2022/23

ANNUAL REPORT AND ACCOUNTS PERFORMANCE AND PROSPECTS

Scottish Water
Trusted to serve Scotland

CONTENTS

TRANSFORMATION

We are transforming how we operate to ensure we increase investment, maintain services to customers and protect the environment - and have highlighted some of this work in our report with this icon.

Our Annual Report & Accounts 2022/23:

ANNUAL REPORT & ACCOUNTS 2022/23: PERFORMANCE AND PROSPECTS

This Annual Report & Accounts 2022/23: Performance and Prospects provides an open and transparent view of Scottish Water's performance in the last 12 months, the second year of our regulatory period. We highlight what has gone well, where we fell short of delivery commitments and provide an overview of our future direction.

Scottish Water is committed to listening to our customers and constantly assess and evaluate our work to continue to drive improvements for the future. This report includes lessons we have learned and what we intend to do differently to enable continued excellent service delivery.

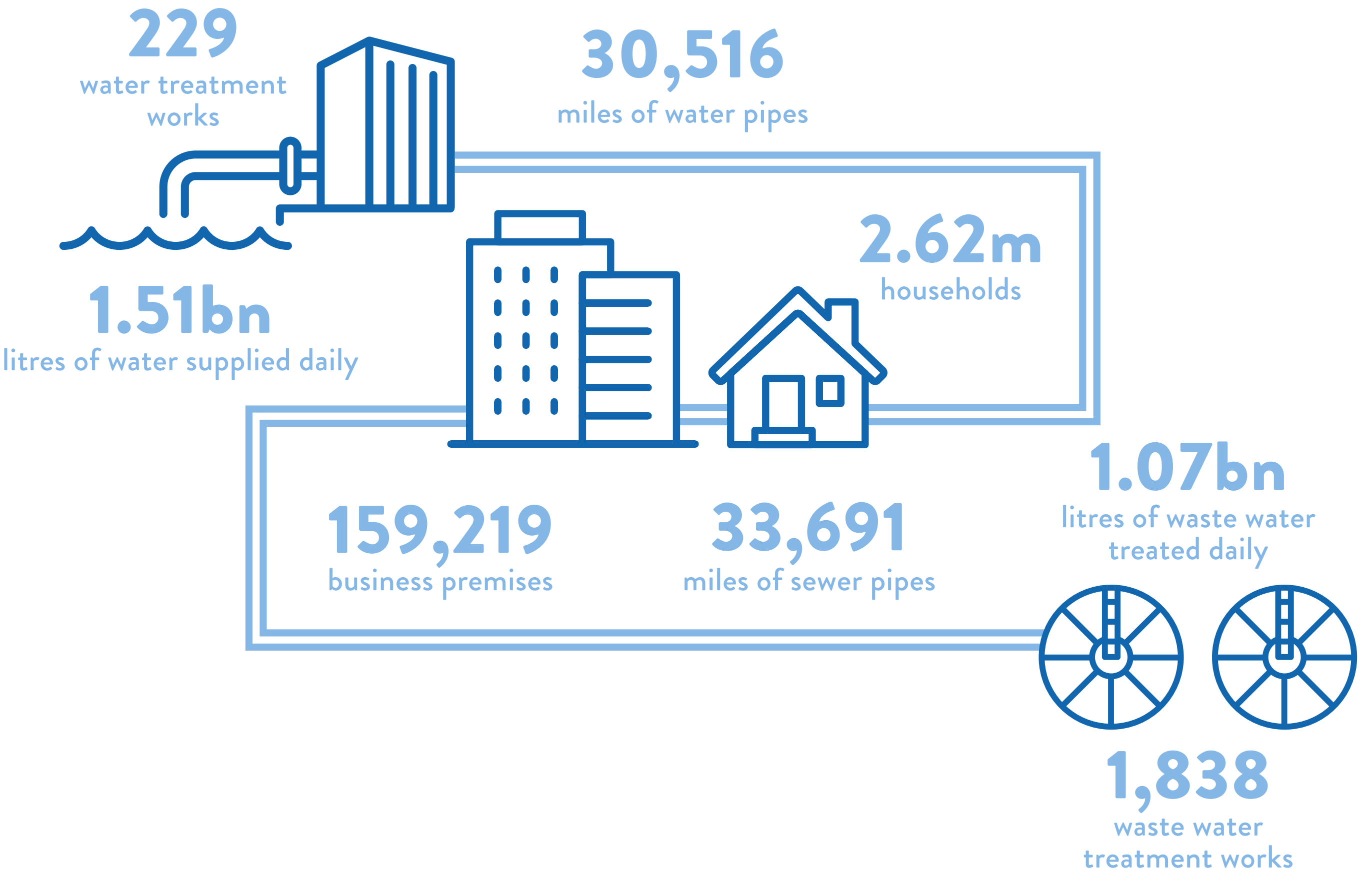
Our strategic plan, Our Future Together, outlines our three strategic ambitions: Service Excellence; Going Beyond Net Zero Emissions; and Delivering Great Value and Financial Sustainability. This report describes our performance and prospects in these three areas during 2022/23.

SCOTTISH WATER'S VITAL ROLE

Every day we:

- deliver 1.51 billion litres of clear, fresh drinking water; and
- remove 1.07 billion litres of waste water which we treat, recover resources from and return safely to the environment.
- Our services support over 2.6 million households and more than 159,000 business premises across Scotland.
- With more than 60,000 miles of pipes and over 2,000 treatment works we support communities across Scotland.
- In 2022/23 we invested £886 million, on a like for like basis with 2021/22 - our biggest annual investment to date.

OUR VITAL ROLE COVERS:



CUSTOMER SERVICE PERFORMANCE 2022/23

RANKED TOP WATER COMPANY IN UK
INSTITUTE OF CUSTOMER SERVICE

WE PROVIDE VITAL WATER AND WASTE WATER SERVICES ESSENTIAL TO DAILY LIFE

Our customers

2.62m
HOUSEHOLDS

MORE THAN
159,000
BUSINESS PREMISES

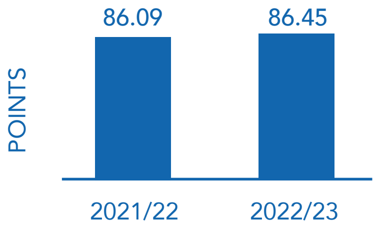
Customer contacts

334,748
SERVICE ISSUE CONTACTS

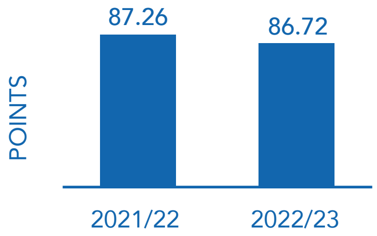
Customer experience

When compared on a like-for-like basis:

Household Customer Experience Measure (hCEM)



Non-household Customer Experience Measure (nhCEM)



Water supply

EVERY DAY WE DELIVER **1.51bn** litres of clear, fresh drinking water to taps

HIGH WATER QUALITY MAINTAINED

Waste water service

WE REMOVE AND TREAT **1.07bn** litres of waste water every day to help protect the natural environment

Customer charges

2023/24:

INCREASE BY **5%**[1]

AROUND **£19**/YEAR HIGHER[2]

AROUND HALF OF HOUSEHOLDS IN SCOTLAND RECEIVE ADDITIONAL FINANCIAL SUPPORT AS THEY AUTOMATICALLY HAVE EITHER A DISCOUNT, EXEMPTION OR REDUCTION APPLIED TO THEIR WATER AND WASTE WATER CHARGES[3].

1 For those who pay full charges.

2 This is based on the average household which is between Council Tax Band B and Band C.

3 The Scottish Government specifies a number of situations where discounts and exemptions applied to Council Tax should also be applied to water and waste water charges. The most common are the discounts based on the number of occupants in a dwelling or if a house has been modified to support a disabled resident, the Council Tax band for the dwellings is reduced to the next lower band.
Legislation specifies situations where dwellings are exempt from Council Tax and most relate to vacant dwellings, with the exemption being indefinite in most situations. Dwellings fully occupied by individuals in another three categories are exempt from Council Tax and water and waste water charges - full time students; individuals who are severely mentally impaired; Ukrainian refugees – who are part of an official refugee programme.
Households that receive Council Tax Reduction as a result of their financial circumstances can receive support from the Water Charges Reduction Scheme which can mean a household paying 65% of the full charge.

INVESTING IN OUR ASSETS

Where we are now

Large asset base

229 WATER TREATMENT WORKS

30,516 MILES OF WATER PIPES

1,838 WASTE WATER TREATMENT WORKS

33,691 MILES OF SEWER PIPES

One of the biggest critical infrastructure investors

£4.4bn[4] 2021-27

£886m IN 2022/23

4 In 2017/18 prices and also includes responsive repair and refurbishment costs

Challenges and expectations

Ageing assets

Requires doubling of investment over the next 20 years

Changing climate

Extreme weather impact on asset capacity

Impact on raw water sources

Achieving Net Zero

Forecast population change

Evolving customer expectations

How we are going to do it

Longer-term strategic approach

Asset Management Transformation Routemap

Transforming investment appraisals

+

Transforming our future delivery programme

Efficient delivery of increased investment

Innovating to achieve Net Zero

+

Collaboration with our supply chain to drive value

=

Transformed investment approach

Smarter investment decisions

Maximised benefits for customers, communities and the environment

NET ZERO EMISSIONS

OPERATIONAL AND INVESTMENT EMISSIONS CALCULATED INCLUDING FROM OUR SUPPLY CHAIN

MAJOR CONSTRUCTION INDUSTRY INVESTOR

ONE OF THE **LARGEST ENERGY USERS** IN SCOTLAND

2022/23

6% Reduction in operational greenhouse gas emissions

46GWh of on-site self-generated renewables

6.8GWh of energy efficiency delivered

2020 ROUTEMAP PUBLISHED

2030 NET ZERO OPERATIONAL EMISSIONS

2040 NET ZERO

Become more energy efficient (seeking a 20% reduction in energy use by 2030)

Use lower carbon energy products, with a goal to operate 100% of our assets using renewable energy (through generation or hosting)

2025: no new petrol or diesel cars in fleet & no new fossil fuel light commercial vehicles
2030: no new fossil fuel commercial vehicles

Maximise the energy recovered from bioresource

Embracing low carbon construction

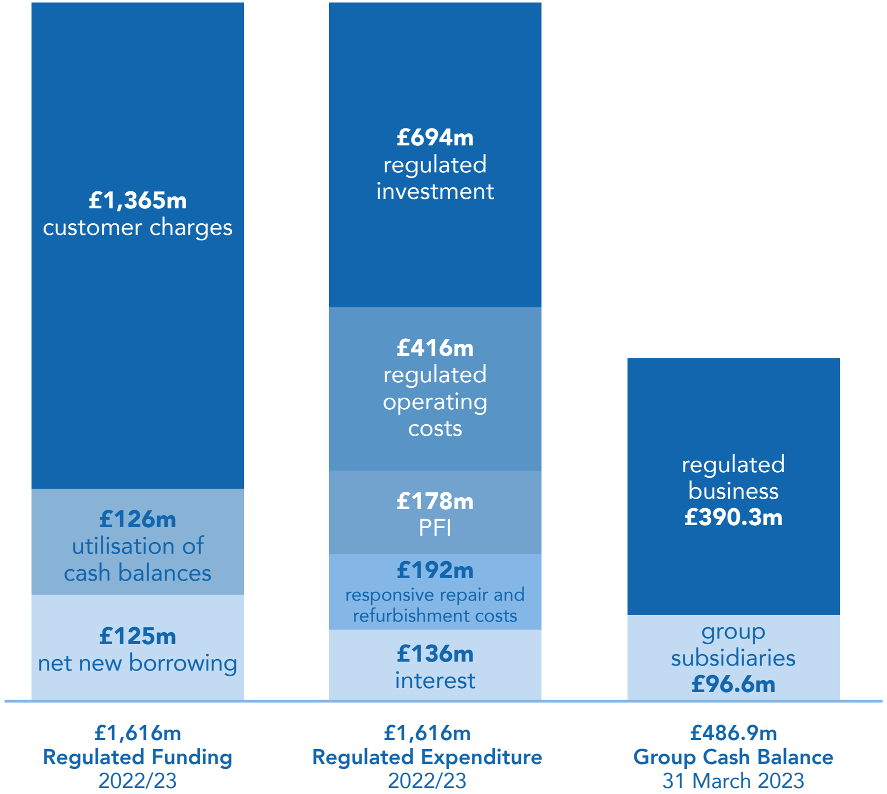
Embracing innovation

Working with our supply chain

Develop natural carbon sinks

Embracing the circular economy

SCOTTISH WATER
FINANCIAL PERFORMANCE 2022/23



VALUE ON TAP -
You get to do all this for around £1 a day[5]

[5] The average household is between Council Tax Band B and Band C and has a combined bill of around £1 a day.

CHAIR'S STATEMENT
DAME SUSAN RICE

At Scottish Water we never forget that water is vital to life, but I've found it striking how water is firmly under the spotlight whether in discussions about the global challenges of climate change and nature loss or community concerns about the local environment.

The United Nations says water is the medium through which nature and human societies experience most of the impacts of climate change, expressed through drought and floods (UN Water 2020). And according to the charity WaterAid, a staggering 90%[6] of all the world's natural disasters are now water-related. So, perhaps it's no wonder more and more people are waking up to just how important water is, not just in our daily lives but for our world to survive and local communities to thrive. It cannot be an afterthought.

I was pleased to see recently, after more than 20 years of talks, the United Nations agreed the first-ever treaty to protect the world's oceans that lie outside national boundaries. The UN High Seas Treaty places 30% of the world's oceans into protected areas, puts more money into marine conservation, and means new rules for mining at sea. Environmentalists say it will help improve biodiversity and ensure sustainable development.

There is now a similar level of concern about nature and threats that come from its degradation as we have around carbon emissions and their role in global warming. Water, of course, underpins what happens in nature. We are seeing its impact more than ever through worsening floods, rising sea levels and droughts, including the worst ever wildfires in Chile, deadly flooding in Bangladesh and a record number of dry canals in Venice. Water is a precious resource and one that needs to be used wisely. Sustainable water management is central to building the resilience of communities and eco-systems and we all have a role to play.

[6] Source: click here

From the actions we take at home to policymakers putting water at the heart of climate action plans. That includes how we do more to save water and, in terms of waste water, all play a part in ensuring it causes as little harm to the environment as possible.

In the last year the environmental performance of water companies and regulators has come under scrutiny across the UK, including in Scotland. This scrutiny is due in part to much more information being publicly available, showing how waste water networks operate and how they can impact the environment. Although the issue is broader than just combined sewer overflows - with other sources of pollution, including agricultural run-off, also responsible for the condition of rivers - most of the media coverage has focused on sewage.

As a Board we welcome the increased transparency on this issue. We are committed to providing accurate information about all aspects of our performance. As part of our Improving Urban Waters Routemap we have committed to increase the monitoring and reporting of spill data from Combined Sewer Overflows (CSOs) that are designed to spill during heavy rains to prevent flooding. We have published historical data for reported spills over the last six years.

Over the years, we have made good progress in enhancing waste water collection and treatment, contributing significantly to the improved quality of Scotland's coastal and inland waters. The Scottish Environment Protection Agency (SEPA) monitor and assess the condition of Scotland's water quality which is now at its highest level since the first Water Framework Directive classification in 2009, with 87% of waterbodies now achieving at least "good condition". Working alongside SEPA we have put sustained effort into improving over 100 waste water treatment works in the last decade. Nevertheless, we know many customers and other stakeholders have strong expectations of further improvements to better protect the environment and we recognise the scope to further improve our waste water system performance. We have pledged to increase the number of storm drain monitors to more than 1,000 by the end of 2024.

Our Nature Calls campaign has had a successful first year with 69% of people who heard about it saying they will think "more carefully about what they flush" into the sewer network. We asked politicians to support a ban on wipes and were pleased when, in April this year, the UK Government announced plans to ban all wipes containing plastic. To date, our call has received cross-party support in the Scottish Parliament. We will continue to take our campaign to elected representatives as well as into local communities and focus more effort on areas where sewer blockages are a particular problem.

There is no single, easy and fast solution to reducing the frequency and volume of CSO discharges going into the water environment at times of heavy rainfall. It will take water companies, governments and regulators working together to find an affordable method of delivering solutions, whilst at the same time financing the steps needed to build the resilience of our services to climate change and move towards wider net zero ambitions.

While some customers may want us to deliver every possible environmental improvement, we will all need to consider the level of environmental improvement that people across Scotland will ultimately be willing to pay for in the context of other financial demands. And it's not just water companies under the spotlight but other businesses, the House of Lords' Industry and Regulators Committee's report 'The affluent and the effluent: cleaning up failures in water and sewage regulation' said co-operation across sectors was needed to help make improvements to the quality of our seas and rivers. It noted "a variety of sectors contribute to the state of the water environment …water pollution is caused by sectors including water, agriculture, housing, and transport". It also highlighted how finding solutions was complex, would take time and require substantial investment.

READ REPORT
Cleaning up failures in water and sewage regulation

As a Board, we have a focus on risk management and continually strive to understand and oversee the mitigation of the escalating long-term risks we face on these issues and many more. There are no easy decisions about dealing with the long-term challenges, but our commitment is to look at what can and should be done to help Scotland flourish now and in the future. And more immediately, we will continue to work, day in and day out, to provide world-class services.

I've served as Chair of this remarkable organisation for eight years. As I prepare to hand over the baton to my successor later this year, it is increasingly clear that tackling current and future challenges will take ambition, vision and energy. Innovation, learning and collaboration are key aspects of moving forward.

But looking back over the past two years shows that without enough investment the standard of our water and waste water services will inevitably decline as assets age and the pressures grow from our changing climate. All those involved in the water industry must plan and commit to maintaining the high standard of service customers expect and ensure new ways are found to cope with the climate change challenges.

It has been a pleasure and a privilege working with such dedicated and caring people, under the steady leadership of Douglas Millican, our Chief Executive since 2012, who is standing down after 27 years in the Scottish water sector.

Douglas' deep understanding of the water sector, strong work ethic and genuine dedication to customers will be sorely missed. I look forward to working with his successor, Alex Plant, in the coming months.

I would also like to record my gratitude to Samantha Barber, who stepped down from the Board in March, and who brought valuable guidance and challenge to our work. I know the Board will continue to lead and guide this remarkable organisation with drive and determination to ensure our customers receive the first-class service they have become accustomed to and are rightly proud of.

Dame Susan Rice
31 May 2023

CHIEF EXECUTIVE'S REPORT
DOUGLAS MILLICAN

Customers, rightly, expect us to provide water and waste water services day in, day out no matter what is happening to the economy, the weather or in global events. What we provide is essential to their lives.

Looking back on the last year I am proud that we have faced and overcome some of these challenges and continued to deliver for our customers. Although the first part of the year was relatively stable, the latter half was a little bumpier as the continued impacts of climate change and our ageing assets caused various challenges to both our water and waste water services.

We work hard to assess issues and risks and do all we can to plan for them, but it is not always possible to prevent some issues impacting the service we provide to customers. In the past 12 months, extremes of weather have caused interruptions to water supply, including, for some customers, during the Christmas and New Year period.

In mid-to-late December we experienced very challenging weather conditions; initially with extensive freezing weather causing frozen valves, burst pipes, and exceptional peaks in demand for water. Given the scale and spread of challenges we faced, our operational teams responded well, supported by people in non-operational roles who volunteered to support the incident. At one point we had 42 tankers on the road, the highest number ever, working to get customers back in water supply. Also, more than 500 employee volunteers handled customer calls or distributed bottled water, including on Christmas Day, during this incident.

Towards the end of December, very heavy rain caused extensive waste water related problems; over 100 waste water treatment works were flooded and our sewer response teams had to deal with hundreds of additional customer requests.

KNOW THE FACTS

This was followed in late January by a major burst on a 160-year-old large trunk main in Milngavie, serving almost half the Greater Glasgow area. The force of the burst was such that a main road into Milngavie was torn up. Our teams worked quickly to rezone supplies, water was restored to all customers within hours and the major road reopened two weeks later. While we know any interruption to supply is hugely inconvenient to customers, the dramatic images from Milngavie served as a timely reminder that much of the infrastructure we rely on is very old. It also highlighted how continued investment is required to protect services.

Hot weather can also bring challenges for water supplies and water quality. This can be through increased customer demand, the drying-out of the ground causing burst water pipes, or greater occurrence of algae and other naturally-occurring issues in our raw water sources.

Despite these challenges we continued to deliver high quality services to customers and our key performance measures are around similar levels to previous years. Water quality remains high, at 99.92%, which is virtually unchanged on last year.

We are committed to building on this strong foundation to increase the reliability and resilience of our water service. Our teams continue to focus on maintaining water quality, operating our assets against challenging and unpredictable weather impacts, replacing assets at the end of their lives and targeting improvements in the capability of our assets.

Overall, our environmental performance remained stable with 96.2% of waste water treatment works fulfilling environmental licence conditions. This compares with 96.6% in 2021/22. We had 11 of the more serious category one and two Environmental Pollution Incidents (EPIs), which was one more than the previous year.

Combined Sewer Overflows (CSOs) are very much in the spotlight just now with considerable media coverage, and in turn public attention, on the issue of CSO spills and river health. We are committed to building on the improvements already made and doing more to further protect the water environment where we are making progress with implementing our Improving Urban Waters Routemap. This will see us invest up to £500 million in the waste water system, including treatment works and CSOs, to improve the quality of waste water discharges and protect rivers and coastal environments. Scotland already has one of the best quality water environments in Europe[7] with 87% of waterways achieving "good' or better condition" for water quality.

As with all of our investment programme, we need to decide which areas are the greatest priority for investment with the resources we have. And, as with most things, people across Scotland will have differing opinions on what they should be. We will continue to work with communities to listen to their views and work with partners, including local authorities, to introduce sustainable infrastructure which helps remove surface water from sewers and protect the water environment.

I am proud that we have delivered cumulative emissions reduction in the last two years of 15,681 tCO_2e (equivalent to 34,000 return journeys from Land's End to John O'Groats in an average diesel car) despite a number of challenges. We remain focused on achieving the long-term targets in our Net Zero Routemap, our ambitious plan to reach Net Zero carbon emissions by 2040.

In the last year we have delivered more energy efficiency projects and several renewable energy projects, including our largest one to date, at Balmore Water Treatment Works in East Dunbartonshire. Our work to restore peatland and create woodland did not progress fully as planned. We have reviewed these programmes and applied learning to our planning for the coming year.

This was the second year of our current six-year regulatory period, during which we aim to significantly increase our year-on-year investment levels, in line with the expectations of regulators and the Scottish Government. I am pleased to report strong performance in our capital investment programme, building on the investment growth we achieved in the previous year. In 2022/23, we invested £886 million in the infrastructure needed to ensure the services customers receive today are protected for future years.

[7] Ecological status of surface waters in Europe (europa.eu)

Our total revenue performance at £1,385 million was £26 million lower than the Final Determination level, principally because our charge increases for the year were limited to 4.2%, this is 2% lower than anticipated by the Final Determination, to reflect the difficult economic circumstances faced by customers. However, with strong cost control, the regulatory surplus available to support investment of £381 million[8] was £56 million higher than the Final Determination level. This surplus provides the largest element of funding for our planned investment programme to replace or refurbish our ageing assets.

Unsurprisingly given the high rate of inflation, we are seeing a number of cost pressures. In terms of energy costs, our forward purchasing of electricity well before market prices started to rise contributed very significantly to our financial performance in the year, which is a major benefit for our customers. For 2023/24, we pre-purchased nearly half our electricity in April 2020 and hope to take advantage of a softening energy market when we purchase the balance during the year. We are also continuing to experience cost pressures in other areas, including Private Finance Initiative (PFI) fees indexed to gas prices and chemicals used in our treatment and testing processes. The availability of some products, including some construction materials, also remains challenging.

We increased water and waste water charges for 2023/24 by 5%, an average of 37 pence per week per household[9].

However, nearly half (49%) of customers receive some form of rebate or reduction in their water and waste water charges. The charges were set after extensive discussions with the Scottish Government, to balance the need for future investment to protect services, with the significant economic challenges faced by many people and businesses across Scotland at the current time. As a consequence, the finance available for investment in the 2021-27 period will be around £500 million - 10% lower than expected at the start of the regulatory period - inevitably delaying delivery of certain aspects of our investment plan. However, those discussions also confirmed the Scottish Government's commitment to the future finance we need to deliver the remaining agreed investment across this regulatory period, including recognition that above-inflation annual customer charges increases will be needed given the decisions on charges taken in the first three years of the 2021-27 period.

We have no alternative but to increase investment levels and raise customer charges in real terms, if we are to protect services and meet the needs and expectations of our current and future customers. At Scottish Water we understand that increasing charges is difficult at any time. But without facing into this, we will simply be passing more of the cost burden onto future generations of customers. Although investment levels have increased significantly over the past two years, we are currently investing around only 40% of the necessary long-term replacement rate. This will need to rise further to ensure we can keep managing the risks of major service failure and the demands arising from the impacts of climate change. We must not allow challenges to be deferred because they cannot be afforded. It is ultimately a matter of choice. No matter how difficult this choice may be, the alternative of not having reliable water and waste water services would be far more difficult.

8 After allowing for £215 million of responsive repair and refurbishment costs.
9 This is based on the average household which is between Council Tax Band B and Band C.

I am not, in any way, diminishing the real financial challenge customers face nor suggesting charges must rise dramatically, at present. But simply, we need to grasp the reality of ageing assets and the required increases in charges to pay for the necessary investment in essential water and waste water infrastructure. We owe it to our customers to be honest with them about the cost of delivering the services they rely on and expect, and will continue to expect, and keep transitioning towards a more sustainable future. There is not a stand-still option. Assets are ageing and need replacing. Our climate is changing, and we must adapt.

Our strategic plan, A Sustainable Future Together, sets out our long-term strategic ambitions and our intent to transform how we work to achieve these ambitions. We have already started the journey to transform our organisation with some successful results to date and plans for some truly ground-breaking projects. Our Transformation is underway with initiatives taking shape and starting to deliver benefits in service delivery, efficiency, and customer experience. Some of the initiatives, some of which are pioneering, have delivered substantial cost and carbon savings and made sign off processes more efficient. Some others have protected the environment by preventing environmental pollution and blockages.

An area of focus for us in the last few years has been the efficiency of our capital programme delivery. One example of improvement is how we are redesigning the end-to-end investment process that enables us to deliver our capital programme - the way we make sure we have the right assets to be able to deliver our services to our customers and communities, now and in the future. The aim is to make this process simpler, easier and quicker. This will support "get to site in half the time" which has set targets to reduce time taken by 50% and cost by 30% to get projects to site. We are also now exploring how to "get off site in half the time" with our supply chain partners.

With tough decisions ahead about where best to invest, and what should take priority, we understand that involving customers has never been so important. The experience of our customers and communities of the services we provide, which we measure with a group of Customer Experience Measure (CEM) scores, has been broadly similar to last year. Our work to further strengthen relationships with local communities, customers and organisations impacted by, or with an interest in, our work continued. We have continued with virtual meetings, where appropriate or requested, following on from the pandemic lockdowns, to make it easier for people to engage at a time and place that suits them.

We know we need to continue to improve the way we communicate with and listen to our customers, to ensure our work reflects their priorities and expectations where we can. The implied trust given to us, every day, by millions of people across Scotland will be eroded if we fail to involve customers when we should, listen to their views, hear their perspectives and take on board what they say. I am certain our customers will expect us to deal with whatever comes our way and keep their services running. We must deliver services in the way that they need and expect.

Scottish Water has just marked its 21st anniversary and I've been privileged to be a member of the executive team and the Board throughout. Looking back to the start of Scottish Water in 2002 there were huge expectations for this organisation to deliver - from government, our regulators, and customers. In those early days, we had a simple motivation as an executive team – to prove that success in our sector was a function of leadership and governance, not ownership. The first few years were, inevitably, challenging with some major flooding incidents and several serious water quality issues to name a few.

Over the following years, we were subject to regular public criticism from the media, politicians, and regulators, sometimes fairly, other times less so. With all these pressures and criticisms, heads went down. Remarkably, through it all, we kept fighting on and as the years passed our progress started to become visible and be recognised. A key to overcoming these challenges was, and remains, our people.

We have a tremendously dedicated workforce – many of whom have also been with Scottish Water for the entire 21 years of its existence - who get on and deal with what they need to, whatever challenges they face. They take pride in ensuring we protect public health, improve the environment and provide genuine care for our customers. Our front-line teams work around the clock, across Scotland, to help our country function and flourish. And our supply chain, partnerships, and stakeholders play a critical role in our work too.

It is vital we continue to inspire, develop and support our people to fulfil their potential and help us transform the way that we work. We strive to provide a stable workplace where people can fulfil their ambitions and get the chance to develop and shine, and much of our transformation work will help ensure this continues. As well, we want to encourage new talent too. This year we launched our biggest ever drive for Modern, Technical and Graduate Apprentices to hire 60 trainees into a varied range of positions across the country. We are one of only eight businesses, and the only utility, in Scotland to have achieved the coveted Investors in Young People Platinum standard, making Scottish Water a leading ambassador for employing young people.

It was a great privilege to be appointed Chief Executive over ten years ago. There are many achievements I could point to over that time, but my greatest pride comes from seeing the steely confidence in our leaders and people; a real can-do attitude to embrace opportunities and overcome adversity to deliver for our customers. This deep resolve has been developed through the strong and cohesive leadership by my executive team. I am immensely proud of, and indebted to, each of them for the way that they have supported me and led the organisation over the years. And likewise, I wish to mark my deep appreciation of the dedication and skill of our leaders and people across Scottish Water.

The end of the second year of the regulatory period is a good time for me to step down and enable my successor, Alex Plant, to take over. I am confident Alex will bring fresh thinking and new ideas to Scottish Water, while embracing so much of what is core to who we are and how we work.

I would like to thank Dame Susan Rice for her strong support over the past eight years. Susan's leadership of the Board, drawing from her extensive corporate, public service and utility sector experience, has been invaluable in supporting me and the executive team. Her warmth and good humour has made working alongside her a joy.

Douglas Millican
31 May 2023


STRATEGIC
REPORT

OUR BUSINESS MODEL

Who We Are

Scottish Water is a public sector body, classified as a public corporation of a trading nature, answerable to the Scottish Parliament through Scottish Ministers and therefore without shareholders. This ownership model allows the surplus generated to be reinvested in the provision of services to our customers.

Our core services are covered by the Water Industry (Scotland) Act 2002. Under that, the charges for these services must be approved annually by the Water Industry Commission for Scotland (WICS). In delivering these services effectively, we have to make use of our resources to achieve Ministerial Objectives at the lowest reasonable overall cost.

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

OUR PURPOSE AND STRATEGY

What We Do

Our purpose is to support a flourishing Scotland through being trusted to care for the water on which we all depend. We supply water and waste water services to households and are also the wholesaler to 24 Licensed Providers who operate in the water and waste water retail market for business customers in Scotland.
Using Scotland's natural resources, our assets and the skills of our people, we are committed to improving our services for customers and communities while protecting and enhancing the environment of Scotland.

DELIVERING MINISTERIAL OBJECTIVES IN THE 2021-27 REGULATORY PERIOD

Scottish Ministers set objectives for Scottish Water. Our objectives for the current regulatory period, 2021-2027, are:

Ministerial Objectives 2021-27:

- Take an integrated and collaborative approach to decisions to maximise the impact of resources and to achieve better outcomes for people and communities.
- Maintain or improve current levels of service over the long term, engaging to establish appropriate standards for the 2021-27 period and beyond.
- Prepare a strategy to inform the long-term asset replacement needs ensuring asset maintenance is fully integrated in the investment programme.
- Identify and provide new strategic capacity to meet the demand of all new housing development and domestic requirements of commercial and industrial development.
- Align with the Scottish Government's circular economy strategy and assess the potential for resource recovery from waste water.
- Comply with drinking water quality duties and address failures to ensure compliance with drinking water quality standards, taking steps to improve resilience and remove lead from the network.
- Improve compliance with environmental licences and limit the amount of plastics reaching the water environment through the sewer network.
- Work with stakeholders to transform how rainwater and waste water are managed to improve flooding and surface water management.
- Maintain and improve the security of its network and systems, to protect them from malicious attack.
- Make substantive progress in the 2021-27 period towards the climate change targets.
- Prepare and implement plans to manage its private finance initiative contracts which end in the 2021-27 period.

For the full list of Ministerial Objectives click here.

SERVICE EXCELLENCE

Overview

The last year has been among the most challenging we have ever faced. Over the past year we have continually adapted our ways of working to ensure excellent service delivery. The views of customers shape our delivery and we strive to engage with them to understand how we can improve.

Most customers enjoy uninterrupted services and do not experience any loss of service. When interruptions do happen there can be many reasons, such as weather conditions or asset failure, and we do all we can to minimise disruption working to rigorous targets to restore normal supply. Occasionally, customers are left without water for longer periods.

CUSTOMERS AND COMMUNITIES

Over the last 12 months we have faced a series of challenges to delivering water and waste water services to our customers from extreme weather due to climate change. In the summer of 2022 we had some very dry weather leading to drinking water quality issues, quickly followed by very wet weather that led to flooding problems. In the winter of 2022 we had to deal with the impacts of a deep freeze, quickly followed by a rapid thaw, which caused an increase in burst pipes and interruptions to customers' supplies.

We have also seen a number of challenges to maintaining the level of service we provide customers from failures of our assets, for example in ageing asbestos cement water pipes. While we are investing more money each year in asset repair, refurbishment and replacement, the age and deteriorating condition of some of our assets, coupled with the impact of climate change, mean it is likely we will continue to face greater numbers of incidents. This would unfortunately impact on the services provided to our customers and their communities.

Despite these challenges the response of our frontline employees has been excellent again this year and we have managed to maintain performance in many of our key performance metrics at or around the same level as last year.

