187.9	97.1	181.0
Cash at bank and in hand	13	75.2	80.2	15.9	29.9
		247.0	272.0	115.9	214.8
Creditors: amounts falling due within one year	14	(299.0)	(313.3)	(279.2)	(295.1)
Net current liabilities		(52.0)	(41.3)	(163.3)	(80.3)
Total assets less current liabilities		4,201.8	3,778.8	4,123.5	3,773.7
Creditors: amounts falling due after more than one year	14	(70.8)	(75.2)	(65.0)	(74.9)
Provisions for liabilities and charges					
Deferred taxation	15	(300.8)	(242.3)	(301.6)	(243.3)
Other provisions	16	(19.1)	(14.8)	(18.7)	(14.8)
Net assets excluding pension liability		3,811.1	3,446.5	3,738.2	3,440.7
Pension liability	21	(160.9)	(34.2)	(160.5)	(34.3)
Net assets		3,650.2	3,412.3	3,577.7	3,406.4
Capital and reserves					
Government loans	17	2,842.9	2,615.2	2,784.4	2,615.2
Income and expenditure account reserve	18	673.9	663.7	659.9	657.8
Other reserves		133.4	133.4	133.4	133.4
		3,650.2	3,412.3	3,577.7	3,406.4

These financial statements were approved by the Board of Members on 3 June 2009 and signed on their behalf by

Richard Ackroyd
Chief Executive

	Notes	2009 £m	2008 £m
Net cash inflow from operating activities	(i)	648.3	639.3
Returns on investments and servicing of finance			
Net cash outflow from returns on investment and servicing of finance	(ii)	(149.3)	(140.4)
		499.0	498.9
Taxation paid		(5.9)	(4.1)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(721.2)	(636.5)
Sale of tangible fixed assets		3.0	9.9
Government grants and other contributions		0.3	2.9
Net cash outflow before management of liquid resources and financing		(224.8)	(128.9)
Financing			
Net cash inflow from financing	(iii)	219.8	196.3
(Decrease)/increase in cash		(5.0)	67.4
Reconciliation of net cash flow movement to movement in net debt			
(Decrease)/increase in cash		(5.0)	67.4
Cash inflow from increase in debt financing		(219.8)	(196.3)
Movement in net debt		(224.8)	(128.9)
Net debt at 1 April		(2,553.0)	(2,424.1)
Net debt at 31 March		(2,777.8)	(2,553.0)

	As at 1 April 2008 £m	Decrease in cash £m	(Increase)/ decrease in debt £m	As at 31 March 2009 £m
Analysis of net debt				
Cash at bank and in hand	80.2	(5.0)	–	75.2
Debt due within one year	(187.0)	–	7.4	(179.6)
Net borrowings due within one year	(106.8)	(5.0)	7.4	(104.4)
Net borrowings due after more than one year	(2,446.2)	–	(227.2)	(2,673.4)
Net debt	(2,553.0)	(5.0)	(219.8)	(2,777.8)

	2009 £m	2008 £m
(i) Reconciliation of operating surplus to net cash inflow from operating activities		
Operating surplus	360.1	372.0
FRS 17 adjustment	(3.4)	3.7
Depreciation charges	266.6	251.8
Amortisation of grants and PFI assets	0.5	0.5
Surplus on disposal of tangible fixed assets	(1.5)	(9.3)
Decrease/(increase) in debtors	18.1	(32.7)
Decrease/(increase) in stocks	0.7	(0.4)
Increase in creditors	8.9	50.3
(Decrease)/increase in provisions	(1.7)	3.4
Net cash inflow from operating activities	648.3	639.3
(ii) Returns on investment and servicing of finance		
Interest received	3.1	4.0
Interest paid	(152.4)	(144.4)
Net cash outflow from returns on investment and servicing of finance	(149.3)	(140.4)
(iii) Financing		
Borrowings due within one year – repayment of loans	(412.3)	(190.0)
– increase in loans	413.6	295.8
Borrowings due after one year – repayment of loans	(81.1)	(68.0)
– increase in loans	299.6	158.5
Net cash inflow from financing	219.8	196.3

1. Accounting policies

The consolidated financial statements have 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. The financial statements comply with all applicable United Kingdom accounting standards and the Companies Acts 1985 and 2006, except as disclosed below in relation to 'Capital grants and customer contributions'. There have been no significant changes to Scottish Water's accounting policies during the year.

The Members consider that the accounting policies set out below are the most appropriate and have been consistently applied.

Basis of consolidation**a. Subsidiary companies**

The consolidated financial information incorporates the results of Scottish Water (the Company) and of its trading subsidiary companies, using the acquisition method of accounting. The consolidated financial information does not include the non trading subsidiary companies as permitted under section 229 of the Companies Act 1985 (note 10).

