

**SCOTTISH WATER
INTERIM ACCOUNTS**

**For the six months to
30 September 2005**

Chair's Statement for Interim Report to September 2005

Scottish Water has continued to reduce costs and significantly increase investment.

Given the imperative of improving efficiency in the public sector, I am pleased to report that we continue to deliver the efficiency savings required in the final year of the 2002-06 price control period. However, there are significant cost pressures associated with increasing energy, fuel and local authority rates costs that are making the delivery of the £265m regulatory operating cost target for 2005/06 an extra challenge.

The surplus before tax to September 2005 was £104.8m (2004 - £55.4m), a year-on-year increase of 89%. This is being fully reinvested in the business to enable delivery of the capital investment programme.

Turnover rose by £23.4m to £508.1m. Household income increased by £10.7m or 3.5%, due predominantly to the tariff increase agreed in the 2005/06 Scheme of Charges. The average household charge in Scotland, at £283 per year for 2005/06, is less than that of six of the private companies elsewhere in the UK. Business customer income was in line with the previous year.

Turnover from new trading activities, which relate primarily to the sale of contracting services to Scottish Water Solutions (SWS) and the provision of water-related services to major business customers, increased by £12.9m from £10.8m at September 2004 to £23.7m at September 2005.

Total reported operating costs reduced by £4.6m to £330.2m. This was driven by a £15.7m reduction in depreciation charges and a £8.4 million reduction in core operating costs partially offset by an increase in PFI costs of £3.6m, increased costs associated with new trading activities of £12.1m and a reduced level of gain on sale of assets of £3.8m.

Regulatory operating costs to September 2005 were £132.9 million, £8.4m lower than September 2004. This is an 8.4% real reduction, or 5.9% in nominal terms.

In the half year to 30th September 2005, expenditure on our capital investment programme totalled £320.2m. £312.2m was invested in the delivery of the Quality and Standards regulatory capital programme and £8.0m related to capital expenditure incurred as part of the "spend-to-save" programme. Capital investment increased by £102.4m when compared to the same period last year. We are planning to invest more than £50 million a month for the remainder of the year on improvements which bring benefits to our customers across Scotland.

Exceptional costs charged to September totalled £2.2m (2004 - £26.6m) and related to restructuring and transformation costs undertaken as part of the final stage of the £200m 'Spend to Save' programme allowed for by the former Water Industry Commissioner for Scotland (WIC) in his Strategic Review of Charges 2002-06. This programme is for a discrete category of expenditure up to 2005-06, allowed by the WIC, to cover one-off transformation and restructuring costs that will reduce future annual operating costs. The programme is approaching completion.

We are now seeing the clear benefits of the creation of Scottish Water. The public sector model is delivering a transformation of our water industry.

During the first half of the financial year the board of Scottish Water, the executive management team and key staff have been heavily engaged in the process through which the Water Industry Commission will decide the funding and financial targets for Scottish Water for 2006-2010.

We await the announcement of the Commission's final determination, due on November 30.

Professor Alan Alexander FRSE
Chair
Scottish Water
23 November 2005

INCOME AND EXPENDITURE ACCOUNT
For the period 1 April 2005 to 30 September 2005

Year to 31 March 2005		Notes	Half year to 30 Sept 2005 Unaudited £m	Half year to 30 Sept 2004 Unaudited £m
£m				
960.5	Turnover		508.1	484.7
<u>671.2</u>	Total operating costs		<u>330.2</u>	<u>334.8</u>
289.3	Operating surplus before exceptional items		177.9	149.9
<u>61.8</u>	Exceptional items	4	<u>2.2</u>	<u>26.6</u>
227.5	Operating surplus on ordinary activities before interest		175.7	123.3
<u>136.1</u>	Net interest payable		<u>70.9</u>	<u>67.9</u>
91.4	Surplus on ordinary activities before taxation		104.8	55.4
<u>27.1</u>	Taxation	5	<u>31.5</u>	<u>17.1</u>
<u>64.3</u>	Surplus on ordinary activities after taxation		<u>73.3</u>	<u>38.3</u>

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There are no recognised gains or losses other than the surplus for the period.