2022/23 Performance

Overall Performance Measure (OPA)

The OPA is a points-based measure that scores our performance across a range of activities essential to maintaining levels of customer service and environmental protection. Our OPA performance for the last year was 401, which is 3 points higher than the previous year.

Customer Experience Measures (CEM)

Our Household Customer Experience Measure (hCEM) score was 86.45 which is around the same as last year's score of 86.09. Our Non-household Customer Experience Measure (nhCEM) of 86.72 is a very slight decrease on last year's score of 87.26, calculated on a like-for-like basis.

There was also a decrease in the number of service issue contacts received from household customers by our Customer Engagement Centre, down by 11,516 to 334,748, compared to a total of 346,264 in 2021/22. We received the highest amount of calls in December and January, when the weather impacted some of our services.

Complaints and Feedback

There was a substantial drop in formal complaints from household customers down to 307 last year compared to 469 in 2021/22. We take complaints seriously and resolution is a priority for us. The areas which received the most complaints were related to bursts, sewer flooding and sewer blockages. We also saw a fall in escalations with 559 for the year – which was 210 fewer than the year before.

KNOW THE FACTS

For non-household customers there were 30,586 service issue contacts, down from 31,958 the year prior. However there were 163 formal complaints, a rise of 20 on the previous year. There were 30 less escalations in the last year down to 101 from 131 in 2021/22.

UK Customer Satisfaction Index (UKCSI)

We are pleased to remain among the better performers in a number of areas of the latest UK Customer Satisfaction Index (UKCSI), a national benchmark of customer satisfaction. Based on a 1000-response survey, we are above both the all-sector and utilities averages for overall UKCSI scores. Out of all the UK utility companies, we also rank second for customer effort, which is the ease with which customers felt they completed their enquiry or transaction. Read More.

KNOW THE FACTS

There were no upheld regulatory complaints from the Scottish Public Services Ombudsman or Drinking Water Quality Regulator (DWQR) in 2022/23.

There were 947 Freedom of Information (FOI) requests, an increase of 33 on the previous year. Topics which received some of the highest number of FOIs related to flooding and our waste water strategy, which included use of CSOs.

Wholesale

We are the wholesaler to the 24 Licensed Providers (LPs) who provide water and waste water services to businesses and other non-household properties across Scotland in a competitive market. We collect more than £350 million per year in wholesale charges from LPs.

Over the last year we have continued to provide a high standard of customer service to LPs and their customers, reflected in our performance measures[10]. We have also seen improvements in quality as a result of recent work on getting things 'right first time'. Our Licensed Provider Satisfaction level increased from 96.62% to 98.38%.

Our annual LP survey showed that our service continues to be rated highly and provided us with valuable insight on further opportunities. We also carried out our first independent survey of LPs based on the R-MeX (Retailer Measure of Experience) methodology used by MOSL (Market Operator Services Limited) in England to allow Scottish Water to benchmark our performance against wholesalers in England. We came second out of 16 wholesalers we benchmarked against: Go to R-MeX Results - Scottish Water.

Read More.

[10] These measures include Wholesale KPI, Non-household Customer Experience Measure, our annual LP Survey and R-MeX survey, a new provisional 'Right 1st Time' metric to monitor our effectiveness of first-time resolution of issues.

Community Engagement

We meet with community members and representatives almost daily in relation to capital investment projects near them. We regularly engage with communities around noise, odour, traffic management, access to land and a broad range of other issues. We engage with communities to understand any concerns of local residents and to help address any issues wherever possible, often influencing the design or delivery of investment projects or other works.

Since the Covid pandemic the nature of this engagement has changed, with much more now taking place online. However, in the last year there has been a notable increase in the number of community council meetings, local events, school visits and meetings with community interest groups that we have been asked to take part in or have proactively approached. We know this is a vital part of our work and always take their comments on board in our planning and decision making. We continue to learn lessons on the best ways to engage with customers and are always looking to improve ways to gain as much feedback as possible.

We use our website and digital media channels to reach as many people as possible where we encounter community issues or concerns. These communications seek to explain as clearly as possible the work being carried out and the benefits it will bring. Communities are also informed of how works could impact them, most notably regarding traffic management in the areas they live, work or visit.

In the last year we carried out independent research seeking the views of customers in 14 communities where major investment projects were carried out. It found one of the most common concerns was traffic management where they lived, worked or visited. The research also shows that those who recalled receiving advance notification of the work and regular updates were overall more satisfied with what we had done. We will use the detailed findings of this research to further develop our community engagement activities.

Increased concerns about waste water and the environmental impact from our assets has led to community campaigns raising the issue with elected members and customers. We have proactively engaged with those communities to address their concerns and explain how the waste water system works and our investment plans. One area of specific activity has focused on the River Almond, West Lothian, where we have a well-established relationship with local campaigners and politicians who we meet regularly with to listen to their views which helps shape our future decision-making. In the past year this has included site visits and members of the action group supporting us in a public engagement event offering advice on ways to prevent sewer blockages.

READ THE CASE STUDY
'Top class' comms for Giffnock sewer project

CAMPAIGNS 2022/23

In the last year we have scaled up our programme of proactive community events, where we promote our customer campaigns. At events including the Royal Highland Show, Water Safety Scotland Open Day, Leith Festival and Burntisland Highland Games, we engaged with an estimated 30,000 customers.

Over the winter months we also visited several shopping centres and supermarkets to promote both our Winter preparedness and Nature Calls campaigns. These engagement events also allow members of the public to ask us questions or raise issues with us which are always followed up. Read More.

Independent Customer Group

The Independent Customer Group (ICG) was established by Scottish Water two years ago to challenge and support Scottish Water to bring customer and community perspectives into decision-making. The Group is operationally independent with a direct line of accountability to the Chair of the Scottish Water Board. It has 10 members from a wide range of backgrounds.

ICG CHAIR UPDATE

Learn To Swim

The Learn to Swim framework, a partnership between Scottish Water and Scottish Swimming aims to teach young people how to swim and be safe and confident around water. A total of 37 Leisure Trusts, local authorities and other Aquatic Providers provide Learn to Swim lessons in more than 160 pools, reaching more than 75,000 young people every week. Olympic medallist Duncan Scott and Paralympic medallist Toni Shaw are both ambassadors for the programme. Learn More.

your water your life

Your Water Your Life & Top Up Taps

We continue to expand our network of refill taps and now have 88 delivering fresh water across Scotland. They are helping people stay hydrated on the move, save money and reduce single-use plastic. Use of the taps has potentially saved more than 3.5 million single-use plastic bottles. Locations have been chosen through collaboration and partnership with communities, interest groups and other organisations. In the last year taps have started flowing in areas as diverse as the Meadows in Edinburgh, Trossachs Pier at Loch Katrine, Mabie Forest in Dumfries and Galloway and Drumnadrochit near Loch Ness. The taps are part of our ongoing Your Water Your Life campaign which encourages people to drink more tap water – highlighting how it is good for peoples' health, pockets and the environment.

KNOW THE FACTS

Nature Calls

We are now in the second year of our Nature Calls campaign, which is aimed at achieving a reduction in sewer blockages caused by wipes and other unflushable items in the sewer network across Scotland every year. These blockages can cause flooding of homes and communities with sewage. In the last year we recorded an 8% increase in public awareness that most wipes contain plastic.

The campaign, which includes TV advertising, a newspaper partnership and a range of partnerships with environmental groups and other public bodies, encourages members of the public to only flush the three Ps (pee, poo and paper) and calls on the Scottish and UK governments to ban the sale of wipes that contain plastic. This April the UK Government announced it intends to implement a ban on wipes containing plastic and the Scottish Government has indicated it is seeking to work with Westminster and devolved governments in Wales and Northern Ireland on a joined-up 'four-nations' approach to a ban.

KNOW THE FACTS

Enabling Responsible Access

We are committed to connecting customers and communities to the natural environment by enabling access to our reservoirs. In February we announced the formation of a new team of rangers who will help the public enjoy the environment, protect the natural habitat and promote safety. They are based at Mugdock & Craigmaddie Reservoirs at Milngavie, near Glasgow; at Gladhouse Reservoir in Midlothian; and Carron Valley Reservoir in Stirlingshire.

There has been an increase in the number of people who visit our reservoirs since the start of the Covid pandemic in 2020. Since then we have updated our public messaging, in line with our national campaigns, to raise awareness and encourage responsible behaviour in accordance with the Scottish Outdoor Access Code. While most visitors enjoy visits responsibly, challenges have emerged around anti-social behaviour including wildfires, littering, cutting down trees and protecting wildlife.

Community Empowerment Act

No asset transfers were completed in the last year under the Community Empowerment (Scotland) Act 2015. The act helps empower community bodies through the ownership or control of land and buildings.

Education and Young People

We know how important it is for us to speak to young people, our customers of the future, to teach them about the water cycle and how they can protect the water and waste water networks. Online resources and outreach activities form the cornerstone of our approach.

Our current education initiatives include a partnership with Fuel Change, which brings together high schools and businesses across Scotland to engage young people on driving a positive transition to net zero through skills development. We have also started to expand our learning programme to include an Education Tracker to help us capture our work to fulfil our strategic objective to reach every school pupil throughout their academic journey. The map provides a visual of areas of successful engagement and highlights areas which need further engagement. Read More.

READ THE CASE STUDY
'Top class' comms for Giffnock sewer project

Prospects

We are increasing the amount of data and insight we receive from our assets to prevent service issues before they impact customers. We are installing 2000 smart meters on our water network which will allow us to better understand water demand and leakage. We are also installing sensors on our waste water networks which provide real time data, including water levels in sewers. These sensors have already prevented 21 sewer blockages. We know waste water spills into the environment are a growing concern and are carrying out research to gain insight to help us better understand public sentiment and shape future activity.

We are working to transform how we capture, connect and analyse data, information and sentiment we have, from and about our customers and communities. Our aim is to use this insight to better understand the customers and communities we serve and enable our people to make decisions as if customers were in the room. We have started exploring what this might look like across incident, investment and community engagement activities.

We want to further build our relationships with young people and are developing a Youth Social Impact Programme to inspire responsible water citizens of the future. It will focus on developing young people's appreciation of Scotland's water and environment, tapping into enthusiasm for protecting the environment and encouraging them to take positive action to protect our most precious resource - our nation's water.

We are also working with the Scottish Community Development Centre to refresh our approach to community engagement, in line with the National Standards for Community Engagement. **Click here to view National Standards for Community Engagement | SCDC - We believe communities matter.** A key aim of this work will be to help customers and communities understand the challenges posed by climate change and ageing assets on our ability to continue to provide the services they pay for. Read More.

KNOW THE FACTS

DELIVERING CONSISTENTLY EXCELLENT WATER SUPPLY

Overview

Performance

This year's weather has, like the previous year, posed significant challenges to how we provide water supplies to customers. The dry, hot summer caused algae growth in some water sources, impacting the taste and odour of supplies to some customers. It also caused leakage from our pipes to rise, in part due to dry ground conditions causing pipes to move and burst.

We were also faced with particularly challenging weather in December as parts of Scotland experienced snow and freezing temperatures as low as –11C, followed by a rapid thaw and flooding. This led to a widespread increase in burst pipes, both in our network and also in customers' properties and commercial premises, with customers experiencing a loss of water supply as a result. We implemented learning from previous similar incidents to help us improve our understanding and decision making.

2022 Performance

99.92%

TOTAL WATER QUALITY COMPLIANCE

In 2021 total water quality compliance was 99.93%

SERVICE RESERVOIR SAMPLE FAILS

44
49

Five of the fails in 2022 were at the same site, Darvel in East Ayrshire (In a two-month period due to ingress into a tank)

WATER TREATMENT WORKS SAMPLE FAILS

24
25

There were 25 sample fails at water treatment works, one more than last year

CRYPTOSPORIDIUM DETECTIONS

10
19

There were 19 cryptosporidium detections not mitigated by UV treatment, 9 higher than in 2021

ANNUAL LEAKAGE

459
454

There was an annual average leakage level of 454 million litres a day (ML/D) in 2022/23, a continued reduction from 459 ML/D in 2021/22 this equates to 9,400 litres for every 1 km of pipe length per day

2021 figure 2022 figure

Winter freeze/thaw incidents

The prolonged cold period in December caused us a high number of issues. This was reflected in a significant increase in customer contacts during the latter half of the month. In some areas the increase in demand for water caused by burst pipes led to demand outstripping our ability to supply water and action was required to protect customers.

The quick daytime thaw also led to a deterioration in the quality of water abstracted from rivers, challenging the ability of some of our water treatment works to purify this water at a time when they were servicing high demand. In addition, Ballater Water Treatment Works in Aberdeenshire was flooded by high river flows, with service to customers only maintained by tanker support.

In mid-March significant snowfall prevented our teams from accessing some of our water treatment works, particularly in Shetland. The freezing weather also resulted in bursts in the pipe network which were challenging to access during the wintry conditions. In future we anticipate seeing these conditions more frequently and will need to invest increasing levels to maintain and improve supply system resilience.

KNOW THE FACTS

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Drinking water quality

The quality of water we supplied to customers during 2022 remained high. We carry out regular testing at customer homes, service reservoirs and commercial premises to ensure the protection of public health. Tests taken during 2022 showed a compliance rate of 99.92% which is consistent with the previous year. 2022 was the first year since 2019 we have been able to resume our full testing programme in customers' homes since the pandemic when compliance was also 99.92%.

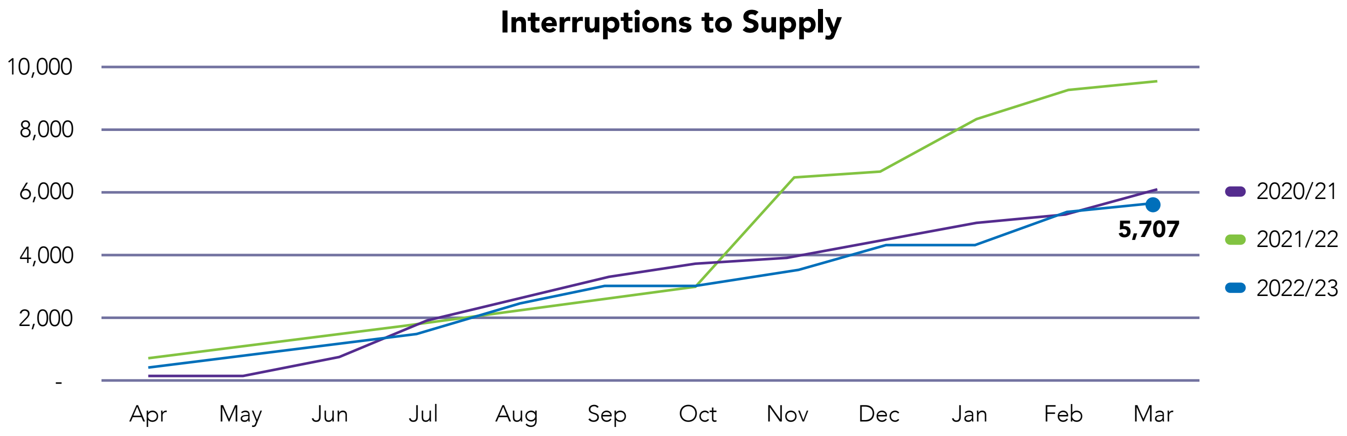
READ MORE ON...
Cryptosporidium

Interruptions to Supply

There were 5,707 unplanned interruptions to supply to properties greater than six hours in 2022/23 which is a significant decrease compared with 9,504 in 2021/22. For most customers we were able to reduce the impact of these events by rezoning our network or using tankers to bring supplies back on quickly while we completed repairs. Like 2021, a lot of the events that exceeded six hours occurred during severe weather events, such as in December, which stretched our normal response capability.

Our improved leakage management technology has helped us detect issues more quickly, meaning burst pipes were found and repaired more quickly. However, we know the weather will continue to bring challenges to the operation of our water networks.

READ THE CASE STUDY
Major burst impacts Scotland's biggest city



Recurring Interruptions to Supply

During 2022/23 a total of 2,281 individual customers contacted us who had experienced three or more interruptions to their water supply in the year or five or more interruptions over the last three years. The majority of these interruptions were associated with the failure of asbestos cement (AC) water pipes which make up around 12% of our water distribution mains. In these incidents there is no risk to public health as a result of any failures. Geographical regions most impacted are Caithness and Sutherland, Dumfries and Galloway, Western Isles, and Aberdeenshire. There is also a high density of AC mains in Tayside and around Glasgow.

AC pipes deteriorate due to our soft waters leaching the lime from the pipe wall resulting in a loss of strength. Once an AC water main starts to burst the rate of failure can increase rapidly, meaning entire sections of pipe need to be replaced rather than repaired. Our current assessment is all AC pipework will reach the end of its usable life within the next 30 years and will have to be replaced. We have started to increase our investment in replacing these pipes.

During the summer we also saw an increase in AC pipe failure associated with ground movement due to drying soils. Changes in climate will mean these conditions become more frequent, potentially further reducing the remaining service life of the pipes.

Leakage

Leakage levels reduced slightly, to 454 ML/d compared to 459ML/d in 2021/22 despite the dry period through the spring and summer months and the freeze and thaw in December. This equates to 9400 litres for every 1 Kilometre of pipe length per day.

We are committed to do all we can to reduce leakage and in the last year have put huge operational effort into tackling this – innovation and digital technology will continue to help us improve monitoring, detection, and repairs. We have also improved our reporting methods and employed a new method of calculating non-household water use at night.

We strive to find the most robust way to report individual component parts of our water balance. These include household and non-household use, leakage, and other water uses such as fire-fighting or operational use (such as flushing the network to maintain it). We recently reviewed our method of calculating non-household night use and concluded it could be improved, as we were using industry standard calculations dating back to 1994, and as a result estimate a more robust night use value for different non-household property types. Through collaboration with Welsh Water, we recognised we did not have a specific enough categorisation of non-household property types and found we were applying lower volumes of water use between 2am and 4am than they - and other companies in the UK. This meant we were underestimating legitimate night use and over estimating leakage. This work helps us identify actual volume consumed which helps us to better target leakage management activity.

Asset equipment failure rise

In line with our forecasts we are seeing an increase in electrical and instrumentation failures at sites, such as equipment used to control pumps, predominantly due to their age and a lack of available spares. The complexity of these assets requires specialists to repair them, of which there are a limited number. We are exploring what our response and recovery capabilities will need to be in the future, to maintain services to customers whilst managing a probable increase in asset failures.

By increasing data capture processes during these incidents, we are increasing our understanding of asset performance and capability. This will allow us to risk assess operational assets and optimise their timely replacement. As we move forward, a higher proportion of our investment will be focused on asset maintenance.
Read More.

New Regulations

Scotland's drinking water quality regulations have been amended to align with the new EU Revised Drinking Water Directive. This has brought in new standards and tightened others from 1 January 2023[11].

We now regularly sample for 20 poly-fluorinated compounds (PFAS/PFOS), often called 'forever chemicals', such as Teflon. We are currently using an external laboratory to undertake the analysis but plan for our own laboratories to be fully accredited later in 2023. Based on previous sampling we anticipated a high level of compliance with these new standards.

A new standard for a by-product of disinfection called chlorate has also been introduced. This is a by-product of disinfecting with chlorine-based compounds. Previous analysis indicates a significant risk around compliance with this standard and we have already seen a number of exceedances of this standard in our monitoring programme. We are investigating how we store and manage the use of our disinfection chemicals to minimise this risk.

[11] The EU Continuity Act 2020 was passed to ensure that EU standards are adopted into Scots Law.

In addition, with changes to the regulatory sampling frequency, risk based targeting and new standards, drinking water quality results for 2023 will not be as easily comparable to previous years, or to other parts of the UK. This is due to the fact we will intentionally focus our sampling on areas where there is a higher risk of failure. Regulatory sampling will primarily give insight into the effectiveness of our approach to water supply risk management. Read More.

READ THE CASE STUDY
Water treatment works of the future

FOCUS

Prospects

In order to deliver consistently excellent water supply we recognise the need to invest significantly more in the resilience and capability of our water treatment and supply systems. We will also continue to improve our response and recovery capabilities, to maintain services when failures occur.

We monitor the performance of our water mains and have criteria for investment based on customer impact. We strive to promote mains renewal in areas where there have been three or more interruptions to supply in a one-year period or five or more interruptions in a three-year period. We have a tiered approach which sets thresholds for investment to ensure the poorest performing water mains are promoted as the highest priority and will continue to evaluate and assess the way we work.

We are currently focusing our increased investment in water mains replacement on areas with high numbers of repeat burst pipes, mainly areas served by asbestos cement pipes. We are installing additional loggers on some of our biggest water mains, notably in Glasgow, to help determine why we are seeing an increase in bursts on these assets. We will use their data to help look for ways to better detect and prevent these incidents in future.

Recent performance issues at water treatment works, following poor source water quality and the failure of some relatively new filters, has highlighted the high level of inspection and maintenance required to ensure these assets reliably deliver the performance expected of them. A programme of asset inspections is underway, with a new delivery partner supporting this. A key area for this programme will be our filters, the primary risk reduction stage in many of our water treatment works.

TRANSFORMING WASTE WATER SERVICES

Overview

Dealing with Scotland's waste water is energy intensive and increasingly affected by climate change.

We need to invest more to keep our assets running effectively, meet our Net Zero ambition and ensure there is enough capacity to enable economic growth. It is a vital part of our service which supports daily life and protects public health and the environment.

2022/23 Performance

INTERNAL SEWER FLOODING

407

364

A total of 364 properties were affected by internal sewer flooding[12]. Properties affected has decreased by 30 from 2021/22.

[12] Last year's recorded figure for the total number of properties impacted by internal sewer flooding was reported as 407. This excluded properties internally flooded due to severe weather. This year, we have included these to better reflect the total number of properties impacted. Had this information been included in 21/22, the total figure would have been 570.

ENVIRONMENTAL POLLUTION INCIDENTS

281

206

There were 75 fewer Environmental Pollution Incidents in 2022/23 compared to 2021/22.

SEWER BLOCKAGES

35,822

36,399

We recorded 36,399 sewer blockages, an increase since 2021/22.

COMPLIANCE AT WASTE WATER TREATMENT WORKS

96.6%

96.2%

We reported a 96.2% compliance rate for 2022/23 compared to 96.6% for 2021/22.

BIOSOLIDS

TON

119,150

120,200

We produced over 120,200 tonnes of biosolids in 2022/23, this is the total from both Scottish Water and PFI operated sites.

2021/22 figure 2022/23 figure

Waste Water Services

Protecting the environment

Our waste water treatment systems handle more than 1 billion litres of waste water each day, treating it and returning it safely to the environment. They are a vital part of the water cycle in Scotland. As a result, the quality of Scotland's water environment is high, and we are committed to invest further, monitor performance at more locations and strive to prevent pollution incidents before they happen. We remain on track to deliver on these commitments.

In the last 12 months issues around pollution of rivers and beaches have gained increasing attention from campaign groups, media and politicians. However, the focus of attention has spread from large-scale incidents to questioning the design and function of the waste water network and treatment processes. Combined Sewer Overflows (CSOs), which have always been a feature of our waste water systems and act as essential safety valves to prevent the flooding of homes and communities, are now seen as unacceptable by some campaigners.

This increased interest and scrutiny of waste water systems comes at the same time that climate change and extreme weather events are placing the network under increasing pressure.

Combined waste water networks, which take both sewage and rainwater from roofs and roads, were never designed to deal with the volumes of water they are now having to deal with. Nor to cope with the level of urban sprawl or the reduction in green spaces which increase the level of rainwater run-off. It will not be possible to address this problem by solely building bigger and bigger sewers, and replumbing the waste water network for entire towns and cities would potentially cost billions of pounds. Cross-sector change will be required to adapt our towns and cities to the impacts of climate change and manage the water environment, reduce surface water flood risk and create water resilient places.

In Scotland, 87% of water bodies have reached 'good' status or better. Under the Scottish Government's River Basin Management Plan 3 (RBMP3) we have committed to playing our part to help achieve a target of 91% by 2027.

In December 2021, we published our Improving Urban Waters Routemap, setting out our plans to invest up to £500 million on improvements to the waste water network, treatment works and CSOs with the aim of reaching the RBMP3 target. This includes a commitment to install 1000 monitors on CSOs to provide better data on spill events. These monitors will be rolled out in the next 12 months following extensive surveys and studies of our CSOs.

We also committed to increase the transparency around the performance of our waste water systems by publishing the data we hold on CSO spills in respect of spill frequency and duration. Understandably, the release of this information has led to further scrutiny of the performance of our network, often from local campaign groups and media.

We fully understand the concerns of environmental campaigners and other stakeholders about the pollution of rivers and beaches and share many of their concerns. The causes of pollution are often complex and varied, with agricultural run-off, industrial pollution, water abstraction for agriculture and industry, for example, all playing a part in rivers being classified as 'poor'. We are working closely with SEPA, the Scottish Government and other stakeholders to help deliver a coordinated response to these varied environmental challenges.

With pressure for further improvements by water companies across the UK continuing to grow, it is important to recognise that the improvements that can be made are limited by the finance available for investment. Any significant further increase in waste water system investment would require to be financed by customer charge increases or additional borrowing.

Operating the waste water network

Extremes of weather can have a significant impact on the operation and performance of waste water networks and treatment works. Dry weather can mean the system does not flush while wet conditions can overwhelm sewers and treatment works and lead to flooding.

There was significant flooding at the end of December when 102 waste water treatment works (WWTWs) were badly impacted, with some totally submerged under water. Many works were not able to operate normally in the days immediately after the rain. The majority were in the South, with Dumfries and Galloway the worst impacted area. Networks were overwhelmed by the volume of waste water entering works and the backing up of rivers through our outfalls which, in some places, overwhelmed flood defences. Teams worked hard to recover the sites as soon as was safe and the impacted works were all brought back into normal operation between one to five days later.

The drier weather in summer also impacted our works as waste water was more concentrated and we had to increase temporary chemical dosing in some areas, made more difficult by some chemical supply issues. Read More.

Waste Water Treatment Work Compliance

The number of waste water treatment works (WWTWs) which failed the Total Compliance measure in 2022/23 is 22 out of 580. This equates to a 96.2% compliance rate, almost unchanged when compared with 96.6%. We are looking at using new technology to collate data which will be used to understand performance and trends and help improve performance.

Sewer Flooding

The total number of properties impacted by internal sewer flooding in the last year was 364. The most significant cause of internal sewer flooding continues to be sewer blockages and collapses, with 329 properties affected in the year, compared to 279 in 2021/22. This year there were 48 properties affected by internal flooding due to overloaded sewers which is significantly lower than 291 properties last year. This is due to a different pattern of rainfall events through this year, where we did not experience the same high number of intense summer storms as 2021[13].

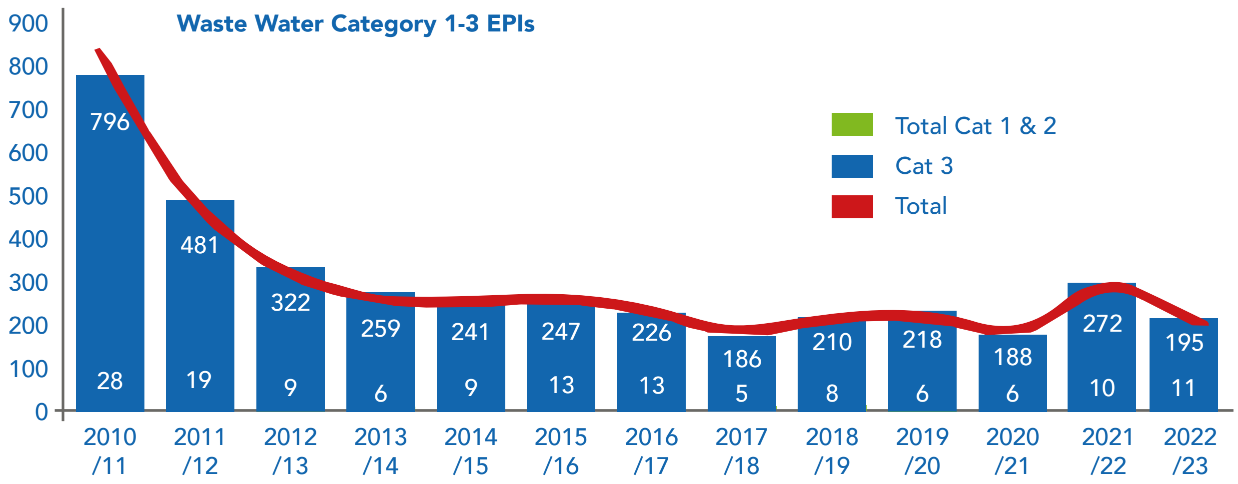
[13] Last year's recorded figure for the total number of properties impacted by internal sewer flooding was reported as 407. This excluded properties internally flooded due to severe weather. This year we have included these to better reflect the total number of properties impacted. Had this information been included in 21/22 the total figure would have been 570.

We investigate every suspected incident of internal sewer flooding due to overloaded sewers and in the last year we have carried out more than 200 investigations. This included a backlog of investigations from 2020/21. The backlog resulted from the high number of extreme weather incidents, plus Covid restrictions which slowed down the ability to carry out the required site activities. The time taken to complete an investigation is now targeted at a maximum duration of five months. Read More.

KNOW THE FACTS

We endeavour to provide long term resolution to customers at the highest risk of sewer flooding but where that is not possible we can implement shorter term mitigation measures such as installing flood doors, smart air bricks and non-return valves. We invested £1.7 million installing mitigation measures at 236 properties in the last year. This was the first year of an enhanced service to customers in all risk categories of internal flooding to ensure they are better protected for intense rainfall events. We have an ongoing programme to deliver installations at 160 properties this coming year.

Last year we completed 18 larger investment projects to reduce the risk of internal sewer flooding to 58 properties and communities ranging from projects to protect individual properties to upsizing the sewer and surface water networks and large-scale projects to prevent flooding to specific communities. This was predominantly areas of cities or towns where flooding has been a repeat issue. The pace of this programme is dependent on the available funding, and next year the pace of this programme will be slowed due to a reduction in available funding.



Environmental Pollution Incidents

In 2022/23 there were a total of 206 Environmental Pollution Incidents (EPIs), including 193 waste water EPIs, down from the previous year's total of 282. In 2022/23 there were a total of 13 water-related EPIs - up from 9 the previous year. Where such incidents occur a full analysis of root cause is undertaken to inform any required improvement plans. Read More.

Improving Urban Waters Routemap Update

Our Improving Urban Waters Routemap sets out steps to achieve improved water quality, increased monitoring and reporting of discharges to all high priority waters, a significant reduction in sewer-related debris in the environment, and reduced spills from the sewer network.

In December we published the first annual update to the Improving Urban Waters Routemap. We have identified and prioritised waste water assets which are impacting water quality and where our network, when spilling, was allowing sewer-related debris (items incorrectly flushed such as wet wipes, sanitary products) to enter the environment. We have started to develop projects to improve water quality and address high priority CSO locations. A full list of these locations is available on our website.

To improve our monitoring capability we have agreed a methodology with our regulator SEPA to identify where we will install monitors for near real time reporting, We are on track with our commitment to install 1,000 new monitors by December 2024.

This methodology is available on our website.

We have also successfully introduced intelligent network monitoring in four catchments, which provides insights into sewer network performance and has enabled a preventative response before the environment and customers are impacted. We are now delivering a second phase of intelligent networks. This is ahead of our Routemap commitment. View Routemap here.

Managing surface water

A growing number of areas, notably towns and cities, are experiencing flash flooding during severe storms. Traditionally, surface water has been drained through underground pipes. The fixed capacity of these drains and sewers can be overwhelmed by short, intense storms or prolonged heavy rainfall. Climate change, combined with population growth and paving over green spaces, is placing an even greater pressure on these networks, leading to an increase in surface water and sewer flooding.

To start to tackle this increased pressure, we have set out a commitment that every flooding and Improving Urban Waters project will actively seek to identify measures that manage surface water before entering the sewer or remove it from the sewer network completely. Progress has been challenging as we work through both the technical and practical requirements of retrofitting these above ground features to store, manage and infiltrate rainwater in communities. Ongoing collaboration with local authorities and buy-in from local communities will be required to enable scaling up of these types of changes.

FOCUS

READ THE CASE STUDY
Nature-based drainage solution to tackle flooding

Bathing Water

Water quality at Scotland's bathing waters is at an all-time high with SEPA figures showing that 38 out of 87 (44%) are rated as 'excellent' ahead of the 2023 bathing season. Overall bathing water quality has consistently improved since 2015, when tighter standards first came into force. This is the highest number of 'excellent' bathing waters ever and is evidence of sustained improvements achieved through partnership projects with a range of organisations and communities. We are committed to supporting the protection and improvement of Scotland's rivers, coastal and bathing waters.

We have continued to work closely with SEPA to deliver temporary and permanent improvements at Ayr South and at Rockcliffe in Kirkcudbrightshire to protect bathing water quality. Over the last year we have provided a private septic tank emptying service at Dhoon Bay which has helped to support that bathing water to achieve sufficient standards for the first time in 5 years. We are carrying out a collaborative study at Lower Largo in Fife to identify potential asset enhancements at this newly designated bathing water and continue to carry out pre-season and ongoing asset checks at hundreds of assets. This will help us to gather data to help us ensure that our operations do not cause water quality issues at Scotland's bathing waters.

Bioresources recycling

Bioresource treatment centres, some run by Scottish Water and some by PFI companies, produced 120,200 tonnes of biosolids in 2022/23. This included a total of 75,499 tonnes recycled to agriculture, 18,035 tonnes used for land reclamation and 394 tonnes disposed of to landfill (less than 1% of the total). We aim to recycle of biosolids in a way that balances cost, greenhouse gas emissions and our circular economy ambitions. Read More.

Prospects

Our waste water network service has been built to respond quickly and effectively to issues reported to us by customers. We are now transforming this to be a predictive and preventative service which anticipates and resolves customer and environmental issues before they occur. To do this we need to improve our real-time understanding of how our networks are operating and reacting to external factors including weather. Our Intelligent Network pilot project has demonstrated real benefits and we are now extending the technology to a further 12 areas.