Intercompany transactions, balances and any unrealised gains on transactions between Scottish Water group companies have been eliminated within the consolidated financial statements.

b. Joint Arrangement Non Entity

The nature of the contractual agreement between Scottish Water and the other shareholders in Scottish Water Solutions Limited is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, Scottish Water Solutions Limited has been accounted for under FRS 9 Associates and Joint Ventures as a JANE, (Joint Arrangement Non Entity). On this basis Scottish Water accounts directly for its own gross assets, liabilities and cash flows in the joint arrangement.

Income recognition

Turnover comprises charges to customers for water and waste water services, excluding value added tax. For measured customers, turnover includes an estimate of the value of water and waste water services supplied to customers between the date of the last meter reading and the year-end. For unmeasured customers billed in advance, income is deferred and released to the income and expenditure account throughout the year.

Tangible fixed assets and depreciation

Freehold land and assets under construction are not depreciated.

The infrastructure network which comprises a network of water and waste water systems including mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are considered to have an infinite life. Expenditure to maintain the network infrastructure is dealt with under a renewals accounting approach whereby the annualised planned expenditure to maintain the operating capacity of this infrastructure is treated and charged as depreciation to the income and expenditure account. The actual expenditure incurred on infrastructure assets is capitalised, as is any expenditure that increases the capacity of the network.

Depreciation is provided on other tangible fixed assets to write-off cost, less residual values, on a straight-line basis over their estimated operational lives, from the date of beneficial use as follows:

Non operational buildings and structures	60 years
Specialised operational buildings and structures	20 to 80 years
Plant, machinery, vehicles and fencing	1 to 20 years
Fixtures and fittings, furniture and temporary buildings	5 years

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be justified. The resulting impairment charge is included within depreciation.

Capital grants and customer contributions

Capital grants and customer contributions in respect of infrastructure assets are deducted from the cost of the fixed asset. This treatment is not in accordance with the Companies Act 1985 but has been adopted to show a true and fair view since, as explained above, infrastructure assets have an infinite economic life and hence no basis exists on which to recognise such contributions as deferred income. Grants and contributions received in respect of non-infrastructure assets are credited to deferred income and are released to the income and expenditure account over the expected useful lives of the relevant fixed assets.

Investments

Investments held as fixed assets are stated at cost less any provision for impairment.

Stocks

Stocks and work in progress are stated at the lower of cost or net realisable value. Cost includes all costs incurred in bringing each asset to its present location and condition. The valuation of work in progress is based on the cost of labour and materials plus appropriate overheads.

Leased assets

Leases where substantially all the risks and rewards of ownership of the assets remain with the lessor are accounted for as operating leases. Rentals payable under operating leases are charged to the income and expenditure account over the term of the lease on a straight-line basis. Scottish Water has no amounts due under finance leases.

1. Accounting policies (continued)**Research and development costs**

Research and development expenditure is charged to the income and expenditure account in the year in which it is incurred.

Private Finance Initiative (PFI) costs

All costs incurred in relation to the development of PFI schemes are charged to the income and expenditure account as incurred. However, costs relating to other tangible fixed assets belonging to Scottish Water and transferred to the PFI operator are treated as a debtor and amortised over the length of the service contract. PFI land transferred to the operator is not amortised. Rental costs arising under PFI operating leases are expensed to the income and expenditure account over the terms of the lease.

Indebtedness to the Scottish Ministers and other long term loans

Loans from the National Loans Fund, the Scottish Consolidated Fund and other Government borrowings are treated as part of capital and reserves, including loan repayments due within one year, in accordance with the Corporate Governance Direction.

Overdrafts and other loans are included under creditors, as appropriate, in accordance with the Companies Act.

Financial instruments

Scottish Water's financial instruments comprise borrowing, cash and liquid resources, and various items such as debtors and creditors that arise directly from operations.

Financial instruments are recognised in the balance sheet when an obligation is identified and released as that obligation is fulfilled. Cash, debtors and creditors are held at cost. Borrowings are held at cost in the balance sheet, but disclosed at fair value in note 17. Fair values were estimated by independent appraisal using a valuation technique based on prevailing market interest rates at the end of the financial year. Interest on loans and cash is recognised and reported in the period in which the payment is made or received.

Scottish Water's policy is not to trade or speculate in financial instruments. All treasury activities are undertaken in accordance with the permitted activities as set out in the Corporate Governance Direction made under the Water Industry (Scotland) Act 2002.

Taxation

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

Deferred tax is recognised in respect of all timing differences which have originated but not reversed at the balance sheet date, subject to certain exceptions. Deferred tax assets are recognised to the extent that they are recoverable.

Full provision has been made without discounting.