BALANCE SHEET

At 31 March 2005		At 30 Sept 2005 Unaudited	At 30 Sept 2004 Unaudited
£m	Notes	£m	£m
	Fixed assets		
2,847.8	Tangible assets	3,052.3	2,666.8
0.1	Investments	-	0.1
	Current assets		
4.2	Stocks	4.5	4.0
181.6	Debtors	496.7	522.3
7.5	Cash at bank and in hand	8.8	1.3
193.3		510.0	527.6
292.8	Creditors: amounts falling due within one year	627.8	643.0
-99.5	Net current liabilities	-117.8	-115.4
2,748.4	Total assets less current liabilities	2,934.5	2,551.5
62.4	Creditors: amounts falling due after more than one year	61.5	69.5
	Provisions for liabilities and charges		
75.7	Deferred taxation	107.3	65.8
83.9	Other provisions	74.6	77.2
2,526.4	Net assets	2,691.1	2,339.0
	Capital and reserves		
2,233.2	Government loans	2,324.6	2,071.8
133.4	Other reserves	133.4	133.4
159.8	Income and expenditure account reserve	233.1	133.8
2,526.4		2,691.1	2,339.0

CASH FLOW STATEMENT
For the period 1 April 2005 to 30 September 2005

Year to 31 March 2005		Notes	Half year to 30 Sept 2005 Unaudited £m	Half year to 30 Sept 2004 Unaudited £m
£m				
552.1	Net cash inflow from operating activities	6	309.2	324.4
-136.3	Net cash outflow from returns on investment and servicing of finance		-70.0	-68.2
415.8			239.2	256.2
-513.1	Purchase of tangible fixed assets		-328.1	-196.6
11.0	Sale of tangible fixed assets		2.4	6.9
1.2	Government grants and capital contributions		-	0.2
-85.1	Net cash inflow/(outflow) before management of liquid resources and financing		-86.5	66.7
82.0	Net cash inflow/(outflow) from financing		87.8	-76.0
-3.1	Increase/(decrease) in cash		1.3	-9.3

NOTES TO THE INTERIM ACCOUNTS

1. Basis of accounting

The accounts have been prepared 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 accounts comply with all applicable United Kingdom accounting and financial reporting standards, with the exception of FRS 17 as detailed in note 2, but do not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985. Figures for the year ended 31 March 2005 are abridged and derived from the full statutory accounts which carry an unqualified auditors report.

2. FRS 17 Retirement Benefits

FRS 17 Retirement Benefits is the replacement accounting standard for SSAP24 Accounting for Pension Costs, and is required to be adopted in full for accounting periods starting after 1 January 2005. For Scottish Water this will therefore be effective for the financial year ending 31 March 2006. Scottish Water, since its inception, has complied fully with the transitional disclosure reporting requirements for FRS 17 and will adopt full disclosure in the financial statements for the year ending 31 March 2006.

Scottish Water participates in three separate defined benefit pension schemes which are part of the Local Government Pension Scheme. The three schemes are currently undergoing their triennial actuarial valuations. Consequently, to adopt FRS 17 within the interim financial statements would mean that assumptions would be based on data over three years old rather than more up to date information from the 2005 triennial valuation exercise. To use these actuarial assumptions at this time may be misleading. As a result the interim financial statements do not reflect the adoption of FRS 17 and the September 2004 and March 2005 comparative information have not been restated.

Scottish Water will adopt full disclosure in the financial statements for the year ending 31 March 2006, with restated comparative results for the year ending 31 March 2005 and associated adjusted opening balances as at 1 April 2004.

The interim financial statements in future years will be prepared in full compliance with FRS 17.

3. Approval

The Board approved the interim report for the half year ended 30 September 2005 on 23 November 2005.

4. Exceptional items

Exceptional costs charged to the income and expenditure account total £2.2m (2004, £26.6m) and relate to restructuring and transformation costs undertaken as part of the £200m Spend to Save programme allowed for by the Water Industry Commissioner for Scotland in the Strategic Review of Charges. These exceptional costs include external and internal costs, predominantly IT related, associated with the fundamental restructuring and transformation of the business.

5. Taxation

Tax has been charged at 30% recognising deferred taxation. Deferred tax is recognised in respect of all timing differences, which have originated but not reversed at the balance sheet date. No corporation tax is due or payable in the period (2004, £nil).

6. Reconciliation of operating surplus to net cash inflow from operating activities

Year to 31 March 2005 £m	September 2005 £m	September 2004 £m
289.3	177.9	149.9
-61.8	-2.2	-26.6
114.2	60.0	57.5
145.0	55.0	73.5
1.1	0.8	0.5
-9.4	-1.9	-5.7
0.3	-0.3	0.5
22.6	36.7	24.7
33.1	-7.5	39.1
17.7	-9.3	11.0
552.1	309.2	324.4
Net cash inflow from operating activities		

7. Analysis of net debt

	As at 1 April 2005 £m	Increase in cash £m	(Increase) / decrease in debt £m	As at 30 Sept 2005 £m
Cash at bank and in hand	7.5	1.3	-	8.8
Other debt due within one year	-70.9	-	1.9	-69.0
Net borrowings due within one year	-63.4	1.3	1.9	-60.2
Net borrowings due after more than one year	-2,203.9	-	-89.7	-2,293.6
Net debt	-2,267.3	1.3	-87.8	-2,353.8