We are also improving how we use the information we receive from network monitoring to maximise the benefits from it. Our modelling capability will become predictive to allow our control and field teams to plan for weather events before they happen and we will equip our people with the skills and tools to realise this. We will continue to assess the value of this approach to determine whether and where to increase the coverage.

Waste water presents opportunities to recycle resources as part of a circular economy approach and we plan to do more in this area. We are exploring opportunities with our partners to extract and reuse resources recoverable from waste water, such as phosphorus. This will also drive down emissions resulting from waste water treatment and contribute towards achieving our Net Zero emissions commitment. In the next year we will develop pilots to test emerging technologies and markets for resources recovered from waste water.

We will continue to work with partners to jointly plan and deliver innovative solutions to adapt to the changing climate. This will include 'blue-green' solutions to manage stormwater as close to where it lands as possible, to mimic natural drainage, slow down the flow, and where possible stop it entering the sewer network. This approach brings added environmental benefits as well as reducing flood risk.

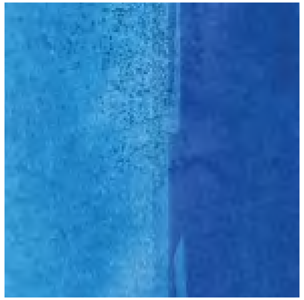
We will also accelerate our work to protect assets from the impact of climate change and maintain and upgrade our ageing assets. All of our plans are subject to available finance and prioritisation of investment.

FOCUS

ENABLING SUSTAINABLE AND INCLUSIVE ECONOMIC GROWTH

Overview

Our investment programme enables economic activity and growth as well as employment, skills development and innovation. The 2021 Hydro Nation report highlighted that the water sector, including our work, is worth £1.7 billion to the country's economy.



Working with developers

We continuously invest in water and waste water assets to enable new housing and other economic development. During the year we completed 22,647 water connections and 21,708 waste water connections. This was a reduction of 1,084 in water connections from 23,731 the previous year and an increase in waste water connections from 21,581.

Development activity has remained high and although we have seen a slight decrease in the number of applications we received compared to the previous year, the volume of properties connected remained relatively stable with a shift in trend to larger-sized developments.

Development Services Satisfaction Survey results for the last year were broadly similar to the previous year, 79.69% compared to 79.32%. There were two less escalations but four more formal complaints – which was up from two in 2021/22 to six last year. Read More.

FOCUS

Working with our supply chain

2022/23 Performance

GOODS AND SERVICES

AROUND

£1 billion

SPENT

In 2022/23 we spent in the region of £1 billion on goods and services - compared to £864.6 million in 2021/22.

OUR SUPPLY CHAIN

75%

SMEs

Of the 400 suppliers in our supply chain, over 75% of our suppliers are Small Medium Enterprises (SMEs) and more than 90% of our spend is on organisations located in Scotland.

Prospects

We have water and waste water assets across Scotland that have existing capacity to serve more customers, while others are already at or beyond capacity. We want to encourage development where we have available capacity and will continue to provide government, local authorities and the development community with visibility of where capacity is available. Where it is not, we will invest to support development and take the lead in increasing capacity in our existing infrastructure where possible to support growth.

Working with developers

2022/23 Performance

WATER CONNECTIONS

23,731

22,647

we completed 22,647 water connections.

WASTE WATER CONNECTIONS

21,581

21,708

we completed 21,708 waste water connections.

2021/22 figure 2022/23 figure

PEOPLE

Overview

We strive to foster a positive culture where our people feel they belong and where we make their safety, health and wellbeing a priority. Our services are delivered around the clock and the continued support of our employees is essential if we are to meet our customers' needs and expectations.

We are a major employer across Scotland and at the end of March 2023 we directly employed 4,473 people. We also rely on an extended network of people who work in our supply chain and partners to help us deliver our services. There are around 2,000 people employed within partner organisations who help support our investment programme and help improve services for customers.

Safety, health and wellbeing

We aspire to create an environment where we always consider the health and safety implications of our actions, continually improve safety standards and reduce the risk of accidents. To achieve this we have refreshed our integrated safety, health and wellbeing strategy, which outlines our aims and key areas for focus. Our ambition is to encourage our people to go beyond zero harm, by creating safe, healthy and productive environments which enable everyone to thrive.

There were two RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations) injuries involving Scottish Water employees, an improvement from the previous two years. There were six RIDDOR injuries involving contractors employed by Scottish Water, an improvement from 12 the previous year. These numbers are amongst the lowest in the UK Water sector.

Lost Time Accidents and RIDDOR Incidents

		Lost Time Accidents	RIDDOR injury
Scottish Water	2022/23	4	2
	2021/22	11	3
	2020/21	5	4
Contractors	2022/23	16	6
	2021/22	17	12
	2020/21	16	7
Total	2022/23	20	8
	2021/22	28	15
	2020/21	21	12

There has been a steady improvement in the important lead indicator of health and safety hazard identification and the number of hazards reported in the last year increased to 2,669 compared to 2,057 in 2021/22. This highlights a greater awareness among our employees and people who work on our behalf of the need to report potential health and safety issues enabling action to be taken to prevent potential incidents.

READ THE CASE STUDY
Gold award for health and safety standards

Absence Rate

Our overall sickness rate for employees over the last year has remained steady at 2.79% - virtually unchanged from 2.78% in 2021/22. Covid remained a significant reason for employees requiring sick leave.

Our Scottish Water Cares monthly bulletin remains a strong route for reaching our employees following its initial implementation during Covid-19 lockdowns, retaining high readership ever since. It offers advice on a range of health issues. Under the same 'SW Cares' identity, we continue to carry out weekly employee surveys to gain anonymous feedback on how people are feeling, enabling insight into key trends at directorate and business-wide level and highlight any concerns to relevant leaders. Read More.

Hybrid Working

Whilst many of our people had the opportunity to work flexibly before the Covid-19 pandemic, with our agile working approach, hybrid working is now firmly established across non-operational parts of our business enabling employees to achieve a work/life balance.

We have seen increasing numbers of office-based employees return to workplaces over the past year, in part encouraged by refreshed office layouts with designs that enhance different ways of working. These include quiet zones, collaboration areas and spaces to enable people to re-connect. Total numbers in our four main offices have stabilised at around 1,800 - 2,000 visits each week. Work is currently underway to shape next steps in our hybrid futures strategy, including how our fixed workers and frontline operational employees might have greater flexibility in where, when and how they work.

KNOW THE FACTS

Apprentice and Graduate Opportunities

This year we launched our biggest ever drive for Modern, Technical and Graduate Apprentices, taking 60 trainees into a range of positions from Engineering to Estate Management. This will ensure we develop the people and skills Scottish Water, and the wider Scottish economy, will need in years to come.

We also have extensive Graduate programmes which are essential in developing our future management capability and some specialist water industry skills. We will take on 45 Graduates this year.

We are monitoring the applicant pools carefully and taking targeted action to ensure that during the selection process we do not lose a disproportionate number from any of our underrepresented talent segments. The numbers and diversity of applicants to our cohort programmes this year has been encouraging.

KNOW THE FACTS

Diversity and Inclusion

By valuing and respecting diverse perspectives we know we can better serve our customers and help employees achieve their professional objectives. An open and inclusive culture is fundamental to striving for excellence in all we do. Scottish Water is committed to equality of opportunity and diversity in employment, including in the way we recruit and reward our employees. We are advancing four key areas to ensure we attract a wide range of people who want to work for us. These areas are defined as Equality Outcomes and progress against them is reported in our biennial Public Sector Equality Duty report. Our current Equality Outcomes were set in 2021 and will be updated again in 2025. Click here to view the PSED report.

As well as building our employer brand to attract diverse talent, we are focused on building positive employee experiences, particularly around times of transition, as we know these are key to wellbeing and retention. We place a strong emphasis on creating learning and development opportunities for employees.

We work hard to encourage and support under-represented groups to apply for roles, build an inclusive work environment and engage, develop and retain diverse talent. Each year our Graduate and Modern Apprentice recruitment campaigns offer the greatest opportunity to balance workforce demographics; however, attracting a diverse applicant pool remains an ongoing challenge for us, particularly for our operational apprenticeship roles in rural geographic locations. We took on 38 graduates into a range of disciplines in 2022 of which 16 were female and a large intake of 51 Modern Apprentices, of which only four were female. The majority of our Graduates and Modern Apprentices will work in STEM (Science, Technology, Engineering, and Mathematics) related fields.

Following a review of our recruitment processes, we have adopted some new practices to attract a more diverse range of people. This includes more considered use of language in recruitment advertising in target areas, partnering with organisations that specifically cater to candidates from underrepresented groups and a focus on adjustments and flexibility, in both our selection process and working practices. We have received positive feedback on our decision to provide all interviewees with a list of questions they will be asked ahead of interviews to make the selection process more equitable for neurodivergent candidates. Read More.

Statutory Trade Union Facility Time

In the last year 2,422.5 hours were used as Trade Union Facility Time, which is paid time-off during working hours for employees who are also trade union representatives, allowing them to carry out trade union duties.

Prospects

We have worked closely with our delivery partners to forecast the skills demand linked to our capital investment programme through to 2027, identifying occupations where there could be a mismatch between skills demand and availability. The current employment market is particularly competitive for project managers and some digital and electrical and mechanical skills. At a corporate level our overall attrition rate has been stable but we have several areas of the organisation where difficulty attracting or retaining scarce skills is causing business challenge.

We place a strong emphasis on creating learning and development opportunities for all employees to help them achieve their full potential. We will continue to develop these opportunities to ensure our people have the skills for our future ways of working. As we continue to transform our business and adapt to the modern world of work, we know our people and our leaders will need to develop new skills, characteristics, and attributes. With an increasingly intelligent asset base (IAB) and digital technology across all of our activities it is vital we continue to develop the digital and analytical skills we need for future success.
Read More.

BEYOND NET ZERO EMISSIONS

Overview - Reducing our Carbon Emissions

Scottish Water has the ambition to be a Net Zero organisation by 2040, five years ahead of the Scottish Government's national target.

This requires radical changes to both operational and investment activities.

In the last year we achieved our emissions reduction target despite a number of significant challenges, including many beyond our control.

We made good progress in reducing our carbon emissions, delivering 15,681 tCO_2e (cumulative) since 2021. In 2022/23 this was 8,253 tonnes and in 2021/22 it was 7,428 tonnes[14].

[14] This relates to our internal initiatives as diverse as peatland management and use of remote monitoring to reduce site visits, which can be equated to a carbon benefit. It does not directly relate to Scottish Water's annual Carbon Footprint.

Our operational greenhouse gas emissions also continued to reduce and our carbon footprint (CFP) was 217,000 tCO_2e - a 6% reduction on the previous year[15]. We set a bold target to reduce operational emissions to Net Zero by 2030 and there is now a risk this may slip because of rephasing of planned capital investment due to constraints on customers charges over the 2021-27 period. Read More.

Electricity remains our largest source of emissions and we continue to look at ways to reduce the amount we use. In the last year we completed energy efficiency projects which will save 6.8 Gigawatt hours (GWh) annually - against our total annual amount of electricity used of 455GWh[16].

15 In our 2021/22 Performance and Prospects we reported our Net Operational Carbon Footprint was 233,000 – this figure was subsequently amended to 231,000 due to under reporting of benefit from renewable exports.
16 This is for Scottish Water usage not including PFI usage.

OPERATIONAL CARBON FOOTPRINT 2022/23
GREENHOUSE GAS EMISSIONS BY SOURCE

54% Grid electricity

Grid electricity breakdown:
Water network 17%
Water treatment 22%
Waste water network 18%
Waste water treatment 28%
Sludge 14%
Admin 1%

26% Process emissions
14% Natural gas
6% Transport & travel
2% Others
-2% Self-generated renewable electricity exports

We delivered cumulative emissions reduction in the last two years of 15,681 tCO_2e which is equal to:

Driving 57 million miles or 34,000 return journeys from Land's End to John O'Groats in an average diesel car

10,000 return flights from London to New York

Renewables

A total of 46GWh of renewable power was generated on-site in the last year, with our PFI partners generating a further 28GWh from biogases produced by waste water treatment processes. Renewable energy sources are a vital part of reducing our operational emissions. We continue to progress the delivery of renewable solar and hydro schemes, with 7.8GWh of new capacity delivered in the last year, a fourfold increase on the previous year.

Nine projects were delivered in the year and the plan is to deliver more than 20 projects in 2023/24 including the construction of our first waste water hydro scheme at Hamilton Waste Water Treatment Works.

READ THE CASE STUDY
Biggest solar project delivered to date

Fleet

Our fleet drove 18.4 million miles on business in the last year (18.5m in 2021/22). We progressed the transition of our fleet and lease vehicles to electric vehicles (EV), taking delivery of a further 79 electric vans and lease cars. We also launched a salary sacrifice scheme which allows employees an alternative route to purchase an EV, and 52 employees have already taken delivery under the scheme. This supports Scottish Government targets to phase out petrol and diesel cars by 2025 and all new petrol and diesel commercial vehicles by 2030.

KNOW THE FACTS

We are also looking to reduce the emissions of our heavy transport with a trial of sustainable hydrotreated vegetable oil (HVO) on some of our tankers. We have also started to use it for temporary power generation on some operational sites. This fuel is already used instead of diesel by some of our contractors in our capital programme.

Carbon Capture

We recognise some emissions will be difficult to reduce with current technology and are planning to mitigate them with carbon capture methods, such as woodland creation and peatland restoration.

We are progressing surveys of all the peatland on our land and will work to either restore it or monitor the peat to ensure it remains in good condition. We have made good progress with screening all of our landholdings for woodland creation. As much of the land is tenant farms, the woodland creation needs to be planned in a way that does not impact the farming activities. We are also engaging community groups on woodland creation schemes. This is proving valuable and has led to a change of focus from woodland creation to biodiversity improvement on some schemes.

As a public body we have a duty to protect and enhance biodiversity on our land and both woodland creation and peatland restoration support this. In the last year we have surveyed 20 operational sites to understand how to improve local habitats and this has led to the installation of bird and bat boxes, hedgerow and tree planting and meadow creation.

Supporting the Hydrogen Economy

Water is vital in the production of hydrogen, a key source of future energy to reduce emissions from fossil fuels. Our subsidiary company Scottish Water Horizons is working with a number of hydrogen production companies to explore where we can help with water supply options. Horizons is also engaged in the design and build of the water network to get the water needed for hydrogen production to site at Whitelee wind farm on the outskirts of Glasgow. The site, owned by Scottish Power, is currently the UK's largest onshore windfarm.

READ MORE ON...
Streamlined Energy and Carbon Reporting

READ THE CASE STUDY
Milestone for Katrine carbon capture

Investment Emissions

Working with our Supply Chain Partners

Investment emissions, the emissions embodied in the concrete, steel and other materials we use, as well as the activities to construct assets, remain an important and challenging part of our net zero commitment. Our focus starts in selecting the lowest carbon option to address a need, we then develop a low carbon design by repurposing existing assets where possible or substituting a high emission material with a lower emission alternative.

We then look to construct with low carbon techniques such as offsite construction, as used at our new Bonnycraig Water Treatment Works in Peebles. We now use lower emission fuels on many sites and have adopted low carbon site set-ups wherever possible.

We are focusing on finding alternatives to steel, concrete, diesel and plastics as these make up over 90% of our investment emissions. We have gained expertise from members of our Construction Expert Panel, made up of executives from our delivery partners. The members bring knowledge of good practices from other sectors and work with us on key technical challenges, such as where low carbon concrete alternatives can be used. Read More.

We have been working with our 400 framework suppliers who provide goods and services for us to develop Carbon Reduction Plans to help better understand the carbon impact of their work and how they aim to reduce it further. Looking ahead we know there remain key technical, behavioural, and commercial challenges across all aspects of investment delivery, and collaboration with our supply partners will be critical in addressing them.

FOCUS

Challenges

In our Net Zero Routemap we recognised we could face challenges in achieving some areas of our plans. Over the last year this has included:

- The pace of delivery of our renewables, energy efficiency and fleet transformation programmes has been impacted by global supply chain issues. In future we will place early orders for key long delivery items to prevent delays.
- Our peatland inventory analysis identified up to 4,600 hectares of peatland that may require restoration to reduce carbon loss. However, complications in negotiating access with a tenant farmer led to us reviewing how we engage with tenants and third-party landowners to ensure their views are taken into account at an earlier stage. Plans are well advanced for the coming year with access agreed in principle at a number of sites.
- We had delivery issues for woodland creation which led to delays to two of four planned schemes. These will now be delivered in 2023/24. We have set up stronger communication with partners to allow closer monitoring of milestones, with a focus on engaging earlier with communities and Scottish Forestry on the design of new woodlands.

Prospects

Over the next year and beyond we will continue to progress our carbon reduction plans in line with our Net Zero Routemap. We will:

- continue to develop, appraise and deliver opportunities to reduce emissions, particularly in energy efficiency, renewable energy and our vehicle fleet;
- work with our partners on the development of hosted wind farms on our land;
- progress the installation of monitors and trial technologies at a number of waste water treatment works to improve our understanding of process emissions and how we might reduce them;
- continue to work with our supply chain partners to introduce low carbon designs and materials and to expand the "art of the possible" in reducing investment emissions;
- continue to develop our pathway to Net Zero investment emissions and build our understanding of the investment needed to achieve this;
- aim to balance emissions that cannot be fully eliminated by completing screening of our remaining landholdings for carbon storage and progressing opportunities to increase tree planting and restore degraded peatland.

As well as our focus on delivery of climate change mitigations to achieve Net Zero, we are also working on understanding what we need to do to adapt to climate change. We are updating our climate change risk assessment and will publish a Climate Change Adaptation Plan later this year.

FOCUS

TASK FORCE
ON CLIMATE RELATED FINANCIAL DISCLOSURES (TCFD)

Overview

Scottish Water aims to lead the way in delivering a flourishing Scotland. We are committed to achieving Net Zero, increasing resource efficiency, adapting our services to climate change and being socially sustainable in everything we do. As such, we fully support the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD); with this being the first year in which we will report on the recommendations.

TCFD requires disclosure of information aligned to its core four elements – governance, strategy, risk management, and metrics and targets. In reporting TCFD we aim to improve our disclosure of climate-related risks and opportunities and provide stakeholders with the necessary information to undertake robust and consistent analyses of the potential impacts of climate change. We recognise the value that the recommendations bring, and we continue to seek to align and enhance our climate-related disclosures.

The environment is integral to everything Scottish Water does; from source to tap and sink to sea, we depend on the Scottish environment to enable us to effectively undertake our essential services. As such, climate considerations are embedded into our everyday activities. Throughout this report we include material that responds to the TCFD recommendations, to summarise our approach and guide the reader to the relevant sections. Pages 52-55 provides an index aligned to the core four elements.

Recommended Disclosure

Governance

Disclose the organisation's governance around climate-related risks and opportunities.

DISCLOSURE DETAIL

Disclosure Overview

Ministerial Objectives

Scottish Ministers set objectives for Scottish Water for each regulatory period. For the 2021-27 period Ministers set expectations in relation to adaptation to and mitigation of the global climate crisis. These include:

- identify the impacts of climate change on assets;
- prepare and implement plans for adaption measures necessary to protect services;
- make substantive progress in the 2021-27 period towards the climate change targets, and ensure an appropriate trajectory to meet or exceed those targets;
- work with customers and the wider industry to support measures that reduce water use in homes and businesses and help ensure that only appropriate items are flushed down the toilet or put down the sink.

Board Oversight

Accountability for climate related activities resides with the Scottish Water Board. The Board sets the strategy and direction, routinely reviews key activities and monitors timeous and effective progress toward objectives. In doing so, Board members bring a diverse range of skills, expertise and experience spanning a number of sectors and industries.

The **Audit & Risk Committee** considers the key climate related threats and opportunities to which the organisation may be exposed. The Committee assesses the appropriateness of mitigating strategies and evaluates the effectiveness of internal control systems.

The **Remuneration Committee** determines executive reward levels which in turn informs associated employee compensation terms. This includes incentive schemes designed to reward out-performance and, as agreed with the Scottish Government in 2020, such schemes incorporate targets for all employees that are directed towards meeting our Net Zero ambitions.

Role of Management

The Executive Leadership Team (ELT) is responsible for oversight of climate change activities within Scottish Water, led by the Director of Strategic Customer Service Planning. The ELT is further advised by the Zero Emissions General Manager.

Since 2010 carbon and climate change considerations has been increasingly built into management and business decisions. Our investment decision making processes have been updated to consider the cost and carbon impact of options to address a need.

Where possible, the lowest cost/carbon option should progress. In developing options, project teams will consider climate risks as relevant, for example rainfall levels when sizing reservoir yields or in flooding projects.

Recommended Disclosure

Strategy

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.

Disclosure Overview

Scottish Water's **Strategic Plan, A Sustainable Future Together**, outlines Scotland's Water Sector Vision and highlights the considerable challenges faced from the global climate crisis.

Climate Change Mitigation

The Strategic Plan highlights our strong contribution to Scotland's emissions' reduction. We seek to achieve this through renewable energy generation and energy efficiency, our ambitious plan to secure Net Zero emissions by 2040, and going beyond that thereafter. Our **Net Zero Routemap** sets out how we will seek to achieve this which includes radical action, transformative change and additional investment.

Climate Change Adaptation

Climate change will impact across the water cycle, from changing the quality of the source waters that we treat to provide drinking water, through to dealing with the extremes of flooding and drought.

We expect to publish an overview of our **Climate Change Adaptation Plan** in late 2023.

Work has also commenced to review existing **Climate Change Risk Assessments**, and to set out the climate change strategy and plans to inform future investment. Scottish Water is following the guidance of the UK Climate Change Committee (CCC) to assess risks across a 2-4°C warming range by the 2080s. Alongside this, consideration is underway to develop scenarios of the long-term financial impacts of climate change.

DISCLOSURE DETAIL

Recommended Disclosure

Risk Management

Disclose how the organisation identifies, assesses, and manages climate-related risks.

DISCLOSURE DETAIL

Disclosure Overview

Corporate Risk Management Process

Scottish Water operates an integrated **risk management framework** which supports the identification, analysis and management of risks across the business. Climate related risks are encompassed within this approach. The most significant climate-related risks are documented within Scottish Water's Corporate Risk Register.

Scottish Water reports its **Principal Risks** within the Annual Report & Accounts each year, which includes Climate Change risk. It should also be noted that a number of other principal risks can be influenced or exacerbated by climate-related challenges. As part of enhanced TCFD reporting for 2022/23, a **subset of risks on Climate Change** is provided to enable stakeholders to understand the key areas of threat and opportunity. These risks are representative of current knowledge and concerns.

Climate Change Risk Management

Many of our existing processes and activities consider climate related risks and the management of these as business as usual. For example, asset planning considers the changing environment in which the assets operate and the future performance that may be required. This incorporates both internal and external views of climate risks and the latest modelling available.

Scottish Water undertook its first risk assessments for climate change across 2010-2015. We are currently in the process of updating our **Climate Change Risk Assessment** using the 2-4°C scenarios recommended by CCC; this will help us to focus on further work to ensure services remain resilient. Similarly, our **Climate Change Adaptation Plan** is under development. Once complete, it will provide an overview of risks and our approach to mitigate across our services.

Business Risk Management Process

In support of the Corporate Risk Management process, detailed climate-related risks are captured within Functional Risk Registers; with operational risk detailed in specialist registers and systems. The requirement to identify and assess climate related risks is embedded within existing business as usual practices, with each business area identifying climate-related risk specific to their objectives.

Overview of aggregate risk and potential areas of compounding is routinely considered with overarching risks noted within the Zero Emissions Risk Register. Escalation to the Corporate Risk Register may occur from individual risk registers or via the **Zero Emissions Risk Register**, where appropriate thresholds are met.

Recommended Disclosure

Metrics & Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

DISCLOSURE DETAIL

Disclosure Overview

Business Performance Metrics & Targets

As part of our quarterly business performance reporting, we detail our journey towards Net Zero which includes YTD actual **Operational Emissions Benefit (tCO_2e)** against our annual targeted range. These indicators also influence annual out performance rewards to our people.

Risk Management Metrics

Corporate and Functional Risk Registers assess risks using a **5x4 risk matrix** which aids in the prioritisation and escalation of risks throughout the organisation. Consequence criteria consider impacts across a number of different areas which may be climate-related including water quality, environment, health & safety and finance.

Greenhouse Gas Emissions

Within the 2022/23 Performance & Prospects Report, Scottish Water has reported on both our **operational Carbon Footprint (CFP) and Streamlined Energy & Carbon Reporting (SECR)** which are UK Government Requirements.

Scottish Water's operational emissions are summarised in the following table, and broader detail regarding our emissions are provided in the Net Zero Emissions section of this report.

	2022/23 report year (tCO_2e)	2006/07 baseline year (tCO_2e)
Scope 1	39,517	36,008
Scope 2	88,839	279,581
Scope 3	92,606	146,735
Total gross operational emissions (reported to the nearest kt)	221,000	462,000
Exported renewables	-4,122	0
Total net operational emissions (reported to the nearest kt)	217,000	462,000

Related Targets

Annually, Scottish Water reports on **operational and investment emissions**, tracking progress to Net Zero. This is focused on showing progress in four key areas of: becoming more energy efficient, using lower carbon energy products, embracing low carbon construction and storing away emissions that cannot be avoided.

As the routemap has developed Scottish Water has been supported by an **expert advisory panel** which has helped test and shape thinking. The panel will continue to support

GREAT VALUE & FINANCIAL SUSTAINABILITY

INVESTING FOR THE FUTURE

Our investment programme is one of the largest infrastructure programmes in Scotland – delivering the vital assets that enable us to maintain and improve the water and waste water services people depend on every day – and supporting growth and development to ensure that communities can flourish. And we are investing at record levels. As we all know Scotland's communities can only flourish with the fit-for-purpose infrastructure – cities, towns and villages need our below ground pipes and our treatment works to be future proof.

In the last year we have significantly increased the amount of planned investment delivered - we invested to £694 million, up from £623 million in 2021/22. When we include responsive repair and refurbishment expenditure it was £886 million, up £92 million on the previous year.

The significant year-on-year step up in investment has only been possible by upskilling our people and working in collaboration with our supply chain partners to bring in new skills and greater capacity into the construction sector. Innovation has been key, embracing the benefits brought from digital construction rehearsals; offsite manufacture; new water and waste water technology; and innovative construction techniques. This has been done in parallel with addressing the challenge of reducing embodied carbon, with our partners trialling Net Zero construction sites. In addition, Scottish Water and its partners have taken the opportunity to engage with communities before, during and after the delivery of projects. This helps to enhance our reputation in communities and leave them with knowledge of the importance of their local infrastructure.

Much of our planned investment has been in the refurbishment and replacement of existing assets to continue to deliver a high level of service to our customers. Many of these assets have been in place for a long time and modernising them in line with circular economy principles means they will continue to function for many more years.

However, we have also invested significantly in adding to our asset base to enhance water quality, environmental performance and to facilitate growth.

For example, we invested in a new waste water treatment works at Winchburgh in West Lothian. Winchburgh is expanding with new housing and new schools. Consequently, it needed a new waste water treatment works. New technology is being applied for the second time in Scotland – Nereda. This allows treatment to be provided for a smaller land take and significantly less carbon. Above ground steel tanks have been installed rather than below ground tanks – an innovation that again significantly reduces carbon. Much of the plant has been built in factories and transported and assembled at site following many months of planning and digital construction rehearsals.

- **Tier 2 Investment** - this is our planned capital investment - total for year: £694 million
- **Tier 1a Investment** - this is responsive repair and refurbishment of assets – total for year: £192 million.

During 2022/23 a total of 7,708 projects - an average 21 projects each day - were delivered. This is the largest number to date. The increase in the number of projects is due to the rise in investment in refurbishing our existing assets where multiple smaller projects are needed. All of these projects of course are supported by our engineers, operational employees and supply chain partners. Our people deal with multiple smaller value projects as well as our major £20 million plus significant construction projects.

This level of investment and associated increase in the number of live projects was aided by continued improvements to our processes and engagement with our delivery partners and communities. This helps us to do all we can to ensure the project delivery cycle is as efficient as possible. Along with our partners we set ourselves an aspiration to 'get to site in half the time' to enable the ramp up of investment levels and projects. Read More.

We have also piloted some productivity improvements with the aspiration of 'get off site in half the time' to allow us to deliver more improvements whilst maintaining quality and safety. This is an exciting initiative looking to tackle productivity in the construction sector with our partners by working in a more integrated way. Read More.

FOCUS

Delivering our capital programme

Key to the delivery of our capital investment programme is the skills, capacity, and experience of our own teams and those of our investment delivery partners.

We have approximately 400 supply chain partners and we are committed to supporting Scottish and UK businesses wherever possible, with over 90% of our procurement spend going through businesses based in Scotland and 75% of our supply chain classified as small or medium-sized enterprises.

In the last year we spent in the region of £1 billion - up from £864.6 million the year before - on goods and services, with a wide economic impact in terms of the numbers of job opportunities created, including many for young people. Our procurement strategies aim to create, support, develop and evolve a resilient, sustainable, and growing supply chain in Scotland.

FOCUS

Investment delivery risks and challenges

Construction market conditions have received a lot of media attention over the last couple of years – from the price of building materials, through to the availability of electrical components globally, shortage of HGV drivers and constraints with experienced people in the UK and beyond. Scottish Water's capital programme has not been immune to these issues. Consequently, in the last year we have faced a range of risks and challenges to the delivery of our capital investment programme, including construction market conditions, construction risks, third party risks and the availability of some material and labour. Inevitably this has meant the delivery of some projects has been impacted and project completion timelines have had to be adjusted resulting in some customer benefits coming later than planned. Key issues experienced, with mitigating actions put in, included:

- price and availability of materials and commodities – Scottish Water has frameworks in place for all key materials and in the last year prices fluctuated significantly, resulting in an aggregate increase in costs of circa 1.5% above CPI inflation. Through our frameworks, strong relationships and forward planning we have been able to mitigate a lot of delays and cost impacts but not all;
- certain key materials, particularly microchips and electrical components for our motorised control systems, are on significantly longer lead times of up to a year. Projects in delivery have been impacted, and for projects in the design phase resequencing has been put in place along with advance procurement;
- our delivery teams have had to alter our delivery processes to facilitate resequencing of project design, planning and procurement to cater for fluctuating prices and materials shortages;
- our delivery partners have also experienced higher than normal employee turnover levels and some shortages. We are working closely with them on skills requirements and recruitment strategies including increasing the recruitment of Graduates and Apprentices. Strategic demand forecasts have been developed to ensure we have the right skills for the future, a big collaborative effort with our partners and trade bodies.

An example of a project impacted by some of these risks is our project to upgrade the water treatment works at Invercannie, near Banchory, one of the largest projects in our capital programme. Read More.

Our positive relationships with key partners have allowed us to navigate many of these challenges, and although some projects have been delayed, overall our programme is still on track and we are ahead of our delivery commitments. We constantly review risks and challenges and implement lessons learned for future projects to try to reduce or prevent delays and cost increases where possible.

READ THE CASE STUDY
A blueprint for future works

READ THE CASE STUDY
Innovative island water supply for Stronsay

READ THE CASE STUDY
Circular Economy

Investing in our communities' futures

Customers generally accept the need for work on water or waste water projects in their area and appreciate it may cause some disruption. We engage with our customers and communities to ensure they are informed and understand the need for our projects. We want to improve our engagement with them, increasingly speaking to them earlier in our investment planning so that we can consider their thoughts, ideas and concerns in our decision-making process.

For every major capital investment project we devise engagement plans well in advance of any work starting. This outlines how we will engage with communities, when, where and why, throughout the entirety of the work.

FOCUS

Prospects

We are committed to increasing our levels of investment year-on-year over this regulatory period. We plan to build on the increased investment levels and customer benefits delivered this year and to continue to increase the pace of investment. We expect to see more asset failures in future, impacting the services we deliver to customers and communities. Investments will continue to be prioritised to achieve the best customer and environmental benefits possible.

To deliver ever-increasing investment levels we will continue to grow capability and capacity in Scottish Water and with our partners. Innovation will be key and we show-cased multiple innovations at our supply chain conference in March this year and our partners continue to bring us new innovations regularly. This has included using recycled plastic kiosks, simplified control panels to reduce size, cost and complexity. We will continue to deal with challenging market conditions, including high inflation and scarcity and rising costs of some materials.

We will monitor our business performance, risk to service, actual level of investment and costs. These insights will help us manage our investment policies for future years to manage service levels and risks. We expect a further increase in our annual investment with a forecast for 2023/24 in the region of between £855 million to £995 million. Read More.

TRANSFORMING HOW WE WORK

TRANSFORMATION

Overview

Our ongoing work to transform how we operate is essential to ensure we are able to increase investment, maintain services to customers and protect the environment in the face of climate change and the deterioration of ageing assets.

Our Plan for Transformation is made up of a number of different elements that all play a key part in helping us ensure our services are fit for the future. At the same time we know we must continue to perform at the highest level possible while we transform.

A number of initiatives are already delivering service benefits, these include work to reduce and ultimately prevent pollution incidents and also to provide quicker delivery of investment in our assets.

Benefits to date since the launch of our Transformation plan in September 2021:

SWIFT

We are replacing our scheduling system with new technology which sees more accurate data passed to our field teams, allowing them to resolve customer issues at a faster pace with more first-time fixes. This has saved around £680,000 to date.

EXEMPLAR

We are optimising 17 of our largest waste water treatment works using real time information to optimise energy usage, maintenance requirements and to understand performance of our assets to operate them as efficiently as we can. This has so far saved more than 370,000 kWh of energy.

INTELLIGENT WATER NETWORKS

We are installing 2,000 smart meters on our networks to enable us to better understand demand and leakage. This insight has seen us defer £12 million of capital investment to date.

INTELLIGENT WASTE WATER NETWORKS

300 sensors on our sewer network are helping us better understand its performance and to take preventative actions to protect the environment and our customers. This has so far prevented three pollution incidents, two bathing water spills and 21 sewer blockages.