Pensions

Employees of Scottish Water participate in the Local Government Pension Scheme administered by Aberdeen, Glasgow and Edinburgh City Councils, all of which are defined benefit schemes.

Pension scheme assets are measured using the bid values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Any increase in the present value of liabilities within the defined benefit pension schemes expected to rise from employee service in the period is charged to operating profit. The expected return on the schemes' assets and the increase during the period in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses. Pension scheme deficits and surpluses, to the extent that the surplus is considered recoverable, are recognised in full and presented on the face of the balance sheet net of related deferred tax.

Bad debts

The bad debt provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile of the outstanding debt.

Provisions

Provisions are recognised when there is a present obligation for a past event, for which it is probable that a transfer of economic benefits will be required and a reliable estimate can be made of the amount of the obligation.

Related party transactions

Scottish Water has taken advantage of the exemption provided by FRS 8, which permits the non-disclosure of transactions and balances with related parties that have been eliminated on consolidation.

2. Segmental analysis

All turnover and surplus before taxation arises from continuing operations within the United Kingdom.

Scottish Water group principal activities 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. An analysis of turnover, operating surplus and net assets by activity is provided below:

	Turnover		Operating surplus		Net operating assets	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Regulated water and waste water services	1,029.7	986.7	345.2	354.2	4,022.3	3,595.7
Business Stream	355.4	351.5	13.5	14.9	29.3	31.5
Non regulated trading activities	31.5	27.9	3.4	2.9	(2.7)	2.0
	1,416.6	1,366.1	362.1	372.0		
Less Intercompany elimination	(322.0)	(314.4)	(2.0)	-		
	1,094.6	1,051.7	360.1	372.0	4,048.9	3,629.2
Reconciliation of net operating assets to net assets						
Net operating assets					4,048.9	3,629.2
Corporation tax					(2.1)	(2.6)
Deferred tax					(300.8)	(242.3)
Non Government loans					(10.1)	(18.0)
Cash					75.2	80.2
Pension liability					(160.9)	(34.2)
Net assets					3,650.2	3,412.3

The segmental analysis has been amended to reflect internal management reporting. This change has been made in preparation for the transition to International Financial Reporting Standards and reflect the requirements of IFRS 8 'Operating Segments'. The comparative figures for Business Stream (previously titled 'Licensed water and waste water services') and the Non regulated trading activities have been adjusted to reflect the transfer of the 'Business Solutions' division to Business Stream.

3. Operating surplus

	2009 £m	2008 £m
Operating surplus is arrived at after charging/(crediting):		
PFI operating costs	132.6	127.5
Infrastructure maintenance charge	104.2	90.0
Depreciation of tangible fixed assets	162.4	161.8
Amortisation of assets transferred to PFI service companies	1.6	1.6
Gain on sale of tangible fixed assets	(1.5)	(9.3)
Release of deferred income in relation to capital grants	(1.1)	(1.1)
Operating lease rentals – land and buildings	1.8	1.7
– other	1.9	2.0
Auditors remuneration – audit services	0.2	0.2
– other	-	-
Research and development expenditure	0.3	0.3

4. Staff costs

	2009 £m	2008 £m
Wages and salaries	113.5	105.8
Social security costs	9.3	8.8
FRS17 pension costs	12.5	17.9
Other pension costs	0.1	-
	135.4	132.5
Less: charged as capital expenditure	(36.8)	(31.2)
Less: seconded staff charged to Scottish Water Solutions Limited	(4.2)	(6.9)
	94.4	94.4

The average number of people (including Executive and Non-executive Members) employed by Scottish Water during the year was 3,737 (2008: 3,683):

	2009	2008
Regulated water and waste water services	3,278	3,158
Non regulated trading activities	213	236
Scottish Water Solutions Limited secondees	92	163
	3,583	3,557
Business Stream	154	126
	3,737	3,683

The number of people employed at 31 March 2009 was 3,738 FTE (2008: 3,727).

5. Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 32 to 36. No Member or Director had, during the year or at the end of the year, any material interest in any contract of significance in relation to Scottish Water's business.

6. Net interest payable

	2009 £m	2008 £m
Interest receivable		
Interest from short-term deposits	3.1	4.0
Interest payable		
Government loans	(151.6)	(142.6)
Other loans	(1.4)	(1.9)
	(153.0)	(144.5)
Net interest payable	(149.9)	(140.5)

7. Other finance (costs)/income

	2009 £m	2008 £m
Expected return on pension scheme assets	53.3	55.4
Interest on pension scheme liabilities	(54.7)	(50.1)
Other finance (costs)/income	(1.4)	5.3

8. Taxation

	2009 £m	2008 £m
Analysis of tax charge in the year		
Current tax: UK corporation tax on surplus for the current year	4.7	4.9
UK corporation tax adjustment in respect of prior years	0.7	–
Deferred tax: Origination and reversal of timing differences	58.5	36.5
Tax on surplus on ordinary activities	63.9	41.4

Factors affecting current tax charge

The total current tax charge for the year is lower than the standard rate of corporation tax in the UK of 28% (2008: 30%). The differences are explained below.