NON-COMPLEX SERVICE DELIVERY

A pioneering app which allows our teams to promote small value capital work, means we can maintain service and deliver our programme more efficiently. To date almost 10,000 needs have been raised and approved and around £600,000 benefits realised since it began in 2021. We are the only UK water company using this technology.

INVESTMENT MANAGEMENT

We have 143 projects going through a new process to help us and our delivery partners get to site quicker which is resulting in lower cost of these projects, carbon improvements and driving customer benefit more quickly than before.

DIGITAL CONNECTIVITY

More than 100 water and waste water sites have had internet connections improved under a 'Getting Customer Service Delivery Connected' initiative. This will ensure portable Wi-Fi and other technology and applications are available for our field teams in rural and remote areas.

Future Transformation projects include:

- more monitors on the water network to help us reduce risks to supply and make it quicker to locate bursts when they happen. This includes placing monitors upstream to enable us to quickly take proactive action to prevent customer issues.
- upskilling our workforce in analytics to help us better understand new data which will be made available across the organisation; to help deliver quicker, smarter resolutions to issues and improve our decision making.
- customer focused improvements in Development Services targeting end to end processes with the aim of reducing complaint volumes, reducing overtime by simplifying and removing processes and increasing productivity.

VIEW OUR STORY

KEEPING CHARGES AFFORDABLE

Overview

Water and waste water charges support service delivery and essential investment in the vital infrastructure we are responsible for. The twin challenges of climate change and ageing assets means investment levels must increase in future to maintain service levels and allow the investment needed so that future generations receive similar levels of service to those we receive today.

Customer charges

When setting the customer charge levels for 2023/24, and following discussions with the Scottish Government, we agreed to limit charge increases to 5%. This was significantly below the October 2022 CPI inflation figure of 11.1%, the benchmark month we use for charge-setting.

The charges were set after extensive discussions with the Scottish Government to balance the need for future investment to protect services that Scottish Water provides with the current significant economic challenges faced by many people and businesses across Scotland. As a result of this, the finance available for investment in the current regulatory period will be around 10% (£0.5 billion) lower than expected at the start of this 2021-27 period. This will delay the delivery of some aspects of our investment plan.

Our discussions with the Scottish Government confirmed its commitment to the future finance needed to deliver remaining agreed investment across this current regulatory period. This included recognition above-inflation annual customer charges increases will be needed given the decisions on charges taken in the first three years of the 2021-27 period.

Around half of households in Scotland receive a discount, exemption or reduction applied to their water and waste water charges due to their circumstances.

Water and waste water charges to LPs who supply businesses and other non-household customers also increased by 5%.

Prospects

We are conscious that increasing charges to pay for additional investment in the nation's public waste and waste water network must take account of the economic circumstances faced by people and businesses across Scotland. However we recognise too that these tough conditions may continue to be challenging for some time.

Further and continued investment is vital if we are to deliver our investment programme and ensure our service is fit for customers today and in the future. Read More.

FINANCIAL SUSTAINABILITY

Scottish Water's regulated business supplies water and waste water services to households and is also the wholesaler to the 24 retailers (Licensed Providers) who operate in the water retail market for businesses in Scotland.

Our subsidiary Business Stream operates as a Licensed Provider competing with other Licensed Providers in the Scottish and English markets to supply water and waste water retail services to business customers.

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

The group also provides non-regulated commercial services primarily through Scottish Water Horizons Holdings Ltd. From December 2018 to 1 October 2022, it owned the companies that operated the four former PFI waste water treatment works in North-East Scotland, under contract to Scottish Water who paid a service fee to Aberdeen Environmental Services Ltd. In September 2022 the external bank debt held by Aberdeen Environmental Services Ltd, including swap break costs was repaid and on 1 October 2022 the Aberdeen Environmental Services group of companies were folded into Scottish Water's waste water operations.

An overview of Group performance is provided below. Performance on the three main business segments covering regulated services, Business Stream and non-regulated services is detailed on pages 65 to 78.

Financial Performance – Group Overview

The tables opposite summarise the key components of surplus before tax, investment and cash by trading segments with expanded commentary provided on the individual trading segments opposite.

The group surplus before tax for the year to 31 March 2023 decreased by £30 million to £61 million (2022: £91 million). This was due mainly to a £13 million reduction in Scottish Water regulated activities and a £9 million reduction in Business Stream which were driven by operating costs rising faster than revenue.

The table opposite summarises consolidated capital investment by trading segment compared to the previous year.

In the year to 31 March 2023, consolidated net debt increased by £265 million to £4,022 million. The increase was driven by a £170 million decrease in cash balances to £487 million and net new borrowing in the year of £95 million to £4,509 million. The movements are summarised in the table opposite by trading segment.

These cash balances have been committed for future investment delivery or are required for working capital.

The table below summarises the key components of surplus before tax, investment and cash by trading segments.

	Scottish Water Regulated £m		Business Stream 'Group' £m		Horizons 'Group' £m		Inter-Company eliminations £m		Consolidated Total £m	
	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22
Revenue	1,365	1,285	657	629	35	50	(220)	(231)	1,837	1,733
Operating Costs	(1,155)	(1,051)	(654)	(616)	(26)	(41)	209	227	(1,626)	(1,481)
Operating Surplus	210	234	3	13	9	9	(11)	(4)	211	252
Finance Costs	(150)	(161)	1	-	(1)	-	-	-	(150)	(161)
Surplus before Tax	60	73	4	13	8	9	(11)	(4)	61	91

The table below summarises the key components of surplus before tax, investment and cash by trading segments.

	Scottish Water £m		Horizons 'Group' £m		Consolidated Total £m	
	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22
Investment	645	581	9	7	654	588

The movements are summarised in the table below by trading segment.

	Scottish Water £m		Business Stream 'Group' £m		Horizons 'Group' £m		Consolidated Total £m	
	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22
Cash	390	516	53	97	44	44	487	657
Debt	4,509	4,383	-	-	-	31	4,509	4,414
Net Debt	4,119	3,867	53	97	44	13	4,022	3,757

Scottish Water - Regulated Services

Performance compared to plan and the Final Determination

The financial performance of Scottish Water's regulated activities is measured on a regulatory accounting basis, which includes items subject to a long-term normative charge (LTNC)[1]. The following tables and commentary have therefore been presented on that basis. Reconciliations to Scottish Water's statutory accounting basis is set out in the 'Financial Summary of Year-on-Year Performance' section below.

The Regulated Income & Expenditure Statement and Capital Investment for the year to 31 March 2023 compared to the Final Determination (FD)[2] is presented below.

Scottish Water's Regulated Income & Expenditure Statement	Actual 2022/23 £m	WICS financial model underpinning FD 2022/23 £m	Inc/(dec) 2022/23 £m	Cumulative inc/(dec) 21-23 £m
Total revenue	**1,385**	**1,411**	**(26)**	**(39)**
Regulatory operating costs	(416)	(609)	16	14
PFI costs	(177)			
Interest charges	(136)	(175)	39	55
Costs before items subject to LTNC	**729**	**784**	**55**	**69**
Total available to support investment before LTNC items	**656**	**627**	**29**	**30**
Responsive repair & refurbishment costs	(215)	(263)	48	75
Developer contributions	(30)	(34)	4	4
Tax paid	(30)	(5)	(25)	(45)
Total LTNC Items	**(275)**	**(302)**	**27**	**34**
Surplus after charging LTNC items	**381**	**325**	**56**	**64**

1 LTNC Items - Responsive repair and refurbishment costs, developer contributions and tax.
2 Updated for outturn inflation and realignment of operating expenditure. After the Final Determination was published, Scottish Water realigned operating expenditure to reflect improvements to its systems of cost capture. This change has the effect of reducing the allowed for operating expenditure by c. £50 million per year and increasing the allowed costs for responsive repair and refurbishment expenditure by c. £50 million per year.

Revenue

Revenue for the year out-turned at £1,385 million, £26 million lower than anticipated in the Final Determination. This was due to charge increases being aligned to CPI inflation for 2022/23 and being at CPI inflation plus 1.8% for 2021/22 rather than being 2% above CPI each year, as assumed in the Final Determination. Consequently, revenue on a cumulative basis since the start of the regulatory period, was £39 million lower than that anticipated in the Final Determination.

Operating Costs, PFI and Interest

Costs before items subject to LTNC for the year were £729 million which, relative to the Final Determination, were £55 million lower. Exposure to increased inflation was managed effectively, mainly due to our electricity procurement strategy which enabled the forward purchase of our electricity requirements before the start of the 2022/23 financial year. Savings from the folding in of the Aberdeen Environmental Services group of companies into Scottish Water's waste water operations helped offset the impact of PFI costs indexed to gas prices. Lower net interest charges also improved performance. However, as set out in the Prospects section below, increased electricity costs and other inflationary pressures will impact our performance in 2023/24.

Costs before items subject to LTNC, on a cumulative basis since the start of the regulatory period, were £69 million lower than that anticipated in the Final Determination.

Long-Term Normative Charge Items (LTNC)

Responsive repair and refurbishment expenditure is difficult to predict over a short-term time horizon as there can be significant variability in the annual level of expenditure associated with, for example, significant water main bursts or collapsed sewers. A LTNC has been applied to remove variability with the expectation that the long-term normative charges will balance with actual expenditure incurred over the 2021-27 period.

Actual expenditure in the year to 31 March 2023 for responsive repairs and refurbishment was £192 million compared to the LTNC charge for the year of £215 million, which itself was £48 million lower than the Final Determination assumption of £263 million. Cumulatively, the LTNC for responsive repairs and refurbishment were £75 million lower than the level assumed in the Final Determination.

Developer contributions and taxation may also experience significant annual variability and hence we have adopted a similar normative charge approach in these areas with normative charges of £30 million per annum for developer contributions and £30 million per annum for tax paid. In the year to 31 March 2023 actual expenditure was £33 million and zero respectively. Consequently, total actual expenditure on LTNC items in the year was £225 million, £50 million lower than the LTNC.

As we progress through the 2023-27 period rebasing of LTNCs will be required to reflect actual expenditure trends and up-to-date forecasts. These updates will be highlighted within our interim and annual reports.

Surplus to support planned investment

The total available to support planned investment after charging for LTNC items for the year was £381 million. This was £56 million higher than that anticipated in the Final Determination for the year, due to lower costs more than offsetting the lower revenue. Cumulatively since the start of the regulatory period, the surplus to support planned investment was £64 million higher.

Capital Investment

Our gross planned investment, on a regulatory accounting basis, in the year was £694 million, which was £49 million or c. 6% higher than our plan. When combined with responsive repair and refurbishment costs, total regulated investment was £886 million in the year. The table opposite compares performance to the investment expectations in the Final Determination.

Investment on a regulatory accounting basis	Actual 2022/23 £m	Final Determination 2022/23 £m	Inc/(dec) 2022/23 £m	Cumulative inc/(dec) 21-23 £m
Planned investment	694	521	173	(31)[3]
Responsive repair & refurbishment costs	192	263	(71)	(161)[4]
Total	**886**	**784**	**102**	**(192)**

Prospects for 2023/24

We remain committed to delivering our Strategic Plan; increase investment to replace our ageing assets; achieve our net zero ambitions and take all possible steps to drive for further efficiency to reduce our expenditure; and targeting at least a 1% year-on-year real reduction (CPI-1%) in line with the challenging target set in the Final Determination.

The planned regulated income & expenditure for the year to March 2024 compared to the Final Determination is presented below.

Scottish Water Regulated Income & Expenditure Statement	Plan 2023/24 £m	Final Determination 2023/24 £m	Inc/(dec) 2023/24 £m	Cumulative inc/(dec) 21-23 £m
Total revenue	**1,458**	**1,608**	**(150)**	**(189)**
Regulatory operating costs	(484)			
PFI operating costs	(177)	(636)	(25)	(11)
Interest charges	(142)	(184)	42	97
Costs before items subject to LTNC	**(803)**	**(820)**	**17**	**86**
Total available to support investment before LTNC items	**655**	**788**	**(133)**	**(103)**
Responsive repair & refurbishment costs	(215)	(275)	60	135
Developer contributions	(30)	(35)	5	9
Tax paid	(20)	(5)	(15)	(60)
Total LTNC Items	**(265)**	**(315)**	**50**	**84**
Surplus after charging LTNC items	**390**	**473**	**(83)**	**(19)**

3 In 2021/22 planned investment (excluding completion) was £505 million, £31 million lower than the Final Determination Level. Completion investment in 2021/22 was £118 million, £173 million lower than the Final Determination level.

4 In 2021/22 responsive repair & refurbishment costs were £152 million, £90 million lower than the Final Determination Level.

Customer charges for 2023/24 have increased by 5% after extensive discussions with the Scottish Government, balancing the impact of the cost of living crisis on our customers with our future investment needs to protect services. The increase is 8.1% below the expected level in the Final Determination for 2023/24. So, to remain aligned with the funding levels in the Final Determination, future charges will need to increase significantly from 2023/24.

Our operating costs will increase in 2023/24 due to higher electricity costs (53% of our electricity costs are exposed to market prices with the other 47% being secured with forward power purchase agreements) and both our operating and PFI costs will increase due to the impacts of inflation. Consequently, we are monitoring energy prices closely as well as inflation forecasts covering our key supply chain requirements. However, relative to the Final Determination, these pressures will be offset by lower net interest charges and further efficiency improvement. So we are planning to outperform costs, before items subject to LTNC, by £17 million in 2023/24.

For LTNC items in 2023/24 we have maintained the level for responsive repair and refurbishment at £215 million. This is broadly the middle of our forecast range for responsive repair and refurbishment over the 2021-27 period of £1.15 billion to £1.45 billion[5], which is slightly lower than the Final Determination assumption of £1.55 billion[6]. We have also maintained the level for developer contributions. Tax payments have been reduced to £20 million reflecting lower forecast tax payments[7].

Net new borrowing from the Scottish Government in 2023/24 is planned to be £196 million. This includes additional Government borrowing of c £25 million to replace the £31 million external bank debt repaid held by Aberdeen Environmental Services Ltd. The Scottish Government has confirmed that this is appropriate given that, at the time of acquisition, Scottish Water's gross borrowings were reduced to reflect the external bank debt being included within Scottish Water's borrowing cap. As such, Group total borrowing will remain unchanged.

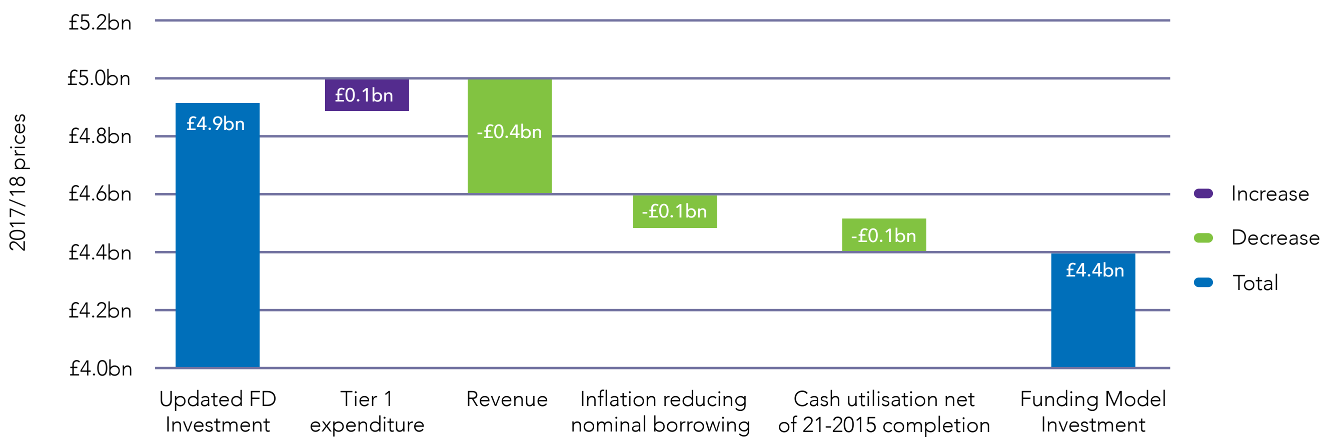
5 In 2017/18 prices this is a range of £0.9bn to £1.2bn
6 £1.3bn in 2017/18 prices
7 Plan for 2023/24 was finalised prior to the Budget in March 2023. If the 100% capital allowances for new plant and equipment are confirmed then forecast tax payments to 2026/27 will drop to nil.

Over the 2021-27 regulatory period, our expectation is that our costs before LTNC items, will be c. £0.1 billion in alignment with the Final Determination to achieve real charge increases of 12.6% over the regulatory period, this will require significant increases above inflation for the last three years of the regulatory period as shown in the table opposite.

However, due to the profile of charge increases, revenue will be c £0.4 billion lower than the Final Determination. Consequently, our central planning assumption is that we could finance £4.4 billion[8] of investment, £0.5 billion less than the Final Determination level. This is shown in the waterfall diagram opposite.

2021/22 Real Increase	2022/23 Real Increase	2023/24 Real Increase	2024/25 Required real increase	2025/26 Required real increase	2026/27 Required real increase
1.8%	0%	(6.1%)	2.3%[8]	6.8%	7.9%

Updated Final Determination to Funding Model



[8] In 2017/8 prices

Financial Summary of Year-on-Year Performance

Revenue

Revenue for the year to 31 March 2023 increased by £80 million or 6.2% to £1,365 million[9] (2022: £1,285 million) above the top end of the range forecast in our Interim Performance and Prospects Report for the six months to 30 September 2022 and significantly above our plan for the year. This is analysed by category in the table opposite. The increase reflects an average charge increase of 4.2% for household and wholesale customers applied on 1 April 2022, new connections to services and increased wholesale consumption, which has now returned to pre-pandemic levels.

Operating Costs, PFI and Depreciation

Total operating costs increased £104 million or 9.9% to £1,155 million (2022: £1051 million). The table opposite reconciles regulatory operating and PFI costs with total operating cost per the statutory accounts.

	2022/23 £m	2021/22 £m	Inc/(dec) £m
Household	991	939	52
Wholesale	359	334	25
Other	15	12	3
Total revenue	**1,365**	**1,285**	**(85)**

	2022/23 £m	2021/22 £m	Inc/(dec) £m
Regulatory operating costs	416	389	27
PFI costs	177	171	6
Repair costs	230	169	61
Cloud computing arrangement costs	17	24	(7)
Depreciation and amortisation	300	283	17
Gain on sale of assets	-	(3)	3
IAS 19 pension & employee cost[10]	37	41	(4)
PFI costs – finance costs to lease liability[11]	(22)	(23)	1
Total operating cost per statutory accounts	**1,155**	**1,051**	**104**
Cost of sales	1,031	920	111
Administrative expenses	124	131	(7)
Total	**1,155**	**1,051**	**104**

Regulated operating costs increased £27 million or 7% to £416 million (2022: £389 million) due to inflationary impacts associated with employee costs, including increased national insurance costs, and chemical costs with the latter increasing by 60% or £12 million.

PFI costs increased by £6 million or 4%, to £177 million (2022: £171 million). This was predominantly due to contract indexation, particularly the impact of gas indexation on the Levenmouth contract, partially offset by savings from the folding of the Aberdeen Environmental Services group of companies into Scottish Water's waste water operations.

Repair costs increased by £61 million or 36% to £230 million (2022: £169 million) due to increased volumes which were influenced by increased disruptions to the network from the freeze/thaw period experienced in December 2022, inflationary pressure on market prices and improved cost capture between replacement and repair activities.

Depreciation and amortisation charges increased by £17 million or 6% to £300 million (2022: £283 million), due to the profile of capital investment and completed projects coming into beneficial use. Cloud computing arrangements costs were £7 million lower at £17 million (2022: £24 million).

[9] This excludes Infrastructure charge income of £20 million (2022: £19 million) and disposal proceeds from sale of assets of £1 million (2022: £4 million) which is included in the regulatory accounting basis set out above.

[10] The £37 million charge to cost of sales and administrative costs is due to the IAS19 'current service cost total' topping-up actual pension contributions charged during the year. The IAS19 current service costs are based on the forecast charge, determined by our actuaries at the start of the year, which reflected the discount rate assumptions as at 31 March 2022 (2.70%; March 2021: 1.95%).

[11] PFI costs, for statutory reporting purposes, are treated as finance leases. The adjustments reclassify part of the costs incurred in the year to finance charges and part to the repayment of the finance lease liability. In addition, there is a depreciation charge in respect of the 'leased' PFI assets.

Finance Costs

Net finance costs in the year to 31 March 2023 were £150 million, a decrease of £11 million (2022: £161 million). The decrease was driven primarily by lower net interest charges as a result of increased interest income from funds on deposit. The table opposite details the elements of net finance costs.

As at 31 March 2023, the weighted average interest cost of the outstanding long-term debt within Scottish Water's regulated business reduced to 3.1% (March 2022: 3.2%). This was due to the repayment of £122 million loans with a weighted average interest rate of 5.2% with new loans drawn down during the period from the Scottish Government of £248 million at a weighted average interest rate of 3.6%.

Surplus Before Tax

The table opposite, reconciles the regulatory surplus, before LTNC items (from the table above to the statutory accounting surplus before tax as per the financial statements of £60 million for the year to 31 March 2023.

[12] The adjustment to finance costs relates to the finance charge calculated on the net pension scheme liabilities using the opening discount rate of 2.70%.

[13] In addition to the IAS 19 adjustments noted above which are taken to the Income Statement, the Statement of Comprehensive Income includes an actuarial gain of £100 million, before tax (£75 million net of tax), for the year to March 2023 (2022: £213 million, before tax (£158 million net of tax)).

	2022/23 £m	2021/22 £m	Inc/(dec) £m
Interest charges	135	142	(7)
PFI finance lease costs (IFRIC 12)	13	15	(2)
Pension scheme finance costs (IAS 19)[12]	2	4	(2)
Net finance costs [13]	**150**	**161**	**(11)**

	2022/23 £m	2021/22 £m	Inc/(dec) £m
Regulated funding for planned investment before LTNC adjustments (per table above)	**656**	**606**	**50**
Deduct actual expenditure on LTNC items	(225)	(191)	(34)
Add back actual tax paid	-	15	(15)
Less depreciation & amortisation charges	(300)	(283)	(17)
Less SW cloud computing costs	(17)	(24)	7
Add back developer contributions less infrastructure charge income awaiting investment	13	6	7
Planned maintenance costs less refurbishment costs capitalised	(38)	(18)	(20)
Retirement benefit obligation:			
Operating costs	(37)	(41)	4
Finance costs	(2)	(5)	3
PFI finance lease costs (IFRIC 12) adjustment	10	8	2
Scottish Water Surplus Before Tax per statutory accounts	**60**	**73**	**(13)**

Capital Investment

On a statutory accounting basis investment for the year to 31 March 2023 was £645 million, £64 million higher than the previous year reflecting the planned increase to our investment programme. The next table reconciles investment on a gross regulatory accounting basis with investment as stated in the statutory accounts.

Cash balances

Cash balances within Scottish Water decreased by £126 million to £390 million (2022: £516 million) reflecting a net cash outflow of £251 million. This was due mainly to the growth of the investment programme and the £35 million acquisition of the assets of Aberdeen Environmental Services Ltd partially offset by net new borrowing from the Scottish government of £125 million.

Any large infrastructure organisation that provides an essential service requires significant access to cash to maintain its activities and to respond to unforeseen events. Our cash balances each year are largely a function of when we borrow from the Scottish Government relative to when we invest and, unlike similar infrastructure businesses, we do not have access to any other form of credit facilities. Our risk appetite determines that the regulated business should always hold a minimum cash balance of £200 million, which is equivalent to approximately eight weeks expenditure.

The balance of our cash has been committed for future investment delivery as set out in note 23 on page 165 of which £111 million is required to complete outstanding investment commitments made in 2015-21.

	2022/23 £m	2021/22 £m	Change £m
Gross investment on a regulatory accounting basis	**694**	**623**	**71**
Less planned repairs charged to the Income Statement	(56)	(38)	(18)
Add refurbishment costs included in responsive refurbishment costs	18	20	(2)
Add developer contributions	33	25	8
Less investment funded mainly from infrastructure charges and the settlement of contractual claims etc	(27)	(25)	(2)
Less cloud-based projects charged to Income Statement	(17)	(24)	7
Company capital additions as at 31 March 2023 per note 9	**645**	**581**	**64**

Business Stream

Strategic and Financial Framework

Business Stream is the largest Licensed Provider operating in the Scottish retail market and one of the largest retailers licensed to operate in the English market. The commercial strategy remains to retain and grow market share by identifying options that will provide scale and add value through a combination of acquisition and organic growth. In order to meet the needs of its growing customer base and be well positioned to be the water and waste water supplier of choice for businesses, Business Stream also offers additional value-added services including water efficiency, new connections support, trade effluent consultancy and automated meter reading.

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

Performance Review

Given the ongoing macro-economic challenges, Business Stream's priority has continued to be focused on providing ongoing support to its customers and people. Despite the challenging external environment, Business Stream has retained its market share at around 20%, cementing its position as one of the largest retailers in the UK water market, and continued to deliver strong results against its key business performance targets, including across its customer service metrics.

Over the past year Business Stream has also successfully delivered its ambitious transformation programme which involved migrating its entire customer base from legacy systems to a new billing platform and web portal. This investment will help to improve customer experience; enhance its digital capabilities; and provide scalability for future growth.

Financial Performance

Revenue from this business segment for the year to 31 March 2023 totalled £657 million (2022: £629 million) (per note 3 to the financial statements). This represents 32% (2022: 32%) of the group revenue, before intercompany eliminations. The surplus before tax within this segment was £4 million (2022: £13 million), with prior year profits reflecting the partial release of bad debt provisions created during the Covid-19 pandemic.

Current year results reflect increased gross profit from a stronger customer base, synergies arising from the Yorkshire Water integration, being offset by higher bad debt provisioning costs in response to the macro-economic challenges. Underlying operating profit, excluding the net impact of bad debt charges (including the release of Covid-19 provisioning in the prior year) and the costs of the Transformation project, grew year-on-year to £17 million (2022: £15 million).

Despite the continuing challenges within the economy and significant investment to date, Business Stream's balance sheet remains strong and debt free, with net assets of £104 million as at 31 March 2023.

Cash balances at 31 March 2023 for the Business Stream 'Group' were £53 million (31 March 2022: £97 million). The decrease of £44 million was mainly attributable to the investment in transformation and delays in customer billing and cash receipts following the migration of customers to the new billing system at the end of January 2023. The reduction in cash balances was anticipated, with the release of bills to customers migrated to the new billing platform carefully phased as part of a robust quality assurance process.

Making a Positive Difference

As a responsible and progressive business, Business Stream is committed to driving positive change for the environment and society as a whole. To achieve this aim, the company launched its vision to make a positive difference to its customers, its people, the environment and local communities in 2019 and has since launched over 30 initiatives to help bring its vision to life.

In the past year this has included actions taken to reduce our carbon footprint; enhancing its education programme to offer further skills training and work experience placements and qualifications to high school students and school leavers; offering free financial wellbeing sessions to colleagues in response to the cost of living crisis; and delivering in-person inclusion training session to all People managers. Having achieved a great deal since launching its vision, over the past year Business Stream has also undertaken a number of activities to track and benchmark its progress against other responsible businesses. This included being assessed by global sustainability assessors, EcoVadis (which bases its assessment on international sustainability standards including the Global Reporting Initiative and the United Nations Global Compact).

Prospects

The Business Stream strategy will continue to be delivered against the backdrop of a very uncertain macro-economic environment. However, the completion of the final phase of the transformation programme and the transition to a new operating model, coupled with the increased profit streams as the benefits from recent investments are realised, will mean the business is strongly positioned to respond and adapt to the changing environment and the challenges and opportunities presented.

Non-regulated Business Activities

Overview

Our non-regulated business activities are predominantly undertaken by Scottish Water Horizons Holdings (SWHH) and mainly operate through Scottish Water Horizons (Horizons).

From December 2018 to 1 October 2022, Scottish Water Horizons Holdings owned the companies that operated the four former PFI waste water treatment works in North-East Scotland, under contract to Scottish Water. The rationale for the acquisition of these companies was to protect environmental performance and reputation whilst also ensuring a commercial return on investment. The acquisition was made through Scottish Water Horizons Holdings (rather than Scottish Water) as a method of protecting Scottish Water's regulated customers from any operational and financial risks associated with the newly acquired works within the scheme which, prior to acquisition, had experienced environmental and operational issues.

In the period from December 2018 to October 2022, the original corporate and contractual structures remained in place, with Scottish Water paying a service fee to Aberdeen Environmental Services Ltd, as required under the terms of the incumbent bank facility agreements.

The scope for synergies was restricted by the contractual agreements in place from the point of acquisition. So, several strategic options were explored for the PFI scheme which led to the decision to repay the external bank debt held by Aberdeen Environmental Services Ltd, including swap break costs in September 2022, and subsequently on 1 October 2022, fold the Aberdeen Environmental Services group of companies into Scottish Water's waste water operations. This provides further opportunity to increase efficiencies and deliver financial benefits for our customers.

Revenue from this business segment to March 2023 totalled £35 million (2022: £50 million) (per note 3 to the financial statements). This represents 2% (2022: 2%) of the group revenue, before intercompany eliminations. The operating surplus within this segment was £9 million (2022: £9 million), £6 million from North-East Scotland PFI waste water activities (2022: £8 million) and £3 million from other non-regulated services (2022: £1 million).

The profits generated within the group are invested in the future development of the business.

Investment during the year within Scottish Water Horizons totalled £8 million with a focus on low carbon investments. This has included successfully completing an energy centre and a district heating network project in partnership with Clyde Gateway, with further solar, hydro-electric and battery storage schemes being progressed.

Seven solar schemes were delivered during the year, including Scottish Water's largest project at Balmore WTW, which collectively have the capacity to generate 7.1 GWh of energy output and save over 2,500 tonnes of carbon per year.

As highlighted above, Scottish Water acquired the assets of Aberdeen Environmental Services Ltd for £35 million which included a payment for the purchase of the investment in the North-East waste water treatment works from SWHH for £20 million (see note 11 to the financial statements).

As a consequence of these transactions, cash balances within the Horizons group of companies remained stable at £44 million. Horizons continues to evaluate new commercial opportunities that will generate additional cash and strengthen financial stability including assessing opportunities to incubate and sell on business activities and associated assets.

Group Taxation

Scottish Water was awarded the Fair Tax Mark for the third time in December 2022. The Fair Tax Mark is reviewed on an annual basis with the expectation it will be awarded in future years demonstrating the continued commitment from Scottish Water to play fair by tax.

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

The consolidated tax charge on the income statement to 31 March 2023 was £20 million (2022: £158 million). The effective tax rate for the year to 31 March 2023 was 34% (2022: 174%). The higher rate in 2021/22 reflected the impact of the revaluation of deferred tax balances caused by the increase in the UK's main corporation tax rate from 19% to 25% effective from 1 April 2023 as highlighted in the table below.

The table below sets out the tax charge by trading segment compared to the previous year.

	Scottish Water		Business Stream 'Group'		Horizons 'Group'		Inter-Company eliminations		Consolidated Total	
	2022/23	**2021/22**	**2022/23**	**2021/22**	**2022/23**	**2021/22**	**2022/23**	**2021/22**	**2022/23**	**2021/22**
Current year tax charge	(4)	4	2	3	4	1	-	-	2	8
Deferred tax charge	23	149	(3)	1	-	1	(2)	(1)	18	150
Total	**19**	**153**	**(1)**	**4**	**4**	**2**	**(2)**	**(1)**	**20**	**158**

Group Pension Arrangements

Scottish Water is a participating employer in the Scottish Local Government Pension Schemes across three funds – Strathclyde Pension Fund, the North-East Scotland Pension Fund and the Lothian Pension Fund. These funds are administered by Glasgow, Aberdeen and Edinburgh City Councils respectively. Business Stream is also a participating employer in the Strathclyde Pension Fund.

Under IAS 19 a snapshot is taken of pension fund assets and liabilities at a specific point in time. Thus, movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities. As at 31 March 2023 the discount rate had increased by 2.05% from 2.7% at 31 March 2022 to 4.75%. The impact was a reduction in the pension liabilities of £677 million. The overall impact is an actuarial gain of £682 million resulting in a pension asset of £596 million at 31 March 2023.