Surplus on ordinary activities before taxation	208.8	236.8
Tax on surplus on ordinary activities at standard UK corporation tax rate of 28% (2008: 30%)	58.4	71.0
FRS 17 pension and financing adjustments excluded for tax purposes	(0.5)	(0.5)
Decrease in general provisions not deductible for tax purposes	(1.0)	(1.4)
Other timing differences	1.2	0.3
Capital allowance in excess of depreciation	(39.3)	(40.2)
Chargeable gains	0.8	0.6
Tax losses	(14.2)	(24.9)
Current tax charge for the year	5.4	4.9

9. Tangible fixed assets

	Specialised operational properties & structures £m	Non- specialised operational properties £m	Infrastructure assets £m	Plant, machinery & vehicles £m	Assets under construction £m	Total £m
Group						
Cost						
At 1 April 2008	1,956.0	61.5	2,098.6	1,036.2	871.0	6,023.3
Additions	–	–	–	0.5	701.3	701.8
Disposals	(5.3)	–	–	(1.9)	–	(7.2)
Transfers	110.5	2.8	166.2	200.8	(480.3)	–
At 31 March 2009	2,061.2	64.3	2,264.8	1,235.6	1,092.0	6,717.9
Depreciation						
At 1 April 2008	596.7	23.6	1,051.8	531.1	–	2,203.2
Charge for the year	51.6	0.8	104.2	110.0	–	266.6
Disposals	(3.8)	–	–	(1.9)	–	(5.7)
At 31 March 2009	644.5	24.4	1,156.0	639.2	–	2,464.1
Net book value						
At 31 March 2009	1,416.7	39.9	1,108.8	596.4	1,092.0	4,253.8
At 31 March 2008	1,359.3	37.9	1,046.8	505.1	871.0	3,820.1

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

Capital grants received during the year and credited to deferred income were nil (2008: £2.9m). No capital grants were received during the year in respect of infrastructure assets.

9. Tangible fixed assets (continued)

	Specialised operational properties & structures £m	Non- specialised operational properties £m	Infrastructure assets £m	Plant, machinery & vehicles £m	Assets under construction £m	Total £m
Company						
Cost						
At 1 April 2008	1,956.0	61.5	2,098.6	1,029.4	871.0	6,016.5
Additions	–	–	–	–	700.5	700.5
Intercompany transfer	(1.2)	–	–	–	(2.2)	(3.4)
Disposals	(5.3)	–	–	(1.9)	–	(7.2)
Transfers	108.0	2.8	166.2	200.8	(477.8)	–
At 31 March 2009	2,057.5	64.3	2,264.8	1,228.3	1,091.5	6,706.4
Depreciation						
At 1 April 2008	596.7	23.6	1,051.8	525.0	–	2,197.1
Charge for the year	51.5	0.8	104.2	109.3	–	265.8
Disposals	(3.8)	–	–	(1.9)	–	(5.7)
At 31 March 2009	644.4	24.4	1,156.0	632.4	–	2,457.2
Net book value						
At 31 March 2009	1,413.1	39.9	1,108.8	595.9	1,091.5	4,249.2
At 31 March 2008	1,359.3	37.9	1,046.8	504.4	871.0	3,819.4

10. Investments

	Company	
	2009 £m	2008 £m
At 1 April 2008	34.6	–
Additions	3.0	44.2
Disposals	–	(9.6)
At 31 March 2009	37.6	34.6

Group**Investment in Joint Arrangement Non Entity (JANE)**

On 26 June 2002 Scottish Water formed a company, Scottish Water Solutions Limited. This company, which commenced trading on 30 June 2003 and is jointly owned with Stirling Water Limited and UUGM Limited, is delivering a majority of Scottish Water's capital investment programme over the current regulatory period. The nature of the contractual agreement between Scottish Water and the other shareholders in Scottish Water Solutions Limited is such that the parties are engaged in joint activities that do not constitute an entity carrying on a trade or business in its own right. Consequently, Scottish Water Solutions Limited has been accounted for, under FRS 9 'Associates and Joint Ventures', as a JANE.

Details of the investments are as follows:

	Country of incorporation	% of Equity & votes held	Investment Value £	Principal activity
Scottish Water Solutions Limited	Scotland	51.0	510	Contracting services

Company**Investment in subsidiaries**

On 1 April 2008 Scottish Water transferred the commercial, non regulated activities into separate legal entities. For this purpose, two wholly owned subsidiary companies were set up – Scottish Water Horizons Holdings Limited (SWHH) and Scottish Water Horizons Limited (SWH). SWH is the operating company, while SWHH is the intermediate holding company, owning 100% of the shares in SWH.

Principal subsidiary undertakings	Country of incorporation	% of Equity & votes held	Investment Value £m	Principal activity
Scottish Water Business Stream Holdings Limited	Scotland	100.0	34.6	Holding company
Scottish Water Horizons Holdings Limited	Scotland	100.0	3.0	Holding company
Scottish Water Business Stream Limited*	Scotland	100.0	11.5	Licensed water and waste water services
Scottish Water Horizons Limited**	Scotland	100.0	–	Commercial non regulated water and waste water services

Notes:

*owned by Scottish Water Business Stream Holdings Limited

**owned by Scottish Water Horizons Holdings Limited

Scottish Water owns shares in a further ten companies, which did not trade during the year ended 31 March 2009. The companies' financial statements have not been consolidated as permitted by Section 229 of the Companies Act 1985, as they did not trade during the year and the issued share capital is immaterial.

11. Stocks

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Raw materials and consumables	2.3	3.0	2.3	3.0
Work in progress – recoverable work	0.9	0.9	0.6	0.9
	3.2	3.9	2.9	3.9

12. Debtors

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts falling due within one year:				
Trade debtors	62.0	64.3	29.5	36.6
Other debtors	22.2	34.3	22.6	34.8
Prepayments and accrued income	53.3	57.0	13.2	18.5
Corporation tax	0.5	–	0.5	–
Amounts due from subsidiary companies			0.7	0.3
Loans to Scottish Water Business Stream Holdings Limited			–	58.5
	138.0	155.6	66.5	148.7
Amounts falling due after more than one year:				
PFI assets transferred to service contractors	30.6	32.3	30.6	32.3
	168.6	187.9	97.1	181.0

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

13. Cash

The total cash balance at 31 March 2009 was £75.2m, of which £15.9m related to the Company.

14. Creditors

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts falling due within one year:				
Non-government loans	2.9	8.0	2.9	8.0
Trade creditors	25.7	20.7	23.9	20.6
Capital creditors and accruals	27.7	39.0	27.7	38.9
Accruals	154.7	157.8	126.1	131.8
Payments received in advance	33.7	28.4	31.2	28.0
Other creditors	19.1	19.1	10.0	11.2
Deferred income	5.3	2.3	1.8	2.3
Corporation tax	2.6	2.6	–	–
Other taxes and social security	2.8	2.8	2.7	2.7
Amounts due to subsidiary companies	–	–	28.4	19.0
Amounts due to Scottish Water Solutions Limited	24.5	32.6	24.5	32.6
	299.0	313.3	279.2	295.1
Amounts falling due after more than one year:				
Non-government loans	7.2	10.0	7.2	10.0
Other creditors	39.0	39.1	38.5	38.8
Deferred income	24.6	26.1	19.3	26.1
	70.8	75.2	65.0	74.9

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

15. Deferred taxation

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Deferred taxation comprises:				
Accelerated capital allowances on fixed assets	338.3	284.2	338.6	285.2
Other timing differences	(20.6)	(17.4)	(20.1)	(17.4)
Tax losses carried forward	(16.9)	(24.5)	(16.9)	(24.5)
Provision for deferred taxation	300.8	242.3	301.6	243.3
The movement in deferred taxation can be analysed as follows:				
At 1 April	242.3	205.8	243.3	205.8
Deferred tax charged to the income and expenditure account	58.5	36.5	58.3	37.5
At 31 March	300.8	242.3	301.6	243.3
Being:				
Deferred tax asset	(0.2)	(1.0)	–	–
Deferred tax liability	301.0	243.3	301.6	243.3
At 31 March	300.8	242.3	301.6	243.3

16. Provisions for liabilities and charges

	Restructure provision £m	Income uncertainty provision £m	Other £m	Net total £m
Group				
At 1 April 2008	5.4	8.9	0.5	14.8
Charged to income and expenditure account	3.9	1.7	–	5.6
Utilised during the year	(0.7)	(0.4)	(0.2)	(1.3)
At 31 March 2009	8.6	10.2	0.3	19.1
Company				
At 1 April 2008	5.4	8.9	0.5	14.8
Charged to income and expenditure account	3.5	1.7	–	5.2
Utilised during the year	(0.7)	(0.4)	(0.2)	(1.3)
At 31 March 2009	8.2	10.2	0.3	18.7

The restructuring provision relates to redundancy costs associated with employees who will leave Scottish Water under voluntary redundancy and early retirement. Pension related liabilities associated with employees who have left Scottish Water under the voluntary severance scheme are recognised in the pension liability (note 21).