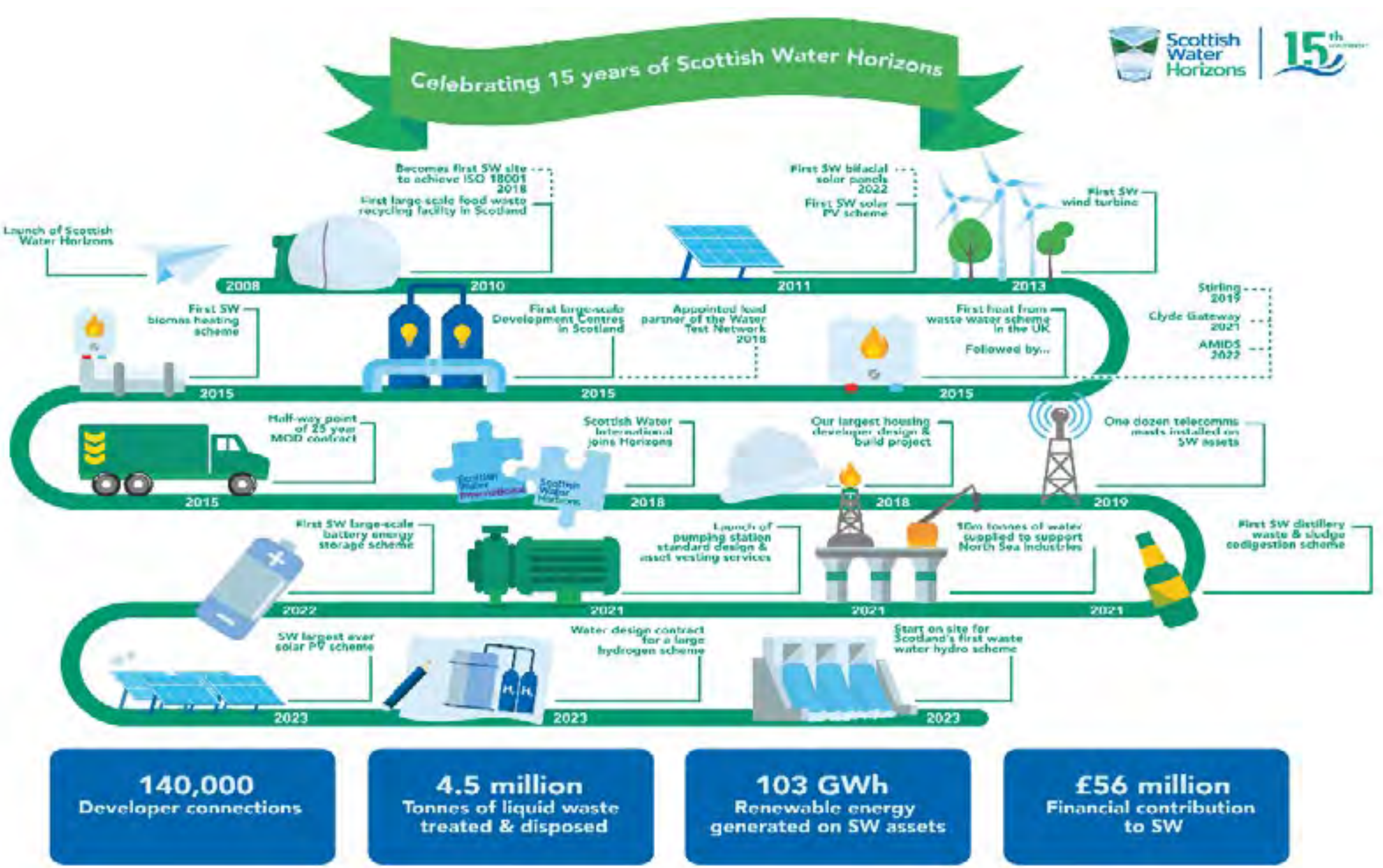
However, under the relevant accounting standards (IAS19 and IFRIC14) the pension asset is restricted to reflect the amount the employer is entitled to as an unconditional refund of the surplus or reduction in future contributions to the pension fund. Management review of the Local Government Pension Scheme regulations concluded that there are no likely circumstances which would result in the company having an unconditional right to a refund in the event of a fund surplus. Actuarial advice was sought in relation to the benefit to the employer in the form of reduced future contributions. This has been calculated as £25 million for Scottish Water and £2 million for Business Stream. As such the full pension asset of £596 million is not recognised but is restricted to a pension asset of £27 million with an actuarial gain of £113 million.

The actuarial movements, net of deferred tax, are presented in the consolidated statement of comprehensive income with further detail in note 22 to the financial statements on pages 161 to 165.

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

SCOTTISH WATER HORIZONS
15 YEARS OF INNOVATION

Scottish Water Horizons is a commercially sustainable, stand-alone business from Scottish Water which has led the way in encouraging growth, establishing renewable technologies and transforming utilities since it was set up in 2008. It has made major headway in driving forward the net zero agenda and spearheading innovation in Scotland and beyond. **Click here** for Scottish Water Horizons website.



OUR APPROACH TO RISK MANAGEMENT

Purpose

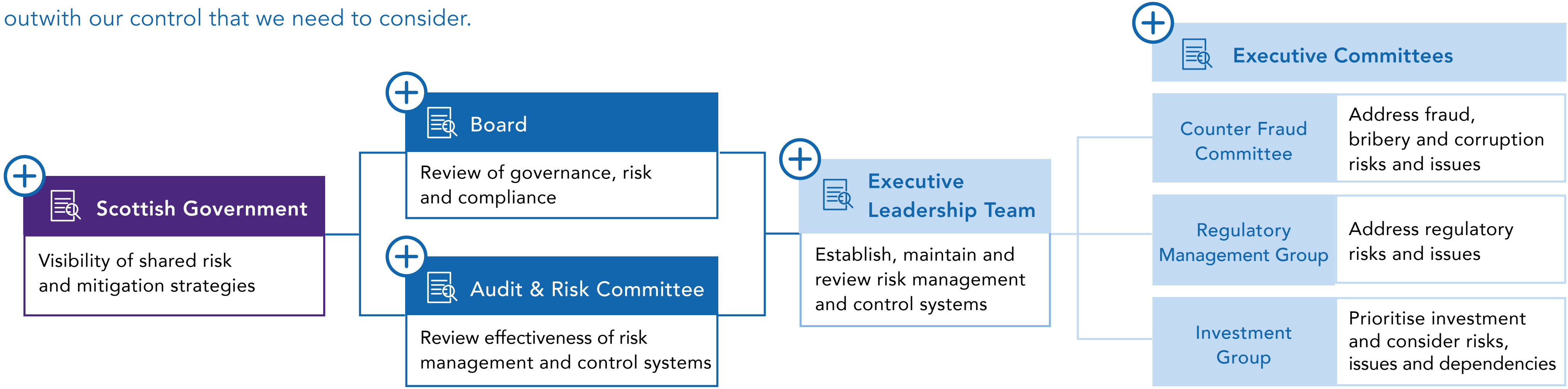
Scottish Water operates within a complex and dynamic environment, managing asset intensive infrastructure within a highly regulated industry. Strong and systematic risk management is integral to our activities. It ensures awareness and understanding of the environment in which we operate and the influences within and outwith our control that we need to consider.

Our integrated approach to risk management is designed to enhance the assessment and prioritisation of activities, enabling effective decision-making on a proactive and reactive basis. It supports continual improvement to achieve and potentially outperform our business objectives and our wider ambitions, by reducing threats and maximising opportunities.

Risk Governance Framework

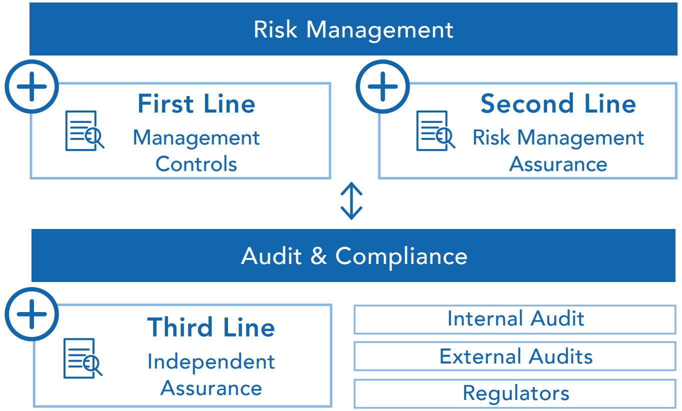
Our risk governance framework includes Scottish Water and our subsidiary - Scottish Water Horizons Limited. In line with the Water Services (Governance Code) Directions 2013, the framework excludes operational risk management for Scottish Water Business Stream Limited.

The Board, supported by the Audit & Risk Committee, the Executive Leadership Team and sub-committees, has overall accountability for the risk governance framework and direction.



Risk Assurance and Compliance Framework

We operate a three lines assurance approach based on the Chartered Institute of Internal Auditors Three Lines Model, with clearly defined roles and responsibilities. This approach ensures the effectiveness of our risk management framework, by providing our key governance groups with appropriate assessment, monitoring and assurance at three different points.



Risk Management

Our risk management activities are championed by the Corporate Risk Function, which is headed by a General Manager reporting to our Chief Executive Officer. The General Manager, supported by a Head of Corporate Risk Management, leads and manages the risk management framework and processes, and is responsible for risk reporting and advice to the ELT, Audit & Risk Committee and the Board.

Audit & Compliance

In the context of risk management, a range of audit activity is undertaken by our specialist teams across the business to provide assurance on risk controls. This is supplemented by internal and external audits and escalation processes, including an externally supported whistleblowing facility.

Risk Management Process

Everyone across our organisation has a responsibility to support the identification, management and escalation of risk. To manage threats and opportunities efficiently and effectively, our framework is based on the principles of the International Standard 31000 Risk Management (ISO 31000). This is tailored to meet the needs of our business and the environment in which we operate, and is underpinned by our risk management culture.

The consequence and likelihood of risks are determined and ranked using a scoring matrix which is aligned to our risk appetite. This aims to ensure a consistent approach is taken when assessing the overall impact to Scottish Water and our customers and communities.

Risk Management Culture

We realise that successful risk management depends on an effective culture within our organisation. This encompasses the knowledge, experience, beliefs and attitudes of our people. Scottish Water's Character, as depicted in the process below, recognises the requirement to continuously maintain and build a healthy and supportive risk culture.

We aim to continually cultivate this by promoting a consistent tone from the top, cascaded throughout the business. Clear responsibilities and accountabilities for those managing risk are established and we recognise individuals who manage risk effectively.

In addition, our people are encouraged to share, report and escalate risk information in a transparent and timely manner. Our risk management culture is aligned with our Scottish Water Characters of Bold, Responsible, Inspiring and Caring.

Awareness	Competence	Management	Transparency	Escalation
Our people are aware and understand the risks that have the potential to affect our service to customers, our ability to undertake safe working practices and our ability to achieve our key business objectives.	Consistent and effective support, advice and guidance equips our people to be confident, competent and capable to manage risks effectively.	Ensures our risk management processes underpin the success of business activities, by effectively directing and empowering our people to manage risk.	Our people have the confidence to share risk information and pursue opportunities, with trust and transparency instilled at all levels of our organisation.	Robust mechanisms are in place enabling our people to pro-actively escalate risks, to either manage existing or avoid emerging threats, supporting our ability to adapt quickly to potential events or incidents.
Caring	Responsible	Bold	Inspiring	Responsible

Risk Appetite

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

We consider risks aligned to five Risk Appetite Perspectives: 'Managing our Assets', 'Working with People', 'Managing External Influences', 'Developing the Business' and 'Scottish Water Subsidiaries'.

We have established Risk Appetite Statements aligned to these for key business areas.

Underpinning each statement is a series of measurable Risk Appetite Definitions. These assist in providing a view as to whether we are operating within our appetite, or whether additional risk mitigation may be required.

These metrics are routinely reviewed by the Corporate Risk Team and risk owners and are incorporated into bi-annual risk reports to the ELT, Audit & Risk Committee and the Board.

Risk Management Protocols

We have an established Risk Management Policy which was refreshed and approved by the Audit & Risk Committee and the Board in December 2021.

The policy is subject to periodic review, with the next formal review due in 2024. Our policy sets out a clear and consistent approach to the management of risk and defines our risk appetite.

This is enabled by our Risk Management Strategy, supporting processes, procedures and guidance, and informed by our Corporate Risk Register.

Integrated Approach To Risk Management

Our integrated Governance, Risk and Compliance model is designed to assure that the opportunities we seek and the threats we face are understood and considered both individually and in aggregation. This informs decisions from a business-wide perspective, in accordance with our risk appetite.

Reviews of the most significant risks are undertaken a minimum of four times per annum, with appropriate mitigation strategies developed, implemented and monitored.

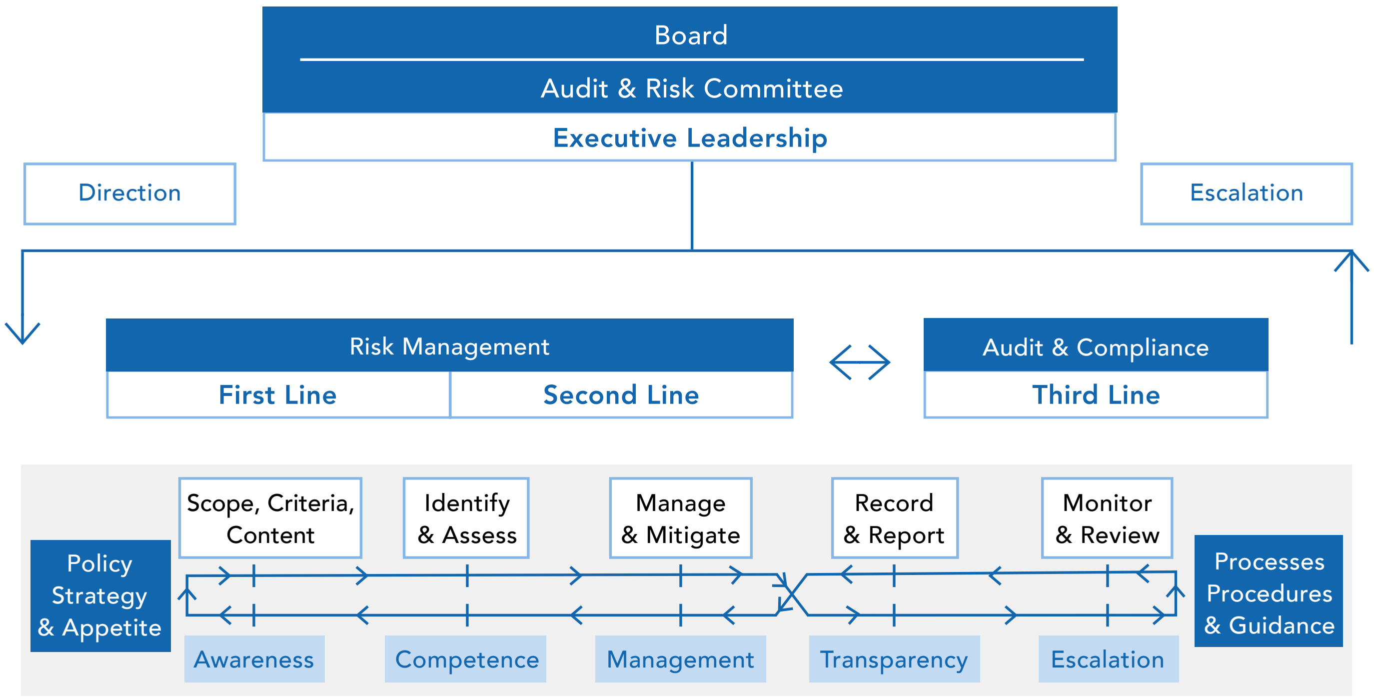
All necessary information is reported to senior managers and escalated to the ELT, Audit & Risk Committee and the Board as appropriate.

Continuous Improvement

To maintain and strengthen our integrated approach to risk management, we have applied lean principles to review our reporting processes across 2023.

In addition to this, we have procured a new risk management IT system, with phased implementation and embedment planned across 2023 and 2024.

INTEGRATED GOVERNANCE RISK & COMPLIANCE MODEL



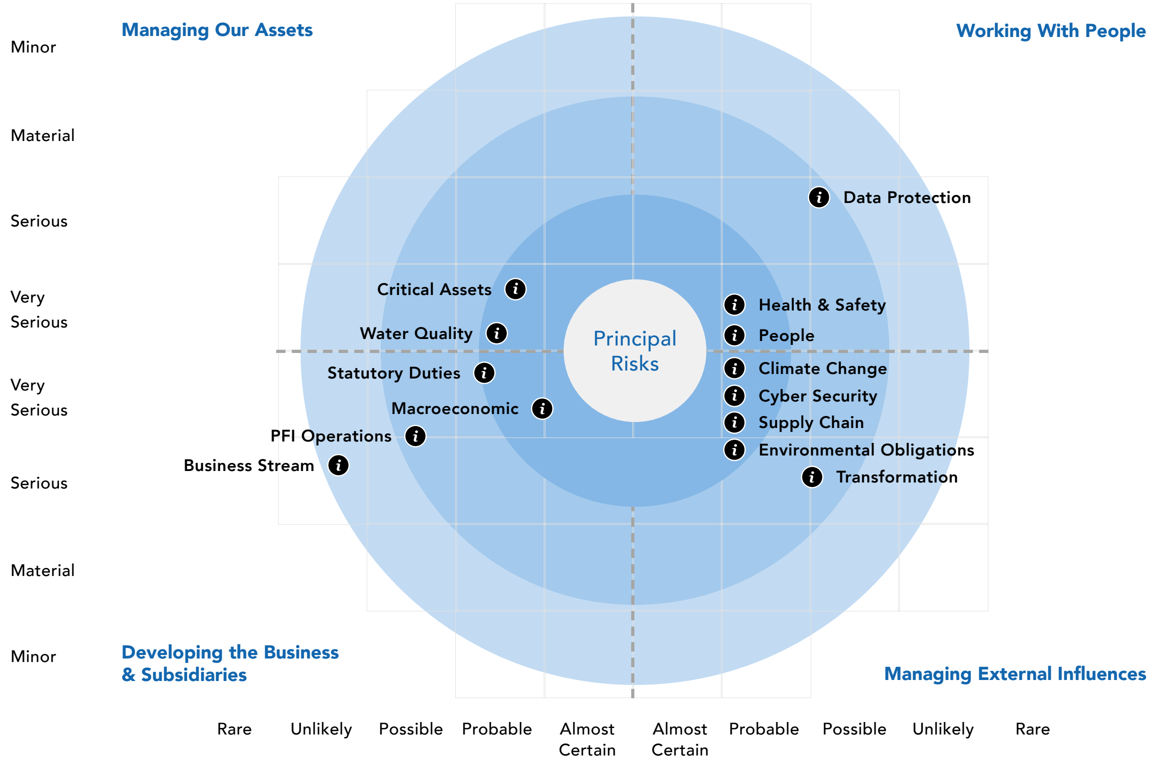
Risk Environment

Over the last year Scottish Water has continued to experience a dynamic and evolving risk environment. This is reflected in the number and scale of principal risks highlighted.

The external nature of a number of the risks presents considerable challenges in our ability to effectively manage or influence these risks. External threats include climate change, cyber security, macroeconomic influences and supply chain vulnerabilities. We acknowledge that the impact of these risks can range in frequency, scale and severity. For example, from a climate change perspective, we can experience intense rainfall events that result in significant flooding. These events are becoming more frequent, affecting larger numbers of customers and communities, as well as our own assets.

There is also risk associated with the age and criticality of our infrastructure, as well as changing environmental expectations/obligations, most recently in relation to discharges to the environment from Combined Sewer Overflows (CSOs). Ensuring appropriate financial sustainability, the importance of people resilience, retention and recruitment, and health & safety in our service delivery are also key areas of focus.

PRINCIPAL RISK RADAR



Principal Risks and Uncertainties

At the time of this report, the Board has carried out a robust assessment of the principal risks and uncertainties facing Scottish Water and its subsidiaries.

The assessment embraces quantitative stress-testing including scenario modelling, and qualitative scenario testing incorporating reverse stress-testing. The risks identified are those considered to be the most material to our business and performance. Also included are risks which could threaten our business model, future performance within our regulatory settlement, and short and long-term financing of Scottish Water.

The risk radar provides a visual representation of the relative likelihood and consequence of each of the principal risks, grouped by our risk appetite perspectives. The diagram illustrates risks in relative terms; the greater the likelihood and consequence, the closer the risk is to the centre.

Our principal risks are grouped within six key risk themes and fuller descriptions of each risk can be viewed by clicking on the information icons within the radar. This section also considers the movement across 2022/23, the outlook concerning emerging threats and opportunities, alignment with our strategic ambitions, risk appetite position and key mitigations being undertaken.

Other Notable Risks

In addition to the principal risks and uncertainties detailed, we also actively manage several other high consequence but lower likelihood risks. These include operational risks arising from key dependencies on third parties, such as electricity providers in the event of a partial or national power outage. Similarly, reputational and financial impacts, can arise from damage by Scottish Water to critical national infrastructure managed by third parties, such as oil and gas transmission pipes and railways.

Furthermore, we manage risks to revenue, water availability, evolving regulatory processes and risks arising from contractors not fulfilling their obligations.

Emerging Risks

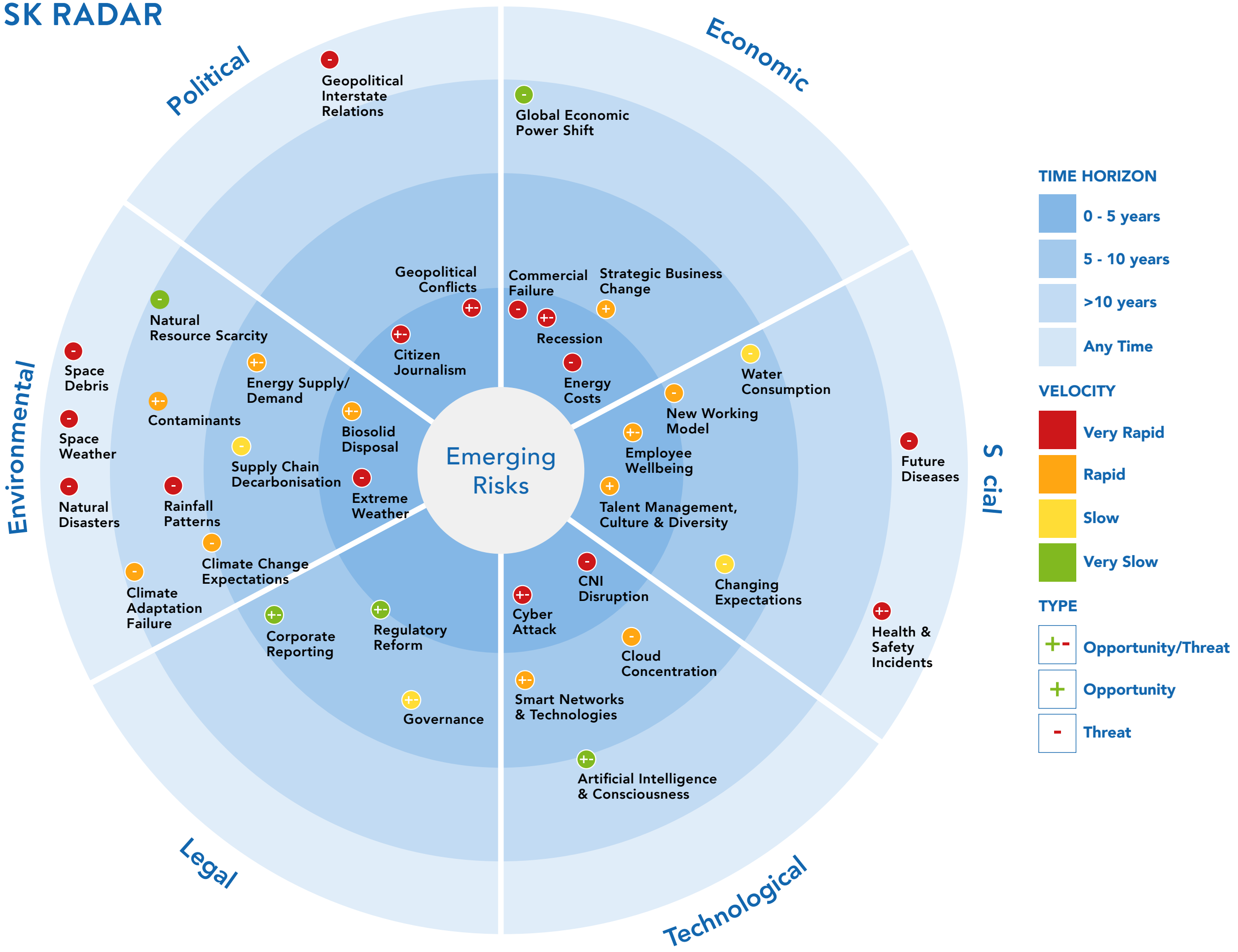
We define emerging risks as future events which present uncertainty and are challenging to fully assess due to lack of information and changing or unpredictable environments. We undertake regular horizon scanning to monitor the internal and external business environment. This supports the identification and review of emerging aspects of known risks as well as new emerging risks.

The volatile nature of the current global and domestic environment can make it difficult to anticipate future trends and patterns. We have augmented our understanding by extending our stakeholder network both internally and externally to further test and validate our findings. Our analysis indicates that these risks are more likely to have a longer-term impact. However, there is the potential for the velocity (i.e. speed at which risks could impact the business), to significantly increase in the shorter-term, which could affect our performance.

These risks are reviewed, monitored and reported a minimum of four times per annum through our existing risk processes and tested annually through our Board Horizon Scanning review to inform strategic direction. In addition, further reviews have been implemented with key internal stakeholders and there has been engagement with other water companies across the UK.

The emerging risk radar opposite provides a representation of key emerging risks, both opportunities and threats. These are plotted over four time horizons, with associated velocity indicators. More information on emerging risks can be viewed using the information icons within our Principal Risk radar or via Pages 86-91.

EMERGING RISK RADAR



Principal Risks & Uncertainties

BUSINESS FINANCING

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
STATUTORY DUTIES: Inability to access full regulatory financing for 2021-27		
Potential Outcome: Reduced ability to deliver our statutory duties, including Ministerial Objectives, increasing the prospect of service deterioration and/or enforcement action.	• Identify and understand external financial pressures influencing customers and Scottish Water costs. • Work with the Scottish Government to determine how financing may be secured if it is not feasible to increase charges to the extent envisaged in WICS final determination. • Ensure alignment of our charge setting process with Scottish Government's budget setting process. • Monitor and manage asset performance and understand impacts should investment require to be delayed.	We will always have sufficient financing through revenue and borrowing in order to undertake our activities. We should always have immediate access to a minimum of approximately eight weeks of operating cash to the regulated business from the group (excluding Business Stream) to enable us to protect the organisation from unplanned shocks and potential shortfalls in revenue.
MACROECONOMIC: Prolonged macroeconomic volatility and financial uncertainty		
Potential Outcome: Increasing cost base, domestic and wholesale revenue impacts.	• Monitor UK & Scottish Government budget announcements and analyse impacts. • Ensure modelling remains up to date with current economic forecasts. • Monitor and, where possible, proactively manage cost base. • Maintain communications with CoSLA, Councils, and Licensed Providers and Scottish Government.	We will always have sufficient financing through revenue and borrowing in order to undertake our activities. We should always have immediate access to a minimum of approximately eight weeks of operating cash to the regulated business from the group (excluding Business Stream) to enable us to protect the organisation from unplanned shocks and potential shortfalls in revenue.
PFI OPERATIONS: PFI plant or operations fail to deliver in accordance with the contract terms		
Potential Outcome: Financial and operational impacts.	• Maintain ongoing strong relationships with PFI companies. • Monitor and manage PFI company performance. • Ongoing review of contingency plans for both the financing and operation of these contracts.	Scottish Water seeks to deliver services in an efficient and cost-effective manner including via a number of PFI waste water contracts.
BUSINESS STREAM: Competitive market conditions and complex operating environments		
Potential Outcome: Reducing value of the business and increased demand on Scottish Water Group cash.	• Improve cash flow and profitability. • Deliver the benefits set out in the Business Stream Transformation business case. • Stabilise following migration of customers onto the new billing platform, minimising the impact on billing, cashflow and aged debt. • Manage macro-economic impact on customer bad debt and cash flow. • Agree terms for an enduring, flexible funding package to support strategic goals.	Business Stream will maintain a financially viable retail business.

Principal Risks & Uncertainties

ENVIRONMENTAL

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
CLIMATE CHANGE: Failure to adapt to extreme and unpredictable weather events on assets and infrastructure, and changes to water resource supply and demand		
Potential Outcome: Operational and customer service impacts.	• Undertake climate change vulnerability assessments. • Update and undertake climate change risk assessments and apply these to service risk assessments. • Develop adaptation pathways and set out plan. • Include carbon costing in appraisals. • Deliver investment in water assets, including 25-year water resource and resilience planning and improved system connectivity, raw water monitoring, catchment management and capability studies. • Deliver investment in waste water assets, including surface water management plans, treatment capability assessments and improved service resilience through flood protection of assets.	As a water utility company, provision of safe drinking water remains our highest priority, and delivering a continuous service to our customers is paramount. Scottish Water seeks to treat and return waste water in a way that does not harm the environment. TCFD CLIMATE RISKS
CHANGING ENVIRONMENTAL OBLIGATIONS: Failure to meet increasing environmental expectations and obligations, including discharges to the environment from combined sewer overflows		
Potential Outcome: Reputational damage, perceived/actual non-compliance, and enforcement action.	• Deliver Improving Urban Waters Routemap including improved monitoring capability at 1,000 priority locations, network intelligence and reporting to SEPA and the public. • Undertake assessment to better understand and inform our current network and waste water treatment work flow compliance position. • Ensure licences are varied to reflect changing parameters. • Ensure continued engagement with SEPA to review and agree approach. • Communicate the role of waste water system environmental interactions, performance and scale of potential change required.	Scottish Water seeks to treat and return waste water in a way that does not harm the environment or cause nuisance to our customers. We should avoid any action which would result in a serious loss of confidence.

Principal Risks & Uncertainties

DEVELOPING THE BUSINESS

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
TRANSFORMATION: Opportunities arising from the development and implementation of large-scale transformational programme		
Potential Outcome: Achievement of our ambitions set out within the Strategic Plan - A Sustainable Future Together.	• Update and refresh regularly the 'Plan for Transformation' which sets out the timescales and objectives. • Keep under review the scale of transformational change required to deliver our strategic plan and ambitions. • Prioritise and sequence the Transformation portfolio of activities reviewing and refining six-monthly. • Manage business priorities to ensure adequate resource levels. • Continuously engage with internal and external stakeholders. • Deliver the strategic change programme and track business benefits. • Undertake regular progress monitoring and reporting.	We will seek to maximise any opportunities and minimise any threats arising from transformational change. We will explore how we can do things differently in order to create value and enhance sustainability.

Principal Risks & Uncertainties

SERVICE & SUPPLY

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
WATER QUALITY: Delivery of water which does not comply with standards		
Potential Outcome: Impact to health and/or significant customer concerns.	• Ensure skilled and trained employees operate our water assets. • Undertake routine monitoring of the water in our catchments, and in our treatment and distribution activities. • Undertake routine testing on water quality, beyond regulatory requirements, to manage drinking water quality and minimise associated risks. • Direct risk management activities through the Water Supply Risk Management Group including overseeing improvements related to Drinking Water Safety Plans. • Actively manage emerging themes/concerns via the Water Quality Improvement Group and implement appropriate actions to address. • Deliver significant investment to maintain and further improve water quality. • Ensure management of detailed emergency and business continuity response plans.	As a water utility company, provision of safe drinking water remains our highest priority.
CRITICAL ASSETS: Failure of a critical asset or assets		
Potential Outcome: Impact on service to customers and non-compliance with directives.	• Continue to develop detailed knowledge and understanding of our critical assets. • Undertake operational inspections, maintenance and emergency planning activities to minimise the risk and consequences of failure. • Identify investment needs for promotion in our future investment programmes, including aging assets. • Meet the requirements of the Network and Information Systems Regulations (NIS) and the Scottish Government Public Sector Action Plan.	Delivering a continuous service to our customers is paramount.
SUPPLY CHAIN: Failure arising from fragile and structurally challenging supply chains		
Potential Outcome: Operational, financial and customer service impacts.	• Engage with chemical suppliers/manufacturers to understand product. availability and ensure sight of emerging concerns. • Explore options for supply outwith UK markets. • Continue dialogue with Water UK on chemical supply chain resilience. • Explore commercial opportunities to self-manufacture some key chemicals. • Explore innovative technologies to minimise reliance on chemical treatment. • Review and test Business Continuity Plans	We should always endeavour to have an ethical, sustainable and resilient supply chain to meet our investment needs.

Principal Risks & Uncertainties

PEOPLE, WELLBEING, HEALTH & SAFETY

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
PEOPLE: Failure to retain, attract and incentivise key people and/or skills; Our people may not have sufficient resilience or capacity and/or are not effectively engaged.		
Potential Outcome: Impact on our ability to deliver core services effectively and drive transformational change.	• Secure appropriate reward framework and policy positioning with Scottish Government. • Monitor and refresh People policies in line with best practice. • Refresh core reward structure, reflecting need to attract and retain essential skills and talent. • Review recruitment processes to enhance talent attraction. • Maintain regular engagement surveys, adapt improvement plans. • Build on change capability and adaptive capacity and resilience. • Ongoing monitoring of short and long term absence, supporting and addressing cases. • Review risks related to essential skills and roles which could impact key activities. • Continue talent identification, with development and succession plans for key roles. • Refresh a person-centric approach to performance conversations, supporting our people to contribute their best.	We will ensure a sufficient capacity of engaged, enabled, diverse and energised people to the required areas of the business at the appropriate times, with the required skills and competency. We will provide appropriate support to enable our people to work in a safe, healthy and well manner wherever their work location.
HEALTH & SAFETY: Harm arising from our assets, activities and actions		
Potential Outcome: Impact on the health & safety of our people, contractors, supply chain, customers and the public.	• Operate Health & Safety Management System and processes. • Continue to review, progress and deliver initiatives within our Strategic Health & Safety Improvement Plan. • Ongoing maintenance, maturity and optimisation of processes to maintain and strengthen our Health & Safety performance. • Further embed health & safety in our culture and processes via engagement and awareness raising. • Review and refresh mandatory Health & Safety training packages. • Continue routine Health & Safety Site Inspections. • Investigate all accidents and incidents and track necessary remedial actions, including learnings for continuous improvement. • Continue engagement with alliances, partners and contractors to share learnings and best practice. • Regular health & safety reporting to key governance groups.	We will ensure the health & safety of our people, contractors, supply chain, customers and the public remains paramount. Our behaviours, activities and assets should therefore not place at risk the health, safety or wellbeing of Scottish Water people, contractors, supply chain, customers and the public.