The income uncertainty provision relates to wholesale non domestic revenues.

The other provision of £0.3m relates to onerous property rental costs which will be utilised over the next three years.

17. Government and other loans

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Government loans	2,842.9	2,615.2	2,784.4	2,615.2
Other loans	10.1	18.0	10.1	18.0
	2,853.0	2,633.2	2,794.5	2,633.2

Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002. The limit at 31 March 2009 on these powers was that total net new borrowings for the year ended 31 March 2009 should not exceed £219.8m. Net new borrowings were £219.8m in the year.

Government loans, both short and long-term, are recorded on the balance sheet under Capital and Reserves in accordance with the Corporate Governance Direction. Other debt is recorded under short and long-term creditors following best practice.

a. Analysis of borrowings by type and maturity

	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Over 10 years £m	Total £m
Scottish Consolidated Fund – SW Company	87.6	22.4	133.0	188.5	1,336.8	1,768.3
Scottish Consolidated Fund – subsidiaries	58.5	–	–	–	–	58.5
Scottish Consolidated Fund – SW Group	146.1	22.4	133.0	188.5	1,336.8	1,826.8
National Loans Fund	18.0	5.0	62.0	104.0	590.9	779.9
Public Works Loan Board	12.6	39.0	38.8	111.5	34.3	236.2
Total Government Loans	176.7	66.4	233.8	404.0	1,962.0	2,842.9
Other loans	2.9	1.5	4.2	0.5	1.0	10.1
At 31 March 2009	179.6	67.9	238.0	404.5	1,963.0	2,853.0
At 31 March 2008	187.0	66.4	220.6	336.9	1,822.3	2,633.2

b. Interest rate profile

The interest rate profile of all borrowings, which were obtained with fixed interest rates, was as follows:

	Total borrowings £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
At 31 March 2009	2,853.0	5.50	18.20
At 31 March 2008	2,633.2	5.83	17.20

c. Fair values

The table below sets out a comparison of the book and fair values of the loan debt.

	Book value £m	Fair value £m
At 31 March 2009	2,853.0	3,233.0
At 31 March 2008	2,633.2	2,856.6

18. Reserves

	Income & expenditure account reserve excluding pension reserve £m	Pension reserve £m	Income & expenditure account reserve including pension reserve £m
Group			
At 1 April 2008	639.6	24.1	663.7
Retained surplus for the year	144.9	–	144.9
Actuarial profit net of deferred taxation (note 21)	–	(134.7)	(134.7)
At 31 March 2009	784.5	(110.6)	673.9

	Income & expenditure account reserve excluding pension reserve £m	Pension reserve £m	Income & expenditure account reserve including pension reserve £m
Company			
At 1 April 2008	633.8	24.0	657.8
Retained surplus for the year	136.2	–	136.2
Actuarial profit net of deferred taxation	–	(134.1)	(134.1)
At 31 March 2009	770.0	(110.1)	659.9

19. Results of the holding company

Of the results for the financial year, a retained surplus of £136.2m (2008: £184.2m) is dealt with in the consolidated accounts of Scottish Water. The Members have taken advantage of the exemption available under section 230 of the Companies Act 1985 and do not present an income and expenditure account for Scottish Water alone.

20. Obligations under leases

Scottish Water had no amounts due under finance leases.

At 31 March 2009 the Group and the Company had annual commitments under non-cancellable operating leases as set out below:

	Land and buildings £m	Other £m	PFI schemes £m	Total 2009 £m	Total 2008 £m
Within one year	–	0.5	–	0.5	0.7
Between two and five years	0.4	0.9	–	1.3	0.6
After five years	1.3	–	133.3	134.6	131.9
	1.7	1.4	133.3	136.4	133.2

PFI schemes

As at 31 March 2009 there were nine PFI contracts in operation with contract start dates ranging from December 1996 to October 2000 and contract end dates ranging from December 2021 to October 2040.

21. Pensions

Employees of Scottish Water participate in the Aberdeen City Council Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund, which are part of the Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively. The schemes provide defined benefits based on final pensionable pay. Actual pension costs for the year for each fund, as a % of employee contributions, were 300% (2008: 285%), 370% (2008: 355%) and 325% (2008: 295%) respectively.

Total FRS 17 pension costs for Scottish Water were £12.5m (2008: £17.9m) (note 4). The unpaid contributions outstanding at the year end included in other creditors (note 14) was £1.8m (2008: £1.6m). It is estimated that Scottish Water will make contributions of £18.5m to the pension funds in financial year 2009/10.

A full actuarial valuation was carried out at 31 March 2008 for all three funds and updated at 31 March 2009 by a qualified independent actuary, to take account of the requirements of FRS 17.

The major assumptions used by the actuaries were:

	2009 %	2008 %	2007 %
Rate of increase in pensionable salaries	4.6	5.1	4.7
Rate of increase in pensions payment	3.1	3.6	3.2
Discount rate	6.5	6.9	5.4
Inflation rate	3.1	3.6	3.2

Longevity assumptions on retiring at age 65 adopted for each fund

	Aberdeen Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2009			
Male staff	22.02	20.72	20.05
Male operatives	22.02	18.03	17.30
Female staff	23.97	23.76	23.02
Female operatives	23.97	21.95	21.15
Retiring at 31 March 2029			
Male staff	23.10	22.04	21.31
Male operatives	23.10	19.22	18.51
Female staff	24.95	25.01	24.22
Female operatives	24.95	23.10	22.32

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

Assumption	Change in assumption	Approximate impact on FRS 17 liability as at 31 March 2009 %	Approximate impact on FRS 17 deficit as at 31 March 2009 £m
Rate of increase in pensionable salaries	+/- 0.5% per annum	Increase/decrease by c. 3.5%-4.5%	Increase/decrease by c. £29m to £38m
Discount rate	+/- 0.5% per annum	Decrease/increase by c. 9%-10%	Decrease/increase by c. £75m to £84m
Inflation rate	+/- 0.5% per annum	Increase/decrease by c. 9%-10%	Increase/decrease by c. £75m to £84m
Longevity	+ life expectancy by 1 year	Increase by c. 3.5%-4.5%	Increase by c. £29m to £38m

21. Pensions (continued)

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

	Group				Company			
	Long term rate of return %	Value 2009 £m	Long term rate of return %	Value 2008 £m	Long term rate of return %	Value 2009 £m	Long term rate of return %	Value 2008 £m
Equities	7.0	461.2	7.7	557.0	7.0	458.3	7.7	554.9
Bonds	4.4	77.3	5.7	84.4	4.4	76.7	5.7	84.0
Property	4.9	51.1	5.7	76.7	4.9	50.8	5.7	76.4
Other	0.5	25.9	4.8	31.3	0.5	25.7	4.8	31.3
Total fair value of assets		615.5		749.4		611.5		746.6
Present value of scheme liabilities		(838.9)		(796.9)		(834.4)		(794.2)
Gross pension liability		(223.4)		(47.5)		(222.9)		(47.6)
Related deferred tax asset		62.5		13.3		62.4		13.3
Net pension liability		(160.9)		(34.2)		(160.5)		(34.3)

Scheme assets are stated at their bid values in line with revised FRS 17 disclosure requirements.

21. Pensions (continued)

Reconciliation of opening and closing retirement benefit liabilities and assets

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Movements in liabilities during the year:				
Opening value of total liabilities	(796.9)	(927.7)	(794.2)	(927.7)
Current service cost	(12.5)	(17.9)	(12.2)	(17.6)
Interest on pension scheme liabilities	(54.7)	(50.1)	(54.4)	(49.9)
Contributions by members	(5.7)	(5.3)	(5.5)	(5.2)
Actuarial gain	1.0	179.8	1.1	178.9
Impact of settlements and curtailments	(0.9)	(0.8)	–	2.2
Benefits paid	30.8	25.1	30.8	25.1
Closing value of total liabilities	(838.9)	(796.9)	(834.4)	(794.2)
Movement in assets during the year:				
Opening fair value of total assets	749.4	777.9	746.6	777.9
Adjustment for restatement of asset value to bid value at 31 March 2007	–	(2.6)	–	(2.6)
Expected return on pension scheme assets	53.3	55.4	53.0	55.2
Contributions by members	5.7	5.3	5.5	5.2
Contributions by the employer	21.9	19.3	21.4	19.0
Actuarial loss	(184.0)	(80.7)	(183.5)	(80.4)
Impact of settlements and curtailments	–	–	(0.7)	(2.5)
Benefits paid	(30.8)	(25.2)	(30.8)	(25.2)
Closing fair value of assets	615.5	749.4	611.5	746.6
Gross deficit in the schemes at 31 March	(223.4)	(47.5)	(222.9)	(47.6)

Actuarial gain/loss in the statement of total recognised gains and losses (STRGL)

	2009 £m	2008 £m	2009 £m	2008 £m
Variance between pension fund actuarial assumptions and actual experience	(183.0)	99.0	(182.4)	98.4
Impact of settlements and curtailments	(0.9)	(0.8)	(0.7)	(0.3)
Adjustment for restatement of asset value to bid value at 31 March 2007 and deferred tax	–	(2.6)	–	(2.6)
Gross actuarial (loss)/gain recognised in the pension fund	(183.9)	95.6	(183.1)	95.5
Deferred tax movement	49.2	(31.6)	49.0	(31.6)
Net actuarial (loss)/gain recognised in the Statement of total recognised gains and losses	(134.7)	64.0	(134.1)	63.9