Principal Risks & Uncertainties

CYBER, DATA & INFORMATION

KEY ›

‹ RETURN TO PRINCIPAL RISK RADAR

EMERGING THREATS & OPPORTUNITIES

RISK	KEY MITIGATIONS	RISK APPETITE
CYBER SECURITY: Deliberate external or internal attack (physical/ virtual)		
Potential Outcome: Loss of key information technology and/or operational technology impacting operations, finances and reputation.	• Organisational wide education and awareness programme rolled out. • Utilise External Expert Vulnerability and Threat Management service. • Undertake routine security gap analysis; plans in place to further increase maturity level. • Undertake regular application of security patching. • Review and test detailed disaster recovery plans. • Continue activities to fully understand dependencies and implications of cyber-attacks on third parties i.e. supply chain or revenue partners. • Participate in UK & Scottish Government and industry cyber incident exercises. • Comply with Networks & Information Systems (NIS) Directive and compliance with Scottish Government Public Sector Cyber Resilience Action Plan. • ISO27001 (Information Security Management) certification for Scottish Water Data Centres.	Scottish Water seeks to ensure the integrity and security of the IT estate.
DATA PROTECTION: Failure to maintain a suitable and sufficient framework		
Potential Outcome: Non-compliance with legislative obligations and reputational harm.	• Continue to review and communicate data protection policies, processes and guidelines in place. • Ongoing awareness raising of data protection and requirements under the Data Protection Act 2018. • Maintain corporate privacy notices. • Review and communication of processes to ensure data breaches are identified, reported and investigated in a timely manner. • Continue to embed and review practices.	Scottish Water seeks to safeguard customer and employee data by complying with relevant standards.

GOING CONCERN AND VIABILITY STATEMENTS

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

The viability statement, required under the 2018 UK Corporate Governance Code, takes a longer-term perspective of the group's operational sustainability. The two statements are set out opposite and below.

Going Concern

Scottish Water's business model, activities and the factors that could impact on its future development and performance are described in the strategic report on pages 18 to 93. The principal risks and uncertainties are described on pages 86 to 91.

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

As at 31 March 2023, Government loans totalled £4.5 billion and Scottish Water group held cash and cash equivalents of £487 million (per note 14 to the financial statements on page 154).

In considering the basis of accounting, cash flow forecasts have been prepared for a period of at least 12 months from the date of approval of these financial statements which consider various scenarios, taking into consideration severe but plausible impact downside risks.
These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. Under all the scenarios, Scottish Water will be able to operate within its available facilities.

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

Viability Statement

In accordance with provision C.2.2 of the UK Corporate Governance Code 2018, the Members have assessed the prospects of the group over a longer period than the 12 months required by the "Going Concern" provision. The Members consider that a 6-year period is appropriate because it is consistent with its near-term rolling investment planning horizon. Members confirm that they have a reasonable expectation that the group will be able to continue in operation and meet its financial obligations as they fall due over the next 6 years to March 2029.

In making their assessment, the Members considered the resilience of the group, taking account of its strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. They considered the potential impacts, in severe but reasonable scenarios, of the principal risks, set out on pages 86 to 91, and the probable degree of effectiveness of current and available mitigating actions.

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

The business and strategic planning processes cover the regulatory period to March 2027, based on key assumptions in respect of the funding of the business. In December 2020, the WICS published their Final Determination for the 2021-27 period. In addition, Scottish Water published its 25-year Strategic Plan for the period to 2045. Business planning is a continual process which forecasts the performance and liquidity of the group over the regulatory period with additional focus on the affordability and phasing of the 6-year rolling investment programme. The planning process considers base, downside and severe downside financial and economic scenarios.

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

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

In conclusion for this assessment, Members have assessed the prospects and viability of the group over a 6-year period to March 2029.

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GOVERNANCE

BOARD MEMBERS
2022/23 BOARD MEMBER BIOGRAPHIES

Executive Members

Douglas Millican, Chief Executive

Douglas has been Chief Executive since 2012 having previously been Finance and Regulation Director since Scottish Water was formed in 2002. He was formerly with East of Scotland Water and, prior to this, he worked with Price Waterhouse and Tyco. Douglas is Chair of World Vision UK, a member of the Scottish Government's National Strategy for Economic Transformation Delivery Board, and a member of Court at the University of Edinburgh. He is a Chartered Accountant with a BCom from the University of Edinburgh and is an Associate Member of the Association of Corporate Treasurers.

Peter Farrer, Chief Operating Officer

Peter was appointed as Chief Operating Officer in 2013 having formerly been Customer Service Delivery Director, General Manager of Asset Planning and Business Performance and General Manager of Operations. Prior to this he held various operational and engineering roles within Scottish Water's predecessor organisations, East of Scotland Water and Lothian Water and Drainage. He has 38 years' experience in the water industry since graduating from Heriot Watt University as a Civil Engineer in 1984. He is a Chartered Civil Engineer, gained an MBA from the Edinburgh Business School in 2001 and is a Fellow of the Institution of Civil Engineers and a Vice President of the Institute of Customer Service.

Alan Scott, Strategy Director

Alan was appointed Strategy Director on 31 January 2022 having served as Scottish Water's Finance Director since he joined in 2013. Alan joined Scottish Water from Balfour Beatty where he was Finance Director of UK Regional Building and Civil Engineering, having previously held the roles of Finance Director and Interim Managing Director of Balfour Beatty Engineering Services. He was Finance Director of Miller Construction for 8 years and has also held Finance Director positions in the oil service industry. He has an MA in Economics and Accounting from Aberdeen University. He qualified as a Chartered Accountant and Insolvency Practitioner with Arthur Andersen where he spent 10 years in the Corporate Recovery Services Team.

Non-executive Members

Dame Susan Rice DBE

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

Samantha Barber

Samantha Barber has worked at CEO and Board level in both the UK and internationally for over 25 years. She worked in Brussels as a Policy Advisor in the European Parliament for 4 years and was CEO at Scottish Business in the Community for 9 years. Samantha joined the Advisory Board at Scottish Power in 2007 and was appointed to the main Board of Iberdrola in 2008, serving until November 2021. She chaired the Sustainable Development and Governance Committee for over 8 years and served on the Executive Committee. Samantha is currently a Managing Director with Accenture and the European Lead for the Board Effectiveness and Sustainability. She has continuously served on not-for-profit boards since 2000.

Graham Dalton

Graham is a chartered civil engineer and fellow of the Royal Academy of Engineering with 35 years of experience planning, building and operating large scale infrastructure in the UK, Middle East and Far East. From 2016 to 2022 he was Chief Executive of the Defence Infrastructure Organisation responsible for the Defence Estate in the UK and overseas. Previously, he was Chief Executive of the Highways Agency where he built the Agency's capabilities in network operation, asset management and commercial performance before leading the change to a Government-Owned Company - Highways England - in 2015. Graham's earlier career was spent with consulting engineering firm Mouchel, and with contractor Bovis. Graham is also a non-executive director of Energy and Utility Skills Ltd and a Policy Fellow of the Institution of Civil Engineers.

Steven Dickson

Steven brings more than 30 years communications, media and digital experience having worked for BT since 1989. Recent roles included leading teams across Europe, Americas and Asia Pacific focusing on global contracts, strategic controls and revenue assurance. He was a member of the leadership team in BT Group Business Services. He is also a non-executive director on the board of the Scottish Courts & Tribunals Service and a Member of the Armed Forces Pay Review Body. Previously, Steven was a member of the National Executive Committee for the Prospect Union, having occupied various executive positions since 2013 and was a senior negotiator on the BT Pay and Reward Committee from 2006 until his retirement. He also served a three-year term on the governance board of BT's pension scheme in 2018.

Iain M Lanaghan

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

Ken Marnoch

Ken has over 35 years' experience working in the energy industry having worked for Shell since graduating from Heriot-Watt University in 1988. Initially based offshore in the North Sea and onshore in Aberdeen, and subsequently 17 years in assignments overseas. His recent roles include leading regional and country businesses in the Gulf of Mexico, USA and Brunei, South-East Asia focusing on corporate responsibility, safety, bottom line delivery, digitalisation and investment in people. His international career has also included leading Internal Audit, major asset and infrastructure project delivery, strategic planning, managing Government and corporate joint ventures and delivering significant organisational change.

Deirdre Michie OBE

Deirdre is a senior leader and business executive in the global energy industry with significant experience in both executive and non-executive roles. Having worked in several senior leadership roles within Shell, Deirdre's experience covers the energy value chain. Deirdre was appointed as CEO of Offshore Energies UK (OEUK) in 2015, a position that she held for almost 8 years. During her tenure at OEUK, Deirdre was instrumental in landing the landmark North Sea Transition Deal, aimed at helping to deliver UK net zero by 2050. She was also a leading member of several industry and government forums, including the UK Government's North Sea Transition Forum, the Fiscal Forum, the Scottish Energy Advisory Board and the Women's Business Council. Deirdre was also sponsor of the UK AXIS network, aimed at improving gender equality in the workplace. Deirdre is currently a Non-Executive Director of Scottish Water, Chair of Scottish Water's Remuneration Committee and a Board member of Opportunity North East Ltd. Deirdre was awarded an OBE for her services to the energy Industry (2018), an Honorary Doctorate from Robert Gordon University (2021) and a Fellowship from the North East of Scotland College (2019).

Catriona Schmolke

Catriona is an experienced Non-Executive Director and Chartered Engineer. She is a Non-Executive Director at the National Physical Laboratory and a Trustee on the Board of the Royal Academy of Engineering, where she holds the role of Vice President. She is a Visiting Professor in Sustainability at the University of Newcastle. Former Global Senior Vice President, with USA based engineering, technical and scientific professional services company Jacobs. Her career has included leading Safety. Security, Sustainability, Quality and Supply Chain Management across a 55,000 multi country workforce and delivering purposeful transformation and organisational change. Honoured in 2020 by the National Safety Council of America for her leadership in Safety.

CORPORATE GOVERNANCE REPORT

Members

The Chair and other Non-executive Members are appointed by Scottish Ministers. Executive Members are appointed by Scottish Water after receiving consent to their appointment from Scottish Ministers. The Members as at the date of this report and their biographies are set out on pages 95 and 98.

Executive Board appointments are based on merit and candidates will be considered against objective criteria, having due regard for the benefits of diversity on the Board, including gender. Non-executive Board appointments are made by the Public Appointments team of the Scottish Government. That team operates in accordance with the Code of Practice and the Diversity Delivers strategy published by the Ethical Standards Commissioner. Both the Code and the strategy are applicable to all public appointments.

The Board of Scottish Water comprised 11 members: 8 Non-executive Board Members and 3 Executive Members. The Board has a formal schedule of matters specifically reserved to it for decision-making. Reporting to the Board are the Chief Executive and the Executive Members, who have responsibility for the management of Scottish Water, and the Board Committees detailed below.

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

During the financial year of 2022/23, the Board met on 10 occasions to review Scottish Water's operational and financial performance, business strategy and risk management.

UK Corporate Governance Code

Scottish Water complies with the revised UK Corporate Governance Code published by the Financial Reporting Council (FRC) in July 2018, so far as applicable to its status as a Statutory Public Corporation. As Scottish Water is not a company registered under the Companies Act, the Financial Conduct Authority (FCA) listing rules are not applicable and an Annual Consultative Meeting (ACM) with stakeholders is held in place of an Annual General Meeting. The arrangements for appointment and removal from office of Board Members and their remuneration are derived from the underlying statutory regime and set out in the Members' Remuneration Report. No Senior Independent Director has been appointed as other arrangements are in place to consult with stakeholders. The Audit & Risk Committee Report on pages 103 to 107 covers the appointment of the external auditor.

Board and Committees

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

	Board		Audit Committee		Remuneration Committee	
	Held	Attended	Held	Attended	Held	Attended
Dame Susan Rice	10	10	-	-	-	-
Samantha Barber	10	8	-	-	6	6
Peter Farrer	10	10	-	-	-	-
Iain M Lanaghan	10	10	5	5	-	-
Ken Marnoch	10	9	-	-	6	5
Deirdre Michie	10	8	-	-	6	4
Douglas Millican	10	10	-	-	-	-
Alan Scott	10	10	-	-	-	-
Steven Dickson	10	9	-	-	6	5
Catriona Schmolke	10	10	5	5	-	-
Graham Dalton	10	9	5	5	-	-

Notes:

*Mr Graham Dalton's term commenced on 1 April 2022

*Mrs Samantha Barber's term ended on 31 March 2023

Audit & Risk Committee

The Audit & Risk Committee reviews the financial reports of Scottish Water and considers the results of the auditor's examination and review of the financial statements. It meets with management and with internal and external auditors to review the effectiveness of internal controls, governance and business risk management. The Chair of the Audit & Risk Committee reports to the Board on internal control and risk management matters following each Audit & Risk Committee meeting. The Committee adheres to the requirements of the Audit and Assurance Committee Handbook. Each year the Committee presents a report of its activities to the Board prior to the Board's consideration of this report.

A more detailed report of the Audit & Risk Committee's activities is provided on pages 103 to 107.

Remuneration Committee

The Remuneration Committee monitors the contract terms, remuneration and other benefits for each of the Executive Members, including performance-related incentive schemes. The Committee has access to external independent advice as it considers appropriate. A more detailed report of the Remuneration Committee's activities is provided on page 108.

Board and Committee Performance

An internal review of Board and Committee effectiveness was undertaken in March 2022 and all actions arising have been implemented. A further internal review will be reported to the Board at its meeting in May 2023, with an external review to be undertaken in 2024. Formal annual evaluation processes are in place for all Members, including the Chair. Induction and ongoing training is provided for Members.

Executive Leadership Team

The Chief Executive is responsible for the management and operation of Scottish Water within the strategy determined by the Board and is supported by an Executive Leadership Team which he chairs. The members of the Executive Leadership Team who are also Executive Members are:

Douglas Millican Chief Executive

Peter Farrer Chief Operating Officer

Alan Scott Strategy Director

Internal Control

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

The systems of internal control are compliant with the relevant sections of the UK Corporate Governance Code and the Scottish Water Governance Directions 2023. They are based on an ongoing process designed to identify those risks material to the achievement of Scottish Water's policies, aims and objectives, to evaluate those risks and to manage them effectively in accordance with good risk management practices.

Risk Management

Scottish Water operates a systematic approach to managing risk which is detailed more fully in pages 79 to 85. These risk management processes have been in place for the full year under review and up to the date of approval of this report and financial statements.

Control Activities

Scottish Water's Internal Control Framework incorporates:

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

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

Control Effectiveness Review

Reviewing control effectiveness is a continuous process throughout the financial year. The Board gains assurance as to the effectiveness of internal control through a collaborative approach, based on the work of internal and external audit, other internal and external review agencies, and Executive Leadership Team reports. The controls assurance process is co-ordinated by Internal Audit and incorporates independent assessment by audit, together with annual statements of assurance from senior management.

Information and Communication

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

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

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

Members of the Board meet quarterly with officials from the Scottish Government to discuss a range of business issues.

External Auditor

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

Independence of External Auditor

The Auditor General for Scotland is responsible to the Scottish Parliament for securing the audit of the financial statements of Scottish Water. The Auditor General for Scotland appointed KPMG LLP as the auditor of Scottish Water for the financial years 2016/17 to 2021/22. In May 2022, KPMG LLP was re-appointed as Scottish Water's auditor for the financial years 2022/23 to 2026/27.

Under the terms of KPMG LLP's appointment, they may not carry out any non-audit work for Scottish Water without the prior approval of Audit Scotland, and must comply with Scottish Water's policy on provision of non- audit services see page 128.

AUDIT & RISK COMMITTEE REPORT

Annual statement by the Chair of the Audit & Risk Committee

I am pleased to present this report covering the role and function of the Group Audit & Risk Committee for the year ended 31 March 2023. During the year I was supported by 2 other Non-executive Members: Catriona Schmolke and Graham Dalton.

I have relevant financial experience and my Committee members have been selected with the aim of providing the wide range of financial, governance and commercial expertise necessary to fulfil the Committee's duties and obligations. Susan Hill, Scottish Water's Managing Legal Counsel, is Secretary to the Committee.

Group Audit & Risk Committee Role and Responsibilities

The Group Audit & Risk Committee was established by the Board to support it in its responsibilities for issues of governance, risk and control and associated assurance and assessment through a process of constructive challenge. Although Scottish Water is not a listed company it does adopt and follow, as far as is appropriate, the accounting and disclosure practices of a listed company.

The governance framework adopted by the Committee links the objectives of Scottish Water's business strategy through the stages, outlined below, with the sources of assurance received from senior management and other assurance providers on the operation of key financial and risk management controls.

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

- The strategic processes for the assessment of governance, risk and control and their effectiveness;
- The risk management framework, including risk appetite and horizon scanning;
- The accounting policies, the financial statements, principal risks, the interim and full year Annual Report & Accounts: Performance and Prospects reports;
- The planned activity and results of both internal and external audit, including approval of the annual and 3 year Internal Audit plans and strategy and annual Cost Audit plan;
- The management response to issues identified by internal and external audit activities;
- The effectiveness of the internal control environment;
- Assurances on the corporate governance requirements for the organisation;
- Anti-fraud activities, whistleblowing processes, arrangements for special investigations and activities and reports by the Counter Fraud Committee;
- Scottish Water's arrangements for complying with legislation and Directions issued by the WICS, including the Annual Return;
- The annual plan and report prepared by the Compliance Officer;

- The annual statement published by Scottish Water under the Modern Slavery Act 2015; and
- The annual tax strategy and statement.

The Terms of Reference of the Committee are approved by the Board and, in accordance with the Scottish Government Audit and Assurance Committee Handbook, are reviewed annually by the Committee. The Committee Terms of Reference are available on the Scottish Water website.

Scottish Water's subsidiary, Scottish Water Business Stream Limited (Business Stream) operates as a Licensed Provider, competing with other Licensed Providers in the Scottish and English markets to supply water and waste water retail services to business customers. Business Stream has its own Board of Directors and is operated in accordance with the Governance Code agreed with the Water Industry Commission for Scotland (WICS). The Governance Code sets out the operating regime that Scottish Water and Business Stream must comply with to enable the operation of the licensed retail market.

Business Stream has the same Chair as Scottish Water but has its own independent Board, Audit & Risk Committee and management team. Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings Limited (SWBSH) in accordance with the Governance Code. As a consequence of the restrictions within the Governance Code upon disclosure of Business Stream's activities, the Group Audit & Risk Committee is in large part reliant on the Board of Business Stream to provide much of the necessary assurance, with further assurance provided through governance of Business Stream by SWBSH, as detailed below.

Committee Meetings

The Committee meets at least 4 times per year, 2 of which are co-ordinated with external reporting timetables.

During 2022/23 the Committee met on 5 occasions, with an extra meeting in May 2022 to review the draft Annual Report & Accounts: Performance and Prospects.

In addition to the Committee members, the Scottish Water Board Chair, Chief Executive, Director of Finance, Head of Internal Audit, General Manager - Financial Control, Group Legal Counsel, Head of Corporate Risk Management, Director of Digital & Transformation, Strategy Director and the external audit partner also attended the meetings by invitation. The Committee invites other senior management to present to the Committee on a regular basis on a variety of topics relevant to its work. In line with the Scottish Government's Audit and Assurance Committee Handbook, the Committee meets in private, excluding any Executive Members, with the external auditor and the Head of Internal Audit at least on an annual basis, or more frequently if required.

The Committee's Activities

The Committee agrees an annual work programme including reports to be received from senior management, Internal Audit and the external auditor during the year.

As well as the normal financial reporting activities, the Committee's main activities during the year included the following:

- Reviewing compliance with the 2018 UK Corporate Governance Code;
- Assessment of corporate strategic and operational risks, risk management controls including risk appetite and business culture, risk management and control systems, the monitoring and review thereof, including sources of assurance and associated public reporting covering going concern and future viability;
- Discussing the work, the issues and management actions in Internal Audit reports;
- Outcomes of investigations resulting from fraud allegations, whistleblowing and results from the Audit Scotland National Fraud Initiative;
- Forming its view of the "fair, balanced and understandable" and viability reporting obligations;
- Operation of the 2021-27 Capital Investment Value Assurance Framework;

- Update on risk management forward planning and risk horizon scanning; and
- Discussing specifically requested papers on capital investment – value for money, cyber security and NIS compliance, Licensed Providers' financial sustainability, pensions accounting and supply chain structural risk.

Financial Reporting

To inform the Committee's reports to the Board, the Committee reviewed and considered the following areas in respect of financial reporting and the preparation of the interim Accounts and the Annual Report & Accounts: Performance and Prospects:

- The appropriateness and quality of accounting policies;
- Compliance with financial reporting standards and clarity of associated disclosures; and
- Material areas in which primary judgements have been applied.

To assist in the discharge of its duties the Committee considers reports from the General Manager - Financial Control and reports from the external auditor on the outcomes of their half-year review of interim financial statements, including confirmation that the Accounts are prepared on a going concern basis.

The Committee also considered and was satisfied with the papers prepared by the General Manager - Financial Control and the external auditor covering the financial statements for full year 2022/23. These included a section from management supporting the going concern basis which the external auditor confirmed was appropriate. Our view was supported by statutory and regulatory provisions applicable to Scottish Water, namely that:

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

Business Stream's Finance Director, the Chair of its Audit & Risk Committee and the external auditor are also in attendance when the Committee reviews the consolidated interim and annual financial statements. The Board of SWBSH receives reports from Business Stream's management covering financial performance and specific risks facing Business Stream.

The primary areas of judgement considered by the Group Audit & Risk Committee in relation to the 2022/23 Accounts were:

- Risks within the corporate risk register which could impact on the financial statements and judgements therein;
- The primary areas of focus included the sensitivities on future household cash collection rates and wholesale revenue collection and the associated level of bad debt provisioning;
- The delivery costs associated with Scottish Water's capital investment programme and the associated expenditure classifications; and

- The key assumptions associated with determining the actuarial valuation of pension obligations, and the ring-fencing of the Scottish Water element of each pension fund.

After discussion of these with management and the external auditor the Group Audit & Risk Committee was satisfied that the issues raised had been properly dealt with and that appropriate disclosures have been included in the accounts. The external auditor carried out their work using an overall materiality of £23.5 million, representing 1.5% of total annualised expenses incurred in 2022/23, in the consolidated income statement .

However, the Committee agreed with the external auditor that the firm would report any misstatements identified during the audit above £250,000, as well as misstatements below that amount that, in their view, warranted reporting for qualitative reasons.

In addition, the Chief Scientist, the Head of Internal Audit and the Head of Horizons carried out a review to verify that the Annual Report & Accounts 2022/23: Performance and Prospects is fair, balanced and understandable, the results of which were considered by the Committee prior to recommending Board approval of the Annual Report & Accounts 2022/23: Performance and Prospects.

Consequently, and supported by a comprehensive management and statutory accounts process, with written confirmations provided by senior management on the 'health' of the financial and risk control environment, the Committee and the Board are satisfied that the Annual Report & Accounts 2022/23: Performance and Prospects, taken as a whole, are fair, balanced and understandable, and provide the information necessary to assess Scottish Water's performance, business model and strategy.

Scottish Water's Internal Control and Risk Management Processes

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

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

In addition, the Committee reviews the framework of internal controls and the processes by which the organisation's control environment is evaluated.
To support this, the Committee receives and considers:

- Reports from Internal Audit on the effectiveness of internal controls and issues requiring improvement, including reported fraud allegations;
- Observations from the external audit on the internal control environment and any specific control issues identified;
- Corporate risk reports summarising key risks in the corporate risk register including mitigating actions, risk trends, and summarising compliance with Scottish Water's risk appetite;
- Reports covering the quantitative and qualitative stress testing of the principal risks facing the Scottish Water group of companies;
- Topical in-depth risk assessments;
- Bi-annual report from the Counter Fraud Committee;
- An annual report from the Compliance Officer;
- An annual corporate governance report;
- An Internal Audit annual opinion and report;
- An annual report on regulatory compliance;
- An annual statement of compliance with the Modern Slavery Act 2015; and
- An annual Tax strategy.

During the year the Committee requested specific reports on cyber security and NIS compliance, capital investment value for money assurance framework, pensions accounting, supply chain structural risk and Licensed Providers' financial sustainability.

The Committee provides the Board with an annual report on the effectiveness of the internal control framework. To support this, the Committee receives an annual report and opinion from the Head of Internal Audit.

Internal Audit

The Committee approves annually the Internal Audit Charter and the annual and 3 year Internal Audit plans, with any subsequent changes requiring Committee approval. It also reviews the scope and results of Internal Audit reviews and its effectiveness throughout the year, including implementation of an annual quality improvement action plan following the external quality assessment by the Institute of Internal Auditors in 2019. At each main Committee meeting reports were received from the Head of Internal Audit. These reports included progress in delivering the Internal Audit plan, audit findings and management action plans to address these, performance in implementing management action plans, fraud allegation investigations and details of relevant Audit Scotland reports. In addition to the private meetings with the Committee members, the Chair of the Audit & Risk Committee also meets the Head of Internal Audit outside of the formal Committee meetings.

External Audit

The Auditor General for Scotland is responsible for the appointment of the Scottish Water external auditor and the auditor's remuneration. The Auditor General undertook a tender and assessment exercise for Scottish Water and many other public sector organisations, which resulted in the appointment of KPMG as Scottish Water's external auditor for a five-year period from 2022/23 to 2026/27.

The Committee received from KPMG an audit plan, including their assessment of key risks and confirmation of their independence. Following completion of their interim review and annual audit, the Committee receive a report highlighting any internal control weaknesses and the management actions to address these.

Annually the Committee assess, with input from management, and provide feedback to Audit Scotland on the effectiveness of the external auditor. In addition to the private meetings with the Committee members, the Chair of the Audit & Risk Committee also meets the external audit partner outside of the formal Committee meetings.

Auditor Independence

During 2015/16 the Committee approved a policy on provision of non-audit services to Scottish Water by the firm appointed as external auditor and this was extended to all subsidiaries in 2016/17. The Committee monitors implementation of the policy through receipt of a report every six months, or as required, analysing fees paid for any non-audit work by the external auditor, with additional commentary on assignments and on work carried out or to be done relating to safeguards of independence.

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

Iain M Lanaghan
Chair of the Audit & Risk Committee

REMUNERATION COMMITTEE REPORT

Annual Statement by the Chair of the Remuneration Committee

I am pleased to present the first Members' remuneration report in my role as Chair of the Remuneration Committee, for the year ended 31 March 2023. In preparing the report I am thankful for the support of former committee chair, Samantha Barber who stepped down from the Board on 31st March 2023, and fellow Remuneration Committee Non-executive Members Ken Marnoch and Steve Dickson.

The Remuneration Committee meets regularly to consider the remuneration arrangements for Executive Members, and other related remuneration matters, making recommendations to the Board. There were six meetings of the Committee in 2022/23. At each meeting a quorum of independent, Non-executive Members was present. No Executive Member was present during discussions about their own remuneration.

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

We maintain and operate a simple remuneration structure made up of base salary and benefits, an annual out-performance incentive plan (AOIP) and a single long-term incentive plan (LTIP), which provide a clear link between pay and Scottish Water's key strategic priorities.

The key decisions made by the Committee over the 2022/23 period were as follows:

Decisions / remuneration for 2022/23

- Agreeing pay progression of 1.5% and a base salary increase of £500 with effect from 1 April 2022 for Executive Members and the Chief Executive, aligned with the Scottish Government's Public Sector Pay Strategy for 2023.
- Confirming the 2022/23 AOIP payment calculated at 32.79% of salary out of the 40% maximum opportunity for Executive Members and Chief Executive.
- As is normal practice, Remuneration Committee maintained a view of corporate performance throughout the year and found this to be strongly supportive of the AOIP payments calculated and disclosed within this year's report.
- To facilitate a managed transition of senior leadership, confirming arrangements for the Chief Executive's flexible retirement as noted below the single figure table in section 2(a) of the main report.
- Noting management's proposed salary increases for Scottish Water employees.
- Review of succession planning for posts on the Executive Leadership Team.

Decisions / remuneration for 2023/24

- Setting the structure and performance criteria for the 2023/24 AOIP.
- Confirming the remuneration package for the new Chief Executive from 1st June 2023, which will appear as part of the single remuneration table of the 2023/24 members' report.
- In line with Public Sector Pay Strategy for 2023, the salaries of Mr Farrer and Mr Scott increased by 1.5% plus £1,500 from 1st April 2023. Their new annual salaries will therefore be £205,817 and £203,517 respectively.

Our Remuneration Policy and our Annual Report on Remuneration is set out on pages 109 to 123.

Deirdre Michie
Chair of the Remuneration Committee

MEMBERS' REMUNERATION REPORT

The presentation of this Remuneration Report complies with the HM Treasury Financial Reporting Manual 2022/23 (December 2021) and as far as is appropriate, also adopts the same practice as quoted companies even though Scottish Water is not a quoted company.

1. Statement of Executive Remuneration Policy

a. General Policy

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

Scottish Water will continue to provide a working environment that matches the expectations placed on our people to deliver best value outcomes in an empowered organisation. Remuneration and incentivisation policies are a major contributor to achieving Scottish Water's goals. This requires terms of employment for all employees that, taken together, ensure the organisation is perceived as a fair employer that encourages excellence, rewards performance and empowers its people while providing scope for personal development.

The overall remuneration policy aims are to:

- Attract, develop, motivate and retain highly talented people at all levels of the organisation; and
- Incentivise and reward good individual and corporate performance as well as out-performance.

b. Remuneration elements

The Remuneration Policy for Executive Members consists of five principal elements:

- Base salary;
- Annual out-performance incentive plan (AOIP);
- Long-term incentive plan (LTIP);
- Pension; and
- Allowances (for business needs, car, relocation, etc.).

c. Relative importance of performance incentives

Scottish Water is a performance-driven business, where Executive Members' remuneration should be closely linked to corporate performance and out-performance. The aim is to pay a base salary that is competitive, but appropriate for a public corporation. Incentive pay is earned for exceeding demanding targets, with the required degree of out-performance reviewed on an annual basis.

d. Base Salary

Scottish Water is publicly owned and accountable to the Scottish Parliament and Scottish Ministers. Within the context of public sector ownership, the company seeks to attract, retain and motivate leadership talent in competition with private sector utilities and other organisations across the UK economy, as well as with employers in the public sector.

Scottish Water subscribes to the remuneration database of Korn Ferry and uses this as required to review the remuneration of comparator organisations and industry in general against its own. This is one of the largest remuneration databases in the UK with each job subjected to the same method of job sizing.

Specific benchmark analysis is carried out approximately every three years. The most recent review was in January 2022, where the Remuneration Committee commissioned Korn Ferry to refresh this market analysis against other UK water companies and comparable UK PLCs with roles of equivalent scale. Results showed that Executive Members' base salaries ranged between 55% and 81% of industry medians, with the overall average position being 67%.

This is a deterioration from the comparative position last calculated in November 2018 (average 70% against median). This is a concern and so we continue to discuss with the Scottish Government steps we can take to ensure we can attract and retain the skills we need, while delivering on the pay expectations of a responsible public sector employer.

e. Annual Out-performance Incentive Plan

The Remuneration Committee has the right to withhold or vary AOIP payments (potentially to zero) should events undermine the financial stability or reputation of Scottish Water. Such variation may be carried out at any time prior to AOIP payments being made and may affect all or only some of the AOIP recipients. As is normal practice, the Remuneration Committee maintained a view of corporate performance throughout the year and for 2022/23 found this to be strongly supportive of the AOIP payments calculated.

The potential maximum annual incentive attainable for out-performance by Executive Members is 40% of base salary and is non-pensionable. Targets, out-performance targets, and actual performance in 2022/23 are set out below.

Performance assessment is based on the incentive framework agreed by the Scottish Government in December 2020, aligned to our strategic plan in order to focus performance on our three strategic Ambitions of Great Value & Financial Stability; Service Excellence; and Net Zero Emissions.

Strategic Outcome	Measure	Target	Weight	Performance
Great Value & Financial Stability (i)	Tier 1 costs (ii)	• Sliding scale with 50% on plan and 100% for £30m below plan	30%	Costs were £54.4m below plan
	PCL (progress of projects from the Development List to the Committed List)	• Zero below target zone • 50% at bottom of target zone (100% of plan) • 100% at top of target zone (110% of plan)	10%	113% (Investment projects promoted by 13% greater than plan)
	Overall Progress of Investment Delivery (Measures rate of investment delivery relative to committed timescale)	• Zero > 3 months either side of plan • 50% +/- 3 months of plan • 75% +/- 2 months of plan • 100% +/- 1 month of plan	10%	+1.01 months (Investment delivery within 1.01 months of plan)
Service Excellence	New Outcome Performance Assessment (OPA)	• Zero below 395 points • 50% at 395 points • 100% at 410 points	15%	401 pts
	Household Customer Experience Measure (hCEM)	• Zero below 85.0 points • 50% at 85.4 points • 100% at 87.78 points	7.5%	86.45 pts
	Non-household Customer Experience Measure (nhCEM)	• Zero below 85.4 points • 50% at 85.4 points • 100% at 88.66 points	7.5%	86.72 pts
Net Zero	Operational emissions route map delivered successfully and achieving emissions reductions	• Zero below 15,000 tCO_2e • 50% at 15,000 tCO_2e • 100% at 28,000 tCO_2e	20%	15,681 tCO_2e (delivered cumulatively since April 2021)

The awards generated by this performance are detailed in the single figure table of the Members' Remuneration Report.

Non-executive Members are not eligible for annual incentive payments.

Notes

(i) Financial surplus is a gateway on the incentive plan and must be sufficient to fund AOIP payments; costs' target plan baseline will be updated for inflation and regulatory out-turn assumptions.

(ii) Operating costs, PFI and interest relative to WICS final determination expectations, (as adjusted by out-turn inflation), excluding responsive repair and refurbishment, developer contributions and tax.

f. Long-Term Incentive Plan to incentivise out-performance

For the period beginning April 2021

We have developed a new structure for LTIP to address two key elements:

1. Our Strategic Outcome of Beyond Net Zero Emissions stretches across multiple regulatory contracts and so the LTIP must reflect that longer-term commitment.
2. Since the first application of an LTIP scheme in 2006-10, the per-year equivalent payment potential has reduced steadily for participants, as plan and regulatory period durations have lengthened. The new scheme restores the annual equivalent value and thus the overall potential of the reward package, in alignment with the earlier stated aims of our Executive Remuneration Policy.

Strategic Outcome	Measure	Target	Basis	Weight
Great Value & Financial Sustainability	Overall positive Tier 1 financial surplus – Tramline Measure	Positive performance for the period within top half of Tier 1 financial tramlines	Aggregate Tier 1 surplus must be above zero for LTIP to pay out	Yes/No gateway on LTIP payments
	Transformation plan	Integrated transformation plan in operation and has delivered on planned activities for the performance period	Assessment informed by stakeholder views on the extent of progress being made to transform Scottish Water	Yes/Partial/ No decision by Remuneration Committee on the extent of LTIP payable
Net Zero Emissions	Net Zero Emissions routemap targets	Meet or exceed 3-year operational emissions reduction targets for the performance period	• 50% at 20,000 tCO_2e reduction[1] • 100% at 40,000 tCO_2e reduction[2]	Sliding scale between 20,000 and 40,000 tCO_2e targets

Note:

(1) tCO_2e reduction rate in line with Net Zero Emissions by 2040

(2) tCO_2e reduction rate in line with Net Zero Emissions by 2030

The degree to which the LTIP is payable considers stakeholder feedback on transformation progress. This not only links long term incentives clearly to Scottish Water's business transformation but provides a credibility check to maintain the integrity of the overall LTIP mechanism. Remuneration Committee will make a holistic assessment of a systematic gathering of stakeholder sentiment, and over the long term it will be important for all stakeholders to verify that our progress warrants LTIP payments, while incentivising the continuing delivery of our strategic transformation.

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

Duration & Potential Value

Scottish Water's new LTIP operates through a Performance period (during which the incentive is assessed by reference to the performance criteria); and a Vesting period (during which the amount identified in the performance period is held for payment at the end of vesting).

Each of these periods lasts three years and allows the LTIP to reflect the rolling nature of truly long-term performance measures, such as Net Zero Emissions. The Vesting period allows Remuneration Committee to verify that payments earned over a three-year Performance period are not based on short-term decisions, which later prove unsupportive of longer-term performance. This allows the Remuneration Committee, if necessary, to intervene and moderate the level of incentives actually paid out.

Year	2021	2024	2027	2030	2033	2036
Performance Period	LTIP1 start	LTIP1 end; LTIP2 start	LTIP2 end; LTIP3 start	LTIP3 end; LTIP4 start	LTIP4 end; LTIP5 start	LTIP5 end; etc.
Vesting Period		LTIP1 start	LTIP1 end; LTIP2 start	LTIP2 end; LTIP3 start	LTIP3 end; LTIP4 start	LTIP4 end; etc.
Payment			LTIP1	LTIP2	LTIP3	LTIP4
New maximum quantum (Directors). see page 137			45% of salary	45% of salary	45% of salary	45% of salary

The first payment for this new LTIP is potentially made after six years in 2027, with a value of up to 45% of a participant's salary. Further payments of 45% are possible every three years thereafter. This differs from the previous LTIP which could pay out up to 60% of participant salaries every six years.

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

g. Pension

All employees, including Executive Members, are eligible to participate in the Scottish Local Government Pension Scheme (SLGPS) which is a contributory, defined benefit scheme operating under regulations determined by the Scottish Parliament. These regulations require Scottish Water to offer this pension to all employees and in the case of the Executive Members participation is via the Lothian Pension Fund. All pension scheme members may request flexible retirement from age 55, reducing their hours or grade to receive all or part of their pension while continuing to work. All members may also choose to take full Early Retirement from age 55 with a reduction in pension value applied by the pension fund.

The value of pension provided through the SLGPS is set out in section 2.c of the Members' Remuneration Report.

Non-executive Members are not eligible to receive pension benefits.

h. Benefits

A car is provided to all Executive Members for business needs. For those opting out of car provision, a car allowance is payable instead. Non-executive Members are not eligible for a car or car allowance.

Executive Members are covered by the Scottish Water Life Assurance Scheme that covers all employees.

The value of benefits received is set out in the relevant column of the single figure table in the Members' Remuneration Report.

i. Approach to recruitment remuneration

The remuneration of any new Executive Member will be agreed with the Scottish Government prior to appointment of that Member. The Remuneration Committee will recommend a recruitment package, encompassing those elements that apply to other Executive Members and that are detailed elsewhere in this remuneration policy.

If recruitment of an Executive Member requires compensation for relocation this would normally be calculated as per Scottish Water's relocation policies and would be included in any recommendation made, as would any other aspect of proposed remuneration.

The appointment and remuneration of the Chair of Scottish Water and Non-executive Members is agreed by Scottish Ministers, with regard to the daily fee framework of the Scottish Government's Pay Policy for Senior Appointments. Fees paid reflect the time commitment anticipated for each role and are detailed in the Members' Remuneration Report.

j. Payments on loss of office

Executive Members are expected to work the notice periods in their service contracts. In circumstances where it is in the operational interests of Scottish Water for an Executive Member to leave before the end of their notice period, the Remuneration Committee will consider options such as 'garden leave' or paying in lieu for all or part notice on a case-by-case basis.

The Remuneration Committee may decide that a portion of the incentive payment is payable to former Executive Members in certain "good leaver" circumstances, including departure due to redundancy and efficiency, ill-health or normal age retirement, agreed early retirement, retirement or departure with substantial notice and responsibility transition, or death in service. Any incentive payment so determined will be paid no earlier than would have been the case had the Member not left Scottish Water. If an Executive Member leaves the employ of Scottish Water for any other reason and before incentive payments under the AOIP or LTIP would be due, their payment will normally be forfeit.

Where an Executive Member leaves for reasons of efficiency or redundancy, any severance payment that may apply will be on the same terms as for any other employee leaving under such circumstances and will be as set out under the approved redundancy scheme in operation at the time. Where the Executive Member is a member of the SLGPS then access to pension benefits on leaving will be determined by the regulations of that pension scheme, as for any other SLGPS member.

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

k. Consideration of employment conditions elsewhere in the company

The Remuneration Committee requests and receives information as required on pay and terms and conditions for all employees in order to provide context for decisions on executive pay. This information includes comparison of the salary and total pay of the Chief Executive versus that received by other employees; as well as consideration of the ratio between the lowest and highest potential total pay in the organisation.

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

Under the Water Industry (Scotland) Act 2002, Schedule 3, one of the Non-executive Members appointed to the Board of Scottish Water must be a person appearing to the Scottish Ministers to have special knowledge of the interests of employees. A Non-executive Member fulfilling this requirement was appointed to The Board and The Remuneration Committee from 1st May 2021, replacing the previous Non-executive Member with such special knowledge.

I. Service contracts

Details of Executive Members' permanent contracts are set out below.

Executive Member	Name	Date of Contract
Chief Executive	Douglas Millican	1 February 2013
Chief Operating Officer	Peter Farrer	1 April 2013
Strategy & Commercial Director	Alan Scott	31 January 2022

All Members are required to give 6 months' notice of resignation. Scottish Water is required to give Members 12 months' notice of termination.

Douglas Millican left Scottish Water on 31st May 2023 after 27 years in the water industry in Scotland and 10 years as Chief Executive. A smooth leadership transition has been achieved with Alex Plant taking up the post of Chief Executive from 1st June 2023.

Alan Scott has given notice of his desire to leave Scottish Water in December 2023. By statute there can be no fewer than three Executive Members at any time and arrangements are in hand to fulfil that requirement.

Non-executive Members

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

Susan Rice (Chair)	31 December 2023
Iain Lanaghan	31 March 2025
Steven Dickson	30 April 2025
Catriona Schmolke	31 October 2025
Deirdre Michie	30 December 2025
Graham Dalton	31 March 2026
Kenneth Marnoch	31 March 2026

Dame Susan Rice agreed to extend her tenure beyond the normal expiry date of 31st May 2023, allowing the Scottish Government to confirm a new Chair during the summer of 2023 and ensure a smooth transition later in the year.

Samantha Barber stepped down from the Board on 31st March 2023 and the appointment of a new Non-executive Board Member will be made in due course by the Scottish Government.

2. Members' Remuneration Report

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

a. Single Total Figure Table

Fee levels for Non-executive Members, including the Chair, for 2023/24 will increase by £4 per day with effect from 1 April 2023 and in line with Public Sector Pay Policy for Senior Appointments.

		Salary/Fees £000	Benefits[1] £000	AOIP[2] £000	Total £000	Pension[3] £000	Total[4] £000
Executive Members							
Douglas Millican[5]	2023	245	12	80	337	-216	121
	2022	268	12	80	360	38	398
Peter Farrer	2023	201	11	66	278	-110	168
	2022	198	11	60	269	-14	255
Alan Scott	2023	199	8	65	272	24	296
	2022	196	11	59	266	29	295
Non-executive Members[6]							
Chair - Dame Susan Rice	2023	105			105		105
	2022	104			104		104
Samantha Barber[7]	2023	27			27		27
	2022	27			27		27
Iain M Lanaghan[8]	2023	27			27		27
	2022	24			24		24
Kenneth Marnoch	2023	22			22		22
	2022	22			22		22
Deirdre Michie[9]	2023	22			22		22
	2022	22			22		22
Steven Dickson[10]	2023	22			22		22
	2022	20			20		20
Catriona Schmolke[11]	2023	22			22		22
	2022	9			9		9
Graham Dalton[12]	2023	22			22		22
	2022	0			0		0
Former Members							
James Coyle[13]	2022	25			25		25
Matt Smith[13]	2022	2			2		2
Paul Smith[13]	2022	5			5		5
Total Remuneration	**2023**	**914**	**31**	**211**	**1,156**	**-302**	**854**
	2022	922	34	199	1,155	53	1,208

Notes:

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

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

(3) The value of pension benefits accrued is calculated in accordance with section 6.5.8 (d) of the HM Treasury's Government Financial Reporting Manual 2022/23. This requires the rea increase/decrease in accrued benefits, as detailed in section 2c below, to be multiplied by 20, plus the real increase/decrease in accrued lump sum and reduced by the contribution made by the individual Member. The reduction in Mr Millican's and Mr Farrer's pension benefits accrued is driven by the impact of applying an inflation adjustment of 10.1%, reflecting CPI at September 2022, relative to their actual salary increase in the year of circa 1.75%.

(4) To enable a like-for-like comparison of remuneration, the 2022 total excludes the one-off LTIP (Long Term Incentive Plan) payments made in 2022, of £160k, £118k and £117k to Mr Millican, Mr Farrer and Mr Scott respectively, for out-performance in the 2015 to 2021 six year regulatory period. The LTIP for the 2021 to 2027 regulatory period is described in section 1(f) above.

(5) Mr Millican commenced flexible retirement on 1 October 2022 with a reduction in salary and opted not to accrue further pension benefits. A payment of £50,147 was made to Lothian Pension Fund in November 2022 to ensure no change in the actuarial reduction to Mr Millican's pension as a consequence of these arrangements. The cost of Mr Millican's flexible retirement was wholly offset by the reduction in his salary and Scottish Water avoiding pension contribution costs for the period 1st October 2022 to 31st May 2023. The salary figure for 2023 in the single figure table reflects Mr Millican's flexible retirement and reduced salary from 1st October 2022.

(6) Annual fees are set on appointment and then adjusted with regard to the daily fee framework of the Scottish Government's Pay Policy for Senior Appointments and the time commitment indicated within appointment terms. In addition to preparation and attendance at Board and Committee meetings, Non-executive Members are flexible in the hours they work and, in their availability, to provide experienced, high value advice and guidance to Scottish Water.

(7) Samantha Barber stepped down as Remuneration Committee Chair and resigned from the Board with effect from 31st March 2023, before the end of her appointment term.

(8) Iain Lanaghan was appointed Audit & Risk Committee Chair with effect from 1st November 2021.

(9) Figures reflect fees earned before Deirdre Michie's appointment as Remuneration Committee Chair from 1st April 2023.

(10) Steven Dickson was appointed from 1st May 2021

(11) Catriona Schmolke was appointed from 1st November 2021.

(12) Graham Dalton was appointed from 1st April 2022.

(13) James Coyle stepped down as Audit & Risk Committee Chair on 31st October 2021 and resigned from the Board with effect from 31st March 2022, before the end of his appointment term. Matt Smith stepped down from the Board at the end of his appointment expiry date of 30 April 2021 and Paul Smith resigned from the Board with effect from 29 June 2021, before the end of his appointment term.

b. Details of benefits received 2022/23

Name	Car benefit or car allowance £000	Life assurance premium £000	Total £000
Douglas Millican	10	2	12
Peter Farrer	10	1	11
Alan Scott	7	1	8

c. Total pension entitlements to end of financial year 2022/23

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

		Increase in accrued benefits during the year net of inflation		Accumulated total accrued benefits at 31 March 2023		Transfer Values		
	Years in Scheme	Pension £000	Lump sum £000	Pension £000	Lump sum £000	At 31 March 2023 £000	At 31 March 2022 £000	Increase in 2022/23 net of Member's own contributions and inflation £000
Douglas Millican	27.6	-9	-4	85	143	1,692	1,658	-149
Peter Farrer	38.7	-4	-5	105	186	2,176	2,082	-137
Alan Scott	9.5	2	–	28	–	398	325	18

Notes:

(1) All figures shown for Mr Millican are calculated on his date of flexible retrial of 1 October 2022.

(2) 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.

(3) The normal retirement age of Executive Members is determined by the rules of the Scottish Local Government Pension Scheme. For pension accrued up to 31 March 2015 this is age 65. For pension benefits accrued after that date, normal retirement age is set equal to the individual's state pension age. Any pension benefits drawn before normal retirement age are usually reduced in value by actuarial factors reflecting the anticipated longer payment period.

(4) 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.

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

d. Pay multiples

The table below shows how the Chief Executive's change in remuneration value compares to the average percentage change in remuneration value of the wider workforce from 2021/22 to 2022/23.

	Salary	Benefits	AOIP (iii)
Chief Executive (i)	1.69%	0.0%	10.9%
All employee median (ii)	5.4%	0.0%	9.1%

Notes:

(i) For fair comparison, figures are based on the Chief Executive full time equivalent salary on 31st March 2023 of £272,499 and AOIP as if calculated on that salary.

(ii) Change in employee salary is calculated as the change in the median paid from one year to the next.

(iii) Chief Executive and Employee AOIP are driven by the same corporate out-performance, but the employee payment has a fixed maximum value, while the Chief Executive maximum is a percentage of salary and thus is affected by salary movement.

The Government Financial Reporting Manual sets out the method of pay multiple comparison to be used from 2021/22 onwards, so that the Chief Executive total pay figure is compared to that received by other employees at the 25th, 50th and 75th percentile of earnings.

Pay for executives and for all other employees is managed with reference to the Public Sector Pay Policy issued each year. The resultant median ratio of earnings of the Chief Executive to other employees is consistent with this approach.

	Remuneration ratio calculations, excluding movement in pension and LTIP (i) £000				
	2022/23 (ii)	2021/22 (iii)	2020/21	2019/20 (iv)	2018/19
Chief Executive earnings	362	360	371.0	375.0	367.0
Employees (v)					
Salary 25th percentile	28.4	27.2	26.3	-	-
25th percentile earnings	29.4	28.1	27.2	26.5	25.8
Salary 50th percentile	33.3	31.6	30.7	-	-
50th percentile earnings	34.3	32.7	31.7	30.7	29.9
Salary 75th percentile	42.6	40.5	39.3	-	-
75th percentile earnings	44.9	42.6	40.6	39.5	38.7
Ratio at 25th percentile earnings	12.3	12.8	13.6	14.2	14.2
Ratio at 50th percentile earnings	10.6	11.0	11.7	12.2	12.3
Ratio at 75th percentile earnings	8.1	8.5	9.1	9.5	9.5

The earned remuneration of the Chief Executive in the financial year 2022/23 was £337k but based on full time equivalent salary would have been £362k (2021: £360k). £362k was 10.6 times (2022: 11.0) the median remuneration of other employees, which was £34.3k (2022: £32.7k). The change in ratio is affected by two factors: the increase in employee earnings as a result of the 2022/23 pay award which was, on average, of proportionately greater value than the salary increase awarded to the Chief Executive; and the change in the earned annual incentive payment aligned with performance against corporate targets. The full range of annual earnings was from £21.3k to £362k (2022: £19.5k to £360k). The remuneration range was affected by the same factors described above, plus the increase in the Scottish Living Wage which impacts entry level salaries.

Notes:

(i) The total excludes the calculation of change in pension as the value relies heavily on length of pensionable service and so has little meaning when comparing one person (the Chief Executive) against a group of employees with varying lengths of service, i.e., an individual with greater pensionable service could see a faster increase in calculated pension value than someone with shorter pensionable service, even if they are paid the same during a financial year.

(ii) For fair comparison, the earnings figure for the Chief Executive for 2022/23 is not Mr Millican's actual earnings but reflect his full-time equivalent salary on 31st March 2023 of £272,499 and AOIP as if calculated on that salary, thus reflecting no reduction associated with his flexible retirement in October 2022.

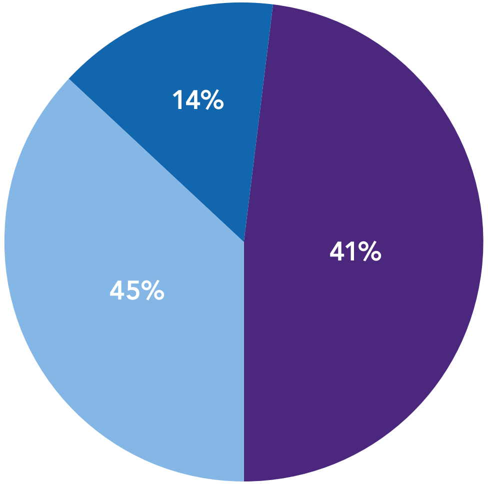
(iii) To allow like-for-like comparison, the Chief Executive figure for 2021/22 uses the total for that year before inclusion of the LTIP payment, which was earned for the out-performance achieved over the six-year period covering 2015 to 2021 and is not an annual amount. The LTIP payment and the pay ratios including that amount were disclosed in the 2021/22 report.

(iv) The figure for the Chief Executive in 2019/20 uses the single total figure in the table at 2(a) that year, excluding pension, as per note (i), but including the value of waived AOIP in that year of £96k.

(v) Employee percentile earnings shown are for full time equivalent salary, benefits and AOIP paid in the reporting year for those with a full year of service, other than Executive Members. In addition, 2021/22 is the first year in which employee percentile salaries are required, but figures for 2020/21 are shown for comparison.

e. Relative importance of spend on pay

The importance of total annual spend on pay is shown in relation to other Operating costs and Capital investment during the year. As Scottish Water is a public sector organisation owned by the Scottish Government, there were no disbursements to shareholders.



Total employee pay

Operating costs (excl. total pay)

Capital investment on a regulatory accounting basis

f. Implementation of Remuneration Policy in 2023/24

As described in the Executive Remuneration Policy, Scottish Water operates an Annual Out-performance Incentive Plan (AOIP) designed to incentivise and reward the out-performance of targets in plans agreed with regulators. To ensure that the AOIP targets remain suitably challenging, the degree of required out-performance has been increased consistently each year. For the 2021/27 regulatory period and beyond, the Remuneration Committee has agreed an overall performance framework with Scottish Ministers, within which the incentive targets will be set each year. For 2023/24 the out-performance targets are as follows.

Strategic outcome	Measure	Target	Weight	Note
Great Value & Financial Stability (i)	Tier 1 costs (ii)	• 50% on regulated full year budget and 100% for £30m below cost base	30%	References Final Determination cost base of £820m (as adjusted by out-turn inflation)
	PCL (progress of projects from the Development List to the Committed List)	• Zero below target zone • 50% at bottom of target zone (100% of plan) • 100% at top of target zone (110% of plan)	10%	No change to target zone from 2022/23 but based on 2023/24 plan
	Indicator of Progress of Overall Delivery (iii)	• Zero > 3 months either side of plan • 50% +/- 3 months of plan • 75% +/- 2 months of plan • 100% +/- 1 month of plan	10%	No change to target zone from 2022/23 but based on 2023/24 plan

g. Executive Members' Directorships of other companies

The Remuneration Committee supports active development of Executive Members including their involvement with other companies and public bodies where this is compatible with fulfilling their responsibilities to Scottish Water. In line with this policy, Douglas Millican, Chief Executive, was appointed as a non-executive director and trustee of World Vision UK in March 2017, from which no remuneration is payable. During the year Mr Millican was also appointed to the Scottish Government's NSET Delivery Board and the Court of the University of Edinburgh, from which no remuneration was paid.

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

Deirdre Michie

Chair of the Remuneration Committee
25 May 2023

Service Excellence	New Outcome Performance Assessment (OPA)	• Zero below 395 points • 50% at 395 points • 100% at 410 points	15%	No change from 2022/23, still a stretch from latest out turn
	Household Customer Experience Measure (hCEM)	• Zero below 85.0 points • 50% at 85.0 points • 100% at 87.8 points	7.5%	Rounded to one decimal point from 2022/23, still a stretch from latest out turn
	Non household Customer Experience Measure (nhCEM)	• Zero below 85.4 points • 50% at 85.4 points • 100% at 88.7 points	7.5%	Rounded to one decimal point from 2022/23, still a stretch from latest out turn
Net Zero	Operational emissions route map delivered successfully and achieving emissions reductions	• Zero below 20,000 tCO_2e • 50% at 20,000 tCO_2e • 100% at 40,000 tCO_2e	20%	Target for 2023/24 represents achievement of mid-regulatory period operational emissions reduction target by March 2024.

Notes:

(i) Financial surplus is a gateway on the incentive plan and must be sufficient to fund AOIP payments; costs' target plan baseline will be updated for inflation and regulatory out-turn assumptions.

(ii) Operating costs, PFI and interest relative to WICS Final Determination expectations, excluding responsive repair and refurbishment, developer contributions and tax, as adjusted by out-turn inflation.

(iii) Change in name of measure only, previously called Overall Progress of Investment Delivery

MEMBERS' REPORT

The Members present the Members' report together with the audited consolidated financial statements for the year ended 31 March 2023.

The Government Financial Reporting Manual 2022/23 (FReM), published by HM Treasury, sets out the form and content for the Annual Report & Accounts 2022/23: Performance and Prospects. This includes the requirements to show a Performance Report and Accountability Report. The Members have reviewed the requirements of the FReM and are satisfied that they are covered within the Overview, Strategic and Governance reports of this report.

The Members' report comprises pages 124 to 126 and the sections of this report incorporated by reference are as follows:

Corporate governance report	See pages 99 to 102
Strategic report, including information in respect of: Scottish Water's results, key financial information and service performance, future developments and the principal risks and uncertainties faced by Scottish Water's group of companies	See pages 18 to 93
Going concern and viability statements	See pages 92 to 93
Greenhouse gas emissions	See page 46
People	See pages 41 to 44
Accounting requirements and basis of account preparation	See Note 1.2, page 136
Financial risk management	See pages 63 to 78

Members and Their Interests

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

Appointment and Replacement of Members

Schedule 3 of the Water Industry (Scotland) Act 2002 specifies Scottish Water's Board must comprise between 5 and 8 Non-Executive Members and between 3 and 5 Executive Members. One Member must have special knowledge of the interests of the employees of Scottish Water. Non-Executive appointments are made by the Scottish Ministers for 3 to 5 years following an open and transparent public appointment process. Executive Members are appointed by Scottish Water with the consent of the Scottish Ministers for an unidentified period. The Members appointments can be terminated under procedures set out in Paragraph 1 of Schedule 3 of the Water Industry (Scotland) Act 2002. Details of the Members' service contracts are on page 109 of the Members' Remuneration Report.

Employee Relations and Involvement

The Scottish Water group of businesses employed an average of 4,542 (2022: 4,360) people during the year. Details of the costs incurred in relation to these employees can be found in note 5 to the financial statements on page 144. Scottish Water is committed to ensuring equality is mainstreamed into all aspects of organisational culture and practice, and all employees have equal opportunities irrespective of race, religion, sex, sexual orientation, disability or age. A number of forums are used to encourage employee involvement. Employees are kept involved through a process of regular team meetings, employee newsletters and representation on consultative forums.

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

Further information can be found in the People section.

Research and Development

To ensure that Scottish Water derives benefit from the most up-to-date research being undertaken within the industry, research expenditure is targeted towards collaborative research with other water operators and regulators within the UK. This ensures that access is gained to high value, widely based research programmes in the Environmental, Quality, Engineering, Operational and Regulatory fields. Research into issues common to the UK water industry is procured through membership of the UK Water Industry Research Centre and the Foundation of Water Research. In addition, Horizons has developed and operates specialist innovation development centres at Gorthleck and Bo'ness to test new products and processes associated with the treatment of drinking water and waste water.

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

Political Contributions

No political contributions were made during the year (2022: nil).

Public Services Reform (Scotland) Act 2010

Sections 31 and 32 of the Public Services Reform (Scotland) Act 2010 impose new duties on the Scottish Government and listed public bodies to publish information on expenditure and certain other matters as soon as is reasonably practicable after the end of each financial year.

In accordance with the Public Services Reform (Scotland) Act 2010, Scottish Water will publish the full information as required by the act on the **Scottish Water website** following the approval of the Scottish Water Annual Report & Accounts 2022/23: Performance and Prospects. The report for this financial year will be available later in 2023.

Members' Responsibilities

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities included in the Independent Auditor's Report on pages 128 to 131, is made with a view to distinguishing the respective responsibilities of the Members and of the auditor in relation to the financial statements.

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

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

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

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

The Members, as at the date of this report, consider that the Annual Report & Accounts 2022/23: Performance and Prospects taken as a whole is fair, balanced and understandable and provides the information necessary to assess Scottish Water's performance, business model and strategy.

Each of the Members, whose names and functions are listed in the Board Members section on pages 95 to 98, confirms that to the best of their knowledge and belief:

1. the Group and Company financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the UK using the cost model for property, plant and equipment, and where otherwise appropriate, as interpreted and adapted by the Government Financial Reporting Manual (FReM), give a true and fair view of the assets, liabilities, financial position and surplus of Scottish Water;
2. the Strategic Report includes a fair review of the development and performance of the business and the position of Scottish Water, together with a description of the principal risks and uncertainties that it faces.

Each of the persons who is a Member at the date of approval of this report confirms that:

1. so far as the Member is aware, there is no relevant audit information of which the Company's auditor is unaware; and
2. each Member has taken all the steps that he/she ought to have taken as a Member in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

By order of the Board,

Douglas Millican,
Chief Executive

31 May 2023

FINANCIALS

INDEPENDENT AUDITOR'S REPORT

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

Reporting on the audit of the financial statements

Opinion on financial statements

We have audited the financial statements in the annual report and accounts of Scottish Water for the year ended 31 March 2023 under the Water Industry (Scotland) Act 2002. The financial statements comprise the Group and Company Balance Sheets, the Group and Company Income Statements, the Group and Company Statements of Comprehensive Income, the Consolidated and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flow and notes to the financial statements, including significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, and, where otherwise appropriate, as interpreted and adapted by the 2022/23 Government Financial Reporting Manual (the 2022/23 FReM).

In our opinion the accompanying financial statements:

- give a true and fair view of the state of the group's and company's affairs as at 31 March 2023 and of the group's and company's surplus for the year then ended;
- have been properly prepared in accordance with UK adopted international accounting standards, and, where otherwise appropriate, as interpreted and adapted by the 2022/23 FReM; and
- have been prepared in accordance with the requirements of the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

Basis for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the **Code of Audit Practice** approved by the Auditor General for Scotland. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We were appointed by the Auditor General on 18 May 2022. Our period of appointment is for five years, covering 2022/23 to 2026/27. Including a previous appointment, the period of total uninterrupted appointment will be 11 years. We are independent of the group and company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the group and company. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for /our opinion.

Conclusion relating to going concern basis of accounting

We have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group and company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

These conclusions are not intended to, nor do they, provide assurance on the group and company's current or future financial sustainability. However, we report on the company's arrangements for financial sustainability in a separate Annual Audit Report available from the **Audit Scotland website**.

Risks of material misstatement

We report in our separate Annual Audit Report the most significant assessed risks of material misstatement that we identified and our judgements thereon.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Responsibilities of the Accountable Officer and Board Members for the financial statements

As explained more fully in the Members' Responsibilities Statement, the Accountable Officer and Board Members are responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Accountable Officer and Board Members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Accountable Officer and Board Members are responsible for assessing the group and company's ability to continue as going concerns, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention to discontinue the group and company's operations.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of these financial statements..

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities outlined above to detect material misstatements in respect of irregularities, including fraud. Procedures include:

- using our understanding of the central government sector to identify that the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers are significant in the context of the group and company;
- inquiring of the Accountable Officer and legal officer as to other laws or regulations that may be expected to have a fundamental effect on the operations of the group and company;
- inquiring of the Accountable Officer and legal officer concerning the company's and group's policies and procedures regarding compliance with the applicable legal and regulatory framework;
- discussions among our audit team on the susceptibility of the financial statements to material misstatement, including how fraud might occur; and
- considering whether the audit team collectively has the appropriate competence and capabilities to identify or recognise non-compliance with laws and regulations.

The extent to which our procedures are capable of detecting irregularities, including fraud, is affected by the inherent difficulty in detecting irregularities, the effectiveness of the company's and group's controls, and the nature, timing and extent of the audit procedures performed.

Irregularities that result from fraud are inherently more difficult to detect than irregularities that result from error as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Report on regularity of expenditure and income

Opinion on regularity

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

Responsibilities for regularity

The Board Members are responsible for ensuring the regularity of expenditure and income. In addition to our responsibilities in respect of irregularities explained in the audit of the financial statements section of our report, we are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Report on other requirements

Opinion prescribed by the Auditor General for Scotland on audited part of the Members' Remuneration Report

We have audited the parts of the Members' Remuneration Report described as audited. In our opinion, the audited parts of the Members' Remuneration Report have been properly prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

Other information

The Accountable Officer and Board Members are responsible for the other information in the annual report and accounts. The other information comprises the Overview, Strategic Report, Governance Statement and the unaudited parts of the Members' Remuneration Report.

Our responsibility is to read all the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on the Performance and Prospects sections on pages 21 to 93 within the Strategic Report and the Corporate Governance Report to the extent explicitly stated in the following opinions prescribed by the Auditor General for Scotland.

Opinion prescribed by the Auditor General for Scotland on Performance and Prospects Report and Governance Statement

In our opinion, based on the work undertaken in the course of the audit,

- the information given in the Performance and Prospects sections on pages 21 to 93 within the Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers; and
- the information given in the Corporate Governance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Matters on which we are required to report by exception

We are required by the Auditor General for Scotland to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the audited part of the Members' Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to our responsibilities for the annual report and accounts, our conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in our Annual Audit Report.

Use of our report

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 108 of the Code of Audit Practice, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

[Signature]

Timothy Cutler
for and on behalf of KPMG LLP
KPMG LLP
St Peter's Square
Manchester
M2 3AE

xx June 2023

INCOME STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2023

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Revenue	3	**1,836.5**	**1,733.5**	**1,367.7**	**1,288.2**
Cost of sales		(1,444.7)	(1,303.1)	(1,033.7)	(923.0)
Gross surplus		**391.8**	**430.4**	**334.0**	**365.2**
Administrative expenses		(181.1)	(178.4)	(124.1)	(130.5)
Operating surplus	3,4	**210.7**	**252.0**	**209.9**	**234.7**
Finance income	7	5.4	0.1	4.3	-
Finance costs	7	(155.2)	(161.3)	(154.5)	(161.4)
Surplus before taxation		**60.9**	**90.8**	**59.7**	**73.3**
Taxation	8	(20.4)	(158.0)	(18.6)	(153.5)
Surplus/(deficit) for the year	21	**40.5**	**(67.2)**	**41.1**	**(80.2)**

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 2023

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Surplus/(deficit) for the year	21	40.5	(67.2)	41.1	(80.2)
Other comprehensive income:					
Items which will not subsequently be reclassified to the income statement					
Actuarial gain on post employment benefit obligations, net of deferred taxation	22	85.0	163.5	75.2	158.4
Effective portion of changes in fair value of cash flow hedge, net of deferred taxation	26	2.5	3.0	-	-
Total comprehensive income for the year		128.0	99.3	116.3	78.2

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

BALANCE SHEETS
AS AT 31 MARCH 2023

	Note	Group 2023 £m	Group 2022 £m	Company 2023 £m	Company 2022 £m
Assets					
Non-current assets					
Property, plant and equipment	9	7,134.6	6,813.1	7,105.3	6,773.1
Intangible assets	10	21.5	26.0	9.2	12.6
Investments	11	–	–	37.6	37.6
Retirement benefit asset	22	27.1	–	24.6	–
Deferred tax asset	16	1.8	3.6	–	–
		7,185.0	6,842.7	7,176.7	6,823.3
Current assets					
Inventories	12	4.5	4.2	4.1	3.8
Assets held for sale	9	7.9	–	–	–
Trade and other receivables	13	307.2	265.1	113.8	99.9
Current tax asset		16.7	11.8	16.4	11.7
Cash and cash equivalents	14	486.9	657.1	390.3	515.9
		823.2	938.2	524.6	631.3
Total assets	3	**8,008.2**	**7,780.9**	**7,701.3**	**7,454.6**
Liabilities					
Current liabilities					
Trade and other payables	15	(520.3)	(495.1)	(406.5)	(356.5)
Other loans and borrowings	18	(22.3)	(26.3)	(22.3)	(24.6)
Current tax liabilities		(1.7)	(2.6)	–	–
Provisions for liabilities	17	(12.1)	(11.9)	(13.9)	(14.4)
		(556.4)	(535.9)	(442.7)	(395.5)
Non-current liabilities					
Trade and other payables	15	(92.5)	(84.9)	(74.4)	(65.9)
Other loans and borrowings	18	(153.7)	(201.5)	(153.7)	(208.7)
Deferred tax liabilities	16	(690.6)	(644.7)	(688.5)	(640.3)
Retirement benefit obligations	22	–	(51.9)	–	(42.9)
Provisions for liabilities	17	(9.2)	(9.3)	(10.0)	(10.7)
		(946.0)	(992.3)	(926.6)	(968.5)
Total liabilities		**(1,502.4)**	**(1,528.2)**	**(1,369.3)**	**(1,364.0)**
Net assets		**6,505.8**	**6,252.7**	**6,332.0**	**6,090.6**
Equity					
Government loans	19	4,508.7	4,383.6	4,508.7	4,383.6
Retained earnings	21	1,863.7	1,738.2	1,689.9	1,573.6
Cash flow hedge reserve	26	–	(2.5)	–	–
Other reserves		133.4	133.4	133.4	133.4
		6,505.8	**6,252.7**	**6,332.0**	**6,090.6**

The financial statements on pages 132 to 170 were approved by the Board of Members on 31 May 2023 and signed on its behalf by:

Douglas Millican
Chief Executive

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Cash flow hedging reserves £m	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2021		(5.5)	1,641.9	133.4	1,769.8
Deficit for the year	21	–	(67.2)	–	(67.2)
Other comprehensive gain:					
Actuarial gain on post employment benefit obligations, net of tax	22	–	163.5	–	163.5
Effective portion of changes in fair value of cash flow hedge, net of tax	26	3.0	–	–	3.0
Total comprehensive income for the year		3.0	96.3	–	99.3
Balance at 31 March 2022		**(2.5)**	**1,738.2**	**133.4**	**1,869.1**
Surplus for the year	21	–	40.5	–	40.5
Other comprehensive gain:					
Actuarial gain on post employment benefit obligations, net of tax	22	–	85.0	–	85.0
Effective portion of changes in fair value of cash flow hedge, net of tax	26	2.5	–	–	2.5
Total comprehensive income for the year		2.5	125.5	–	128.0
Balance at 31 March 2023		**–**	**1,863.7**	**133.4**	**1,997.1**

COMPANY STATEMENT OF CHANGES IN EQUITY

	Note	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2021		1,495.4	133.4	1,628.8
Deficit for the year	21	(80.2)	–	(80.2)
Other comprehensive gain:				
Actuarial gain on post employment benefit obligations, net of tax	22	158.4	–	158.4
Total comprehensive income for the year		78.2	–	78.2
Balance at 31 March 2022		**1,573.6**	**133.4**	**1,707.0**
Surplus for the year	21	41.1	–	41.1
Other comprehensive gain:				
Actuarial gain on post employment benefit obligations, net of tax	22	75.2	–	75.2
Total comprehensive income for the year		116.3	–	116.3
Balance at 31 March 2023	21	**1,689.9**	**133.4**	**1,823.3**

The 'Statement of changes in equity' above excludes Government loans which, in accordance with the Scottish Water Governance Directions 2009, are recorded on the balance sheet under Equity. Full details of Government loans are provided in note 19.