21. Pensions (continued)**History of experience gains and losses**

	Group		2009 £m	2008 £m	Company		
	2009 £m	2008 £m			2007 £m	2006 £m	2005 £m
Difference between the expected and actual return on scheme assets:							
Amount	(184.0)	(80.7)	(183.5)	(80.4)	1.7	89.4	16.0
Value of assets	615.5	749.4	611.5	746.6	777.9	720.0	558.9
Percentage of scheme assets	(29.9)%	(10.8)%	(30.0)%	(10.8)%	0.2%	12.4%	2.9%
Experienced gains/(losses) on scheme liabilities:							
Amount	13.1	(0.3)	13.3	(0.3)	(5.3)	(4.0)	10.5
Present value of liabilities	838.9	796.9	834.4	794.2	927.7	955.7	761.8
Percentage of the present value of scheme liabilities	1.6%	(0.0)%	1.6%	(0.0)%	(0.6)%	(0.4)%	1.4%
Changes in assumptions underlying the present value of scheme liabilities:							
Amount	(12.1)	180.0	(12.2)	179.1	79.4	(114.1)	(15.6)
Percentage of the present value of scheme liabilities	(1.4)%	22.6%	(1.5)%	22.6%	8.6%	(11.9)%	(2.0)%
Total variance between pension fund actuarial assumptions and actual experience	(183.0)	99.0	(182.4)	98.4	75.8	(28.7)	10.9
Gross deficit in the schemes at 31 March	(223.4)	(47.5)	(222.9)	(47.6)	(149.8)	(235.7)	(202.9)

22. Capital commitments

The Group (and Company) has contracted capital commitments of £340.3m (2008: £677.9m) at the balance sheet date.

23. Contingent liabilities

In May 2007 a material legal claim was received from Caledonian Environmental Services Ltd (CES), the Concessionaire in respect of Levenmouth PFI Project, relating to alleged losses arising under the PFI contract between Scottish Water and that company. The claim originates from an action raised by Degremont Societe Anonyme and Amec Capital Projects Limited under their Design and Construction Contract (DCC) and the extent of CES's claim against Scottish Water will depend on the outcome of that claim. Defences were lodged and the action has been sisted until the resolution of the DCC claim.

Central Market Agency

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

Water Regulatory Advisory Service

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

24. Related party transactions

Scottish Water is a public corporation of a trading nature sponsored by The Scottish Government. In terms of FRS 8 'Related Party Transactions', the Scottish Government is regarded as a related party. During the year Scottish Water has had various material transactions with the Scottish Government and with entities for which the Scottish Government is regarded as the parent.

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

	2009 £m	2008 £m
Sales and costs charged to Scottish Water Solutions Limited	11.4	21.6
Purchases from Scottish Water Solutions Limited	(347.2)	(323.1)
Amounts due to Scottish Water Solutions Limited (note 14)	24.5	32.6

25. Financial instruments

Scottish Water's financial instruments comprise cash, borrowings, certain provisions for liabilities and charges and items such as trade debtors and trade creditors arising in the ordinary course of business. No trading in derivative financial instruments was undertaken.

Fair values of financial assets and liabilities

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

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

Risks and uncertainties

The management of Scottish Water and the execution of its strategy are subject to a number of risks as detailed below. All risks are reviewed by the Board and appropriate processes are in place to monitor and mitigate them. See Corporate Governance report on pages 29 to 31.

a. Operational and business risk

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

b. Credit risk

Credit risk is the risk that Scottish Water is exposed to loss if another party fails to perform its financial obligation to Scottish Water. Scottish Water monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its exposure to any one party to ensure that they are within board approved limits and that there are no significant concentrations of credit risk. The maximum exposure to credit risk for receivables and other financial assets is represented by their carrying amount.

c. Liquidity risk

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

26. Ultimate controlling body

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

27. Regulatory information

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

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

In March 2009 the Scottish Government issued The Scottish Water Governance Directions 2009, which superseded all previous Governance Directions. These Directions are available on the Scottish Government web site.

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

Project expenditure	Threshold	Project	Cost
Capital expenditure on major works including improvements to existing assets	£10 million	Assynt WWTW upgrade	£17.6 million
		Turret WTW upgrade	£25.5 million
		Glencorse WTW	£107.5 million
		Aviemore (Blackpark) WTW	£18.4 million
		Philipshill WWTW upgrade	£10.5 million
		Alness & Invergordon WWTW Phase 2	£19.6 million
Purchase of individual capital items, including land, with a life of more than one year	£1 million	None	–
Advertising	£1 million	None	–
Sponsorship	£10,000	None	–
Gifts	£100	None	–