STATEMENTS OF CASH FLOW
FOR THE YEAR ENDED 31 MARCH 2023

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Surplus before taxation		60.9	90.8	59.7	73.3
Depreciation charges	9	309.9	293.9	305.5	288.3
Amortisation of intangible asset	10	12.8	14.0	9.3	11.3
Amortisation of grants		(1.8)	(1.8)	(1.5)	(1.5)
Loss /(surplus) on disposal of property, plant and equipment		8.3	(2.7)	(0.6)	(3.4)
Non cash impact on acquisition of assets and liabilities of subsidiary	11	-	-	3.1	-
Non cash adjustment for retirement benefit obligations		38.4	42.8	37.1	41.0
Finance costs - net		149.8	161.2	150.2	161.4
Operating cash flow before changes in working capital and provisions		**578.3**	**598.2**	**562.8**	**570.4**
Changes in working capital and provisions:					
(Increase) / decrease in receivables		(46.2)	(19.8)	(18.0)	10.4
Increase in inventories		(0.3)	(0.3)	(0.3)	(0.3)
Increase in payables		6.1	44.8	29.2	33.3
(Decrease) / increase in provisions		(1.9)	3.2	(3.2)	1.5
Cash flows from operating activities		**536.0**	**626.1**	**570.5**	**615.3**
Taxation paid		(7.8)	(12.9)	(0.2)	(14.6)
Net cash generated from operating activities		528.2	613.2	570.3	600.7
Cash flows from investing activities					
Purchase of property, plant and equipment		(636.5)	(604.9)	(630.5)	(596.7)
Proceeds from sale of property, plant and equipment		0.3	3.6	0.6	3.9
Purchase of intangible asset	10	(8.4)	(10.0)	(6.0)	(6.6)
Government grant income received		1.6	2.0	2.3	1.8
Acquisition of assets and liabilities of subsidiary companies	11	-	-	(35.3)	-
Infrastructure income receipts		19.6	29.6	19.6	29.6
Net cash used in investing activities		(623.4)	(579.7)	(649.3)	(568.0)
Cash flows from financing activities					
Repayments of loans		(153.4)	(144.8)	(122.6)	(139.7)
Proceeds from borrowings		247.7	374.9	247.7	374.9
Interest received		5.4	0.1	4.3	–
Interest paid		(153.7)	(157.0)	(153.2)	(157.4)
Payment of finance lease liabilities		(21.0)	(20.0)	(22.8)	(23.3)
Net cash (utilised in) / generated from financing activities		(75.0)	53.2	(46.6)	54.5
Net (decrease) / increase in cash and cash equivalents		**(170.2)**	**86.7**	**(125.6)**	**87.2**
Cash and cash equivalents at beginning of year	14	657.1	570.4	515.9	428.7
Cash and cash equivalents at end of year	14	**486.9**	**657.1**	**390.3**	**515.9**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2023

1. Accounting policies

1.1 General information

Scottish Water is a public sector body, classified as a public corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers. Scottish Water is referred to as the 'company' within these financial statements. The subsidiaries of Scottish Water, detailed in Note 11 to the financial statements, are consolidated and presented as the 'Group' within these financial statements.

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below.

1.2 Basis of preparation

The financial statements of Scottish Water for the year ended 31 March 2023 have been prepared in accordance with UK adopted and endorsed International Financial Reporting Standards (IFRS) using the cost model for property, plant and equipment, as directed under the Scottish Water Governance Directions and International Financial Reporting Interpretations Committee (IFRIC) interpretations, and where otherwise appropriate, as interpreted and adapted by the Government Financial Reporting Manual (FReM). The FReM is published by HM Treasury and is available from their website.

The consolidated financial statements have been prepared on the going concern basis under the historical cost convention, as modified by the revaluation of derivative financial instruments at fair value through the income statement. The financial statements are prepared in a form directed by Scottish Ministers in accordance with section 45(2) of the Water Industry (Scotland) Act 2002. The Company's financial statements have been prepared on the same basis.

Scottish Water's accounting policies, as set out below, have been consistently applied to all the years presented, unless otherwise stated.

Scottish Water's financial statements have been prepared in accordance with IFRS using the cost model for property, plant and equipment and where appropriate as interpreted and adapted by the FReM since 1 April 2008. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying Scottish Water's accounting policies (note 2).

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

Going concern

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

In considering the basis of accounting, cash flow forecasts have been prepared for a period of at least 12 months from the date of approval of these financial statements which consider various scenarios, taking into consideration severe but plausible impact downsides. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. Under all of the scenarios, Scottish Water will be able to operate within its available facilities.

Consequently, the Members are confident that Scottish Water will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of these financial statements and therefore have prepared the financial statements on a going concern basis.

1.3 Accounting standards not yet adopted by Scottish Water

IFRS 16 Leases came into effect for financial periods beginning on or after 1 January 2019 for the subsidiary companies. However, the implementation for public sector was deferred by the Financial Reporting Advisory Board (FRAB) in April 2022 to 1 April 2024. IFRS 16 is not expected to have a material impact on the results and net assets of Scottish Water.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

1. Accounting policies (continued)

1.4 Basis of consolidation

Subsidiaries

The consolidated financial information incorporates the results of Scottish Water (the company) and its trading subsidiaries. The consolidated financial information does not include the non trading subsidiaries as permitted under section 405 of the Companies Act 2006. Subsidiaries are all entities over which Scottish Water has the power to direct the relevant activities of the entities, the rights to variable returns and the ability to use its power to influence the returns. Scottish Water Business Stream Limited (Business Stream) is treated as a subsidiary although there are special governance arrangements which were established in conjunction with the Water Industry Commission for Scotland and associated with the conditions attached to Business Stream's licence for the supply of water and waste water services. Scottish Water is, however, satisfied that the controls and governance in place are such that consolidation is appropriate. Subsidiaries are fully consolidated from the date on which control is transferred to Scottish Water; they are de-consolidated from the date when control ceases.

Intercompany transactions, balances and any unrealised gains on transactions between Scottish Water related companies have been eliminated within the consolidated financial statements. Uniform accounting policies have been adopted across the Scottish Water group of companies.

1.5 Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board of Scottish Water.

1.6 Revenue recognition

Revenue is recognised to the extent it is probable that economic benefits will flow to Scottish Water and that the revenue can be reliably measured. Revenue is recognised when, or as, the performance obligations to the customer are satisfied. Revenue is shown net of associated sales taxes and value added tax and after eliminating sales between the Scottish Water related companies. Where services have been provided, but for which no invoice has been raised at the year end, an estimate of the value is included in revenue.

Revenue comprises charges to customers for water and waste water services, and related services provided during the year in the normal course of business. For measured customers, revenue includes an estimate of the value of water and waste water services supplied to customers between the date of the last meter reading and the year end. For unmeasured customers billed in advance, income is deferred and released to the income statement throughout the year.

1.7 Research and development expenditure

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects which either do not meet the criteria defined in IAS 38 'Intangible assets' or are deemed to be not material, are recognised as an expense as incurred. Development costs which meet the relevant criteria are capitalised and written off over their expected useful lives. Development costs previously recognised as an expense are not recognised as an asset in subsequent periods.

1.8 Finance income and costs

Finance income comprises interest receivable on funds invested and recognised in the income statement. Finance costs comprise interest payable on borrowings and interest on pension scheme net liabilities. Interest income and costs are recognised in the income statement as they accrue, on an effective interest rate method.

Borrowing costs incurred by Scottish Water that are not directly attributable to the acquisition, construction or production of qualifying assets are expensed in the period in which they are accrued.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

1. Accounting policies (continued)

1.9 Taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, unless it relates to items recognised directly in reserves in which case it is recognised in reserves.

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

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by Scottish Water and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

1.10 Property, plant and equipment

Property, plant and equipment comprises water and waste water infrastructure assets and other assets, being overground assets including operational properties, plant, machinery and vehicles.

Property, plant and equipment are included at historical cost less accumulated depreciation and impairment. Cost includes the acquisition or construction cost together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs and, where material, borrowing costs. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that the future economic benefits associated with the item will flow to Scottish Water and the cost of the item can be measured reliably. The carrying amount of the replaced parts, with the exception of infrastructure assets, are derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. All items of property, plant and equipment, with the exception of land and assets under construction, are subject to depreciation.

Infrastructure assets

The infrastructure assets comprise a network of water and waste water systems including mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and outfalls. Expenditure on infrastructure assets, which relates to increases in capacity or enhancements of the network, is treated as additions. Expenditure incurred in maintaining and repairing the operating capability of the network is expensed in the year in which it is incurred. Depreciation is calculated for each component of the network with similar characteristics and asset lives.

Other assets

All other property, plant and equipment are depreciated on a straight-line basis over their estimated useful economic lives.

Depreciation

Depreciation is charged to the income statement to write-off cost, less residual values, on a straight-line basis over the estimated operational lives of the assets, from the month in which the asset comes into beneficial use. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Freehold land and assets under construction are not depreciated. The estimated useful lives for assets depreciated are as follows:

Infrastructure assets	80 to 150 years
Non-specialised operational buildings and structures	60 years
Fixtures, fittings and furniture within non-specialised operational buildings	5 years
Specialised operational buildings and structures	15 to 80 years
Plant, machinery and vehicles	1 to 60 years

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

1. Accounting policies (continued)

1.11 Leased assets

Leases where Scottish Water control through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the service concession agreements are treated as finance leases. Private Finance Initiative (PFI) contracts are treated as finance leases, in accordance with IFRIC 12.

Assets held under finance leases are recognised as part of property, plant and equipment at their fair value or, if lower, at the present value of the minimum lease payments, as determined at the inception of the PFI contract. The corresponding liability is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation. Finance charges are charged directly to the income statement. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

All other leases are categorised as operating leases. Payments made under operating leases are charged to the income statement over the term of the lease on a straight-line basis.

1.12 Impairment of assets

The carrying values of non-current assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be justified. An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

1.13 Capital grants and customer contributions

Capital grants and customer contributions in respect of infrastructure assets are deducted from the cost of the non-current asset. Grants and contributions received in respect of non-infrastructure assets are credited to deferred income and are released to the income statement over the expected useful lives of the relevant non-current assets.

1.14 Intangible assets

Intangible assets represent software that is controlled by Scottish Water and/or its subsidiaries and the acquisition of non-household customer bases, by Business Stream. Intangible assets are recognised at cost and treated as having a finite life. They are stated at cost less accumulated amortisation. Amortisation is charged to the income statement to write off the cost, less any residual value, on a straight-line basis over the expected useful life from the date of beneficial use.

The expected useful lives and residual values are reviewed annually, and adjusted if appropriate, at the balance sheet date.

1.15 Investments

Investments in subsidiaries, held as non-current assets, are stated at cost less any provision for impairment. Any impairment is charged to the income statement as it arises.

1.16 Inventories

Inventories and work in progress are stated at the lower of cost or net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Cost includes all costs incurred in bringing each asset to its present location and condition. The valuation of work in progress is based on the cost of labour and materials plus appropriate overheads.

1.17 Financial instruments

Financial assets and liabilities are recognised in the balance sheet when an obligation is identified and released as that obligation is fulfilled. Scottish Water's financial instruments comprise trade and other receivables, cash and cash equivalents, borrowings, as well as trade and other payables that arise directly from operations. Scottish Water’s policy is not to trade or speculate in financial instruments but under special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures. As such circumstances are rare, approval is required from Scottish Ministers. All treasury activities are undertaken in accordance with the permitted activities as set out in the Scottish Water Governance Directions.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

1. Accounting policies (continued)

a. Trade receivables

Trade receivables are recorded at net realisable value after deducting a provision where there is evidence that Scottish Water will not be able to collect all amounts due. The provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile of the outstanding debt. Trade receivable balances, with the exception of statutory debt, are written off when Scottish Water determines that it is unlikely that future remittances will be received. Trade receivables do not carry any interest.

b. Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits with banks, which have a maturity of 3 months or less from the date of acquisition and which are subject to an insignificant risk of change in value.

c. Trade and other payables

Trade and other payables are stated at cost.

d. Interest-bearing loans and borrowings

Borrowings are recognised initially at fair value and are subsequently stated at amortised cost. Overdrafts and non Government loans are classified as current liabilities unless Scottish Water has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

e. Derivative financial instruments

In special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures such as foreign exchange fluctuations. As such circumstances are rare, in addition to the approval of the Scottish Water Board, approval is required from Scottish Ministers under the terms of section 42(3)(b) Water Industry (Scotland) Act 2002.

Financial derivative instruments are recognised at fair value and are re-measured to fair value each reporting period with the exception of derivatives that qualify for cash flow hedge accounting.

f. Cash flow hedges

Where the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost the effective part of any gain or loss on the derivative financial instrument is recognised in other comprehensive income (OCI). Any ineffective portion of the hedge is recognised immediately in the income statement.

When the hedging relationship ends or when a hedge no longer meets the criteria for hedge accounting, any hedging gain or loss recognised in OCI is reclassified to the income statement.

1.18 Employee benefit obligations

Employees of the Scottish Water group of companies participate in the Scottish Local Government Pension Scheme (SLGPS) administered by Aberdeen, Glasgow and Edinburgh City Councils, all of which are defined benefit schemes. Pension scheme assets are measured using the bid market values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

Any increase in the present value of liabilities within the defined benefit pension schemes expected to arise from employee service in the period is charged to operating surplus. The net interest cost for the period, calculated by applying the discount rate to the net pension scheme liabilities, is included in the finance costs. Actuarial gains and losses are recognised as an item of 'other comprehensive income' in the consolidated statement of comprehensive income. Pension scheme deficits and surpluses, to the extent that the surplus is considered recoverable, are recognised in full and presented on the face of the balance sheet.

Within the subsidiary companies there are also two defined contribution pension schemes under which the companies pay fixed contributions and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

1. Accounting policies (continued)

1.19 Provisions

Provisions are recognised when there is a present obligation for a past event, for which it is probable that a transfer of economic benefits will be required and a reliable estimate can be made of the amount of the obligation. Provisions currently relate to onerous property rental costs, income uncertainty and redundancy costs associated with employees who will leave Scottish Water under voluntary redundancy and early retirement. Pension related liabilities associated with employees who have left Scottish Water under the voluntary severance scheme are recognised in the pension liability.

1.20 Foreign currency transactions

Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transactions. Foreign exchange gains and losses resulting from (i) the settlement of such transactions and (ii) the retranslation to exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

1.21 Indebtedness to the Scottish Ministers

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

1.22 Common control transactions

Any business combinations or transfer of assets and liabilities within the group are transferred at book value at the transaction date. These transactions are considered to be common control transactions and are excluded from the scope of IFRS 3 - Business Combinations'.

1.23 Assets held for sale

Non-current assets are classified as held-for-sale if it is highly probable that they will be recovered through sale rather than through continuing use. Assets classified as held for sale are presented separately on the Balance sheet and are measured at the lower of carrying value and fair value less cost of sale. Once classified as held-for-sale, property, plant and equipment are no longer depreciated. Impairments are considered at the point of, and following classification as held for sale. Any impairments are recognised through the income statement.

2. Accounting estimates and judgements

The preparation of financial statements to conform to IFRS requires the use of estimates, assumptions and judgements that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts for revenue and expenses during the reporting period. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Although based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from these estimates, the effect of which is recognised in the period in which the facts giving rise to the revision arise.

The most critical of these accounting judgement and estimation areas are noted below.

a. Revenue recognition

Revenue relating to metered customers includes an estimate of the value of water or waste water services supplied between the date of the last meter reading and the year end. At the balance sheet date, the estimated consumption by customers will either have been billed (estimated billed revenue) or accrued (unbilled revenue). Using historical consumption patterns, management apply judgement to the measurement of the quantum of the estimated consumption and to the valuation of that consumption. The judgements applied, and the assumptions underpinning these judgements, are considered to be appropriate. However, a change in these assumptions would have no material impact upon the amount of revenue recognised.

b. Impairment of trade and other receivables

Scottish Water and each of its subsidiaries evaluate the recoverability of their trade receivables as at the reporting date and assess the allowances for doubtful receivables. The group has adopted IFRS 9 'Financial instruments' from 1 April 2018 which requires an expected loss method of impairment of financial assets to be used. This is based on, amongst other factors, actual collection history, forecast rates and customer category.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

2. Accounting estimates and judgements (continued)

The actual level of receivables collected may differ from those estimated, due to factors such as changes in customer behaviour, potential impact of government policy initiatives and the economic outlook, which could impact positively or negatively on operating results (see sensitivity analysis in note 26).

c. Carrying value of property, plant and equipment

Property, plant and equipment (PPE) represents the majority of the asset base and a significant proportion of annual expenditure (see funding chart on page 9). Consequently, the estimates and assumptions made in determining the carrying values and related depreciation are critical to Scottish Water's financial performance and position.

The estimated useful economic lives and residual values of PPE are based on management's judgement and experience. Due to the significance of PPE investment, variations between actual and estimated economic lives could impact on operating results both positively and negatively. When management identifies that actual useful economic lives differ materially from the estimates used, the relevant depreciation charge is adjusted prospectively.
However, historically, any changes to estimated useful lives and residual values have not resulted in material changes to Scottish Water's depreciation charges.

Each financial year, in accordance with IAS 23 'Borrowing costs', Scottish Water calculates the amount of borrowing which would be attributable to the PPE acquired or under construction. To date these amounts have been immaterial and therefore not capitalised.

d. Provisions

The assessments undertaken in recognising provisions and contingencies have been made in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The evaluation of the likelihood of the contingent events has required the best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseen developments, this likelihood could alter.

e. Retirement benefits

Scottish Water and its subsidiaries are participating employers in 3 Scottish Local Government Pension Schemes (SLGPS) which are defined benefit schemes. Actuarial valuations of the schemes are carried out by the administering authorities triennially in line with SLGPS regulations. The assumptions in relation to the cost of providing post-retirement benefits during the period are set after consultation with qualified actuaries. These assumptions include discount rates, returns on the schemes' assets, pay growth and increases to pension payments (see note 22) and, while these assumptions are believed to be appropriate, a change to the assumptions would impact the surplus of Scottish Water and the carrying amount of pension obligations. These assumptions may differ from the actual results due to changes in market and economic conditions and longer or shorter lives of participants.

3. Segmental analysis

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

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

3. Segmental analysis (continued)

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Revenue				
Regulated water and waste water services	1,364.9	1,285.3	1,364.9	1,285.3
Business Stream	657.4	629.0	–	–
Non-regulated activities	34.8	50.0	2.8	2.9
	2,057.1	1,964.3	1,367.7	1,288.2
Inter company elimination	(220.6)	(230.8)	–	–
	1,836.5	**1,733.5**	**1,367.7**	**1,288.2**

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Operating surplus				
Regulated water and waste water services	209.7	234.5	209.7	234.5
Business Stream	2.3	12.4	–	–
Non-regulated activities	8.8	8.6	0.2	0.2
Reversal of IFRIC 12 adjustments on consolidation	(10.1)	(3.5)	–	–
	210.7	**252.0**	**209.9**	**234.7**

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Total assets				
Regulated water and waste water services	7,662.8	7,414.5	7,701.0	7,452.7
Business Stream	256.8	273.0	–	–
Non-regulated activities	88.6	120.7	0.3	1.9
Reversal of IFRIC 12 adjustments on consolidation	–	(27.3)	–	–
	8,008.2	**7,780.9**	**7,701.3**	**7,454.6**

	Capital additions to property, plant & equipment		Depreciation on property, plant & equipment	
	2023 £m	2022 £m	2023 £m	2022 £m
Regulated water and waste water services	644.4	581.3	305.5	288.3
Business Stream	0.3	–	1.5	1.5
Non-regulated activities	9.1	7.3	2.9	4.1
	653.8	**588.6**	**309.9**	**293.9**

Revenue by geographical location of customers is as follows:

	Revenue	
	2023 £m	2022 £m
United Kingdom	1,836.3	1,733.3
Rest of the World	0.2	0.2
	1,836.5	**1,733.5**

£0.2 million of revenue has been generated outside the UK (2022: £0.2 million) and this resulted in a current tax charge of £nil (2022: £nil). The revenue was entirely derived from Australia where we have a tax residency and registered branch. There are no offices in Australia and only one member of staff in the country.

All revenue for the company has been generated within the United Kingdom.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

4. Group operating surplus

Group operating surplus is arrived at after charging/(crediting):

	Note	2023 £m	2022 £m
Scottish Water PFI operating costs		138.9	133.0
Depreciation of property, plant and equipment	9	309.9	293.9
Amortisation of intangible asset	10	12.8	14.0
Loss / (surplus) on sale of property, plant and equipment		8.3	(2.7)
Release of deferred income in relation to capital grants		(1.8)	(1.8)
Operating lease rentals		3.1	2.6
Auditor's remuneration*			
audit fee for the audit of all group company financial statements		0.6	0.3
(including £162,956 (2022: £128,898) in respect of the audit of subsidiary companies)			
other services		–	–
Research and development expenditure		0.5	0.5

* The Auditor General for Scotland appoints the auditor for Scottish Water with remuneration agreed by Audit Scotland for the Scottish Water company audit.

5. Staff costs

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Wages and salaries		185.9	173.4	167.2	155.9
Social security costs		21.3	18.9	19.3	16.9
IAS 19 total service costs [1]	22	73.7	75.3	71.5	72.8
Other pension costs		0.6	0.5	–	–
Employee benefit expense		281.5	268.1	258.0	245.6
Less: charged as capital expenditure		(125.9)	(108.6)	(124.4)	(107.6)
		155.6	**159.5**	**133.6**	**138.0**

[1]The charge in the year prior to adjustments for IAS 19 in 2022 was £35.2 million (2021: £32.5 million)

The average monthly number of people (including Executive and Non-executive Members) employed by Scottish Water, split by activity, during the year was:

	2023	2022
Regulated water and waste water services	4,127	3,943
Business Stream	319	324
Non-regulated activities	97	92
	4,543	**4,359**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

5. Staff costs (continued)

Off-payroll engagements
The tables below show the total number of off-payroll engagements, by reportable segment, at a cost equal to or greater than £245 per day. The tables show the number that continue to be engaged at the balance sheet date and the number engaged during the year.

Off-payroll worker engagements as at 31 March 2023, earning £245 per day or greater.

	Regulated water and waste water services	Business Stream	Non-regulated services
No. of existing engagements as at 31 March 2023	118[1]	3	1
Of which…			
Number that have existed for less than one year at time of reporting.	31	2	1
Number that have existed for between one and two years at time of reporting.	17	-	-
Number that have existed for between two and three years at time of reporting.	6	1	-
Number that have existed for between three and four years at time of reporting.	5	-	-
Number that have existed for four or more years at time of reporting.	59	-	-

All Off-payroll workers engaged at any point during the year ended 31 March 2023, earning £245 per day or greater.

	Regulated water and waste water services	Business Stream	Non-regulated services
No. of engagements during the year ended 31 March 2023	148[1]	19	1
Of which…			
Not subject to off-payroll legislation	148	-	1
Subject to off-payroll legislation and determined as in-scope of IR35	-	11	-
Subject to off-payroll legislation and determined as out-of-scope of IR35	-	8	-
No. of engagements reassessed for compliance or assurance purposes during the year	-	-	-
Of which: no. of engagements that saw a change to IR35 status following review.	-	-	-

For any off-payroll engagements of board members, and/or, senior officials with significant financial responsibility, between 1 April 2022 and 31 March 2023

	Regulated water and waste water services	Business Stream	Non-regulated services
No. of off-payroll engagements of board members, and/or, senior officials with significant financial responsibility, during the financial year.	-	-	-
No. of off-payroll engagements of board members, and/or, senior officials with significant financial responsibility, during the financial year.	18	15	18

[1] Scottish Water does not engage with off-payroll workers where Scottish Water is the end client. For regulated water and waste water services the values disclosed include workers engaged via umbrella organisations and agencies which fall outwith the off-payroll worker legislation.

The table below shows the total cost of consulancy and temporary staff by reporting segment in the year.

	2023 £m
Regulated water and waste water services	16.8
Business Stream	4.3
Non-regulated services	0.1
	21.2

6. Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 109 to 123.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

7. Finance income and costs

	Notes	Group 2023 £m	Group 2022 £m	Company 2023 £m	Company 2022 £m
Interest income:					
Short-term deposits		5.4	0.1	4.3	–
Finance income		**5.4**	**0.1**	**4.3**	–
Interest expense:					
Government loans		(137.5)	(140.6)	(137.5)	(140.6)
Other loans		(4.0)	(3.1)	(2.5)	(1.0)
Finance lease liabilities		(11.6)	(12.7)	(12.7)	(15.2)
Interest on pension scheme net liabilities	22	(2.1)	(4.9)	(1.8)	(4.6)
Finance costs		**(155.2)**	**(161.3)**	**(154.5)**	**(161.4)**
Net finance costs		**(149.8)**	**(161.2)**	**(150.2)**	**(161.4)**

8. Taxation

	Notes	Group 2023 £m	Group 2022 £m	Company 2023 £m	Company 2022 £m
Analysis of tax charge recognised in the income statement					
Current tax: UK corporation tax		6.4	9.6	–	5.0
Current tax: Adjustment in respect of prior years		(4.5)	(1.6)	(4.5)	(1.3)
		1.9	8.0	(4.5)	3.7
Deferred Tax: origination and reversal of timing differences - current year		13.4	13.8	17.9	14.6
Deferred Tax: origination and reversal of timing differences - prior years		5.1	(1.0)	5.2	(1.0)
Remeasurement of deferred tax - change in UK corporation tax rate		–	137.2	–	136.2
	16	18.5	150.0	23.1	149.8
Total tax charge		**20.4**	**158.0**	**18.6**	**153.5**
The charge for the year can be reconciled to the surplus per the income statement as follows:					
Group surplus before tax		60.9	90.8	59.7	73.3
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2022: 19%)		11.6	17.3	11.4	13.9
Adjustment in respect of prior years		0.6	(2.6)	0.7	(2.3)
Impact of change in UK corporation tax rate		4.6	140.2	3.4	139.0
Accounting gain with no capital gain		0.7	(0.9)	0.6	(0.9)
Depreciation on non qualifying additions		3.6	3.8	3.0	3.5
Other permanent differences		(0.5)	0.7	(0.5)	0.3
Differences relating to closure of company		1.7	–	–	–
Previously unrecognised deferred tax asset now recognised		–	(0.4)	–	–
Other timing differences		(2.0)	(0.1)	–	–
Foreign Tax		0.1	–	–	–
Total tax charge for the year		**20.4**	**158.0**	**18.6**	**153.5**

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8. Taxation (continued)

	2023 £m	2022 £m
Group additional disclosure		
The table below reconciles the notional tax charge at the UK corporation tax rate to the total current tax charge for the year:		
Group surplus before tax	60.9	90.8
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2022:19%)	11.6	17.3
Relief for capital allowances in excess of depreciation	(29.6)	(20.9)
Financial transactions timing differences	16.5	17.1
Utilisation of tax losses	3.3	(8.4)
Expenses not deductible for tax purposes	1.0	0.7
Depreciation on non qualifying additions	3.6	3.8
Adjustment in respect of prior years	(4.5)	(1.6)
Current tax charge for the year	**1.9**	**8.0**

The Group's current tax charge is lower than the UK headline rate of 19% (2022: lower) primarily due to the utilisation of brought forward losses and the availability of capital allowances, specifically super-deductions.

Tax Relief is available in the form of capital allowances in relation to qualifying items of capital expenditure instead of accounting depreciation. This leads to significant differences between the accounting profit and the taxable profit and is designed to encourage investment.

The Finance Act 2021 introduced a super deduction for asset purchases made in the period 1 April 2021 to 31 March 2023, allowing companies to benefit from a 130% first year allowance for capital expenditure on qualifying new plant and machinery assets. The Group's current tax charge for the year includes the benefit of this additional permanent deduction which is available on expenditure incurred on qualifying plant and machinery assets acquired in the period.

On a regulatory basis, in 2022/23 Scottish Water invested £694million on our assets, including treatment works, large diameter mains, historic sewers and IT. This investment has been aimed at improving customer service, drinking water quality, protecting the environment and supporting economic growth.

The Group is able to utilise losses carried forward in compliance with the loss restriction rules to reduce the current tax charge.

Some expenses are disallowed for tax purposes. These include the private use element of lease car rentals.

There are also various other financial transaction adjustments where there is a simple timing difference between recognition of the income or expenses in the accounts and in the related tax computations submitted to HMRC. The main adjustment is the movement in general provisions which are disallowed unless utilised and the acquisition of the PFI business assets which are giving rise to accelerated capital allowances. The financial transactions timing differences also includes the impact of elimination entries within the group.

For all of the timing differences, the corresponding deferred tax movements are at 25% as this is the rate of corporation tax that has been enacted as at the balance sheet date.

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Tax charge recognised directly in reserves					
Deferred tax relating to:					
Pension scheme actuarial movements	22	28.3	55.2	25.1	54.3
Movements in cash flow hedge	26	0.9	0.4	–	–
Total	16	**29.2**	**55.6**	**25.1**	**54.3**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

8. Taxation (continued)

The UK Budget 2021 announcements on 3 March 2021 included an increase to the UK's main corporation tax rate to 25%, effective from 1 April 2023. These changes were substantively enacted at the balance sheet for our 2021/22 financial statements and were reflected in the remeasurement of deferred tax balances at that period end.

9. Property, plant and equipment

	Note	Specialised operational properties and structures £m	Assets held for sale (SOPS) £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant, machinery and vehicles £m	Assets under construction £m	Total £m
Group Cost								
At 1 April 2021		3,383.7	–	96.8	2,823.9	2,948.5	939.4	10,192.3
Additions		(2.5)	–	–	–	2.0	589.1	588.6
Disposals[1]		(3.7)	–	(3.6)	–	(129.6)	–	(136.9)
Reclassifications		81.8	–	4.4	90.9	193.0	(376.7)	(6.6)
At 31 March 2022		3,459.3	–	97.6	2,914.8	3,013.9	1,151.8	10,637.4
Additions		0.3	–	–	–	0.7	652.8	653.8
Disposals [1]		(77.9)	–	(1.1)	–	(95.7)	–	(174.7)
Reclassifications		112.0	8.5	9.9	131.2	222.1	(489.7)	(6.0)
Group Asset Transfer		24.7	–	0.2	–	(24.9)	–	–
Disposal of IFRIC 12 assets		(15.4)	–	–	–	(17.3)	–	(32.7)
At 31 March 2023		3,503.0	8.5	106.6	3,046.0	3,098.8	1,314.9	11,077.8
Accumulated depreciation								
At 1 April 2021		1,296.9	–	33.1	580.7	1,755.7	–	3,666.4
Charge for the year	4	66.4	–	2.1	20.8	204.6	–	293.9
Disposals[1]		(3.0)	–	(3.6)	–	(129.4)	–	(136.0)
At 31 March 2022		1,360.3	–	31.6	601.5	1,830.9	–	3,824.3
Charge for the year	4	66.8	0.2	2.5	21.8	218.6	–	309.9
Disposals[1]		(77.5)	–	(1.1)	–	(95.6)	–	(174.2)
Reclassifications		(0.4)	0.4	–	–	–	–	–
Group Asset Transfer		17.7	–	0.1	–	(17.8)	–	–
Disposal of IFRIC 12 assets		(7.4)	–	–	–	(17.3)	–	(24.7)
At 31 March 2023		1,359.5	0.6	33.1	623.3	1,918.8	–	3,935.3
Net book value								
At 31 March 2023		**2,143.5**	**7.9**	**73.5**	**2,422.7**	**1,180.0**	**1,314.9**	**7,142.5**
At 31 March 2022		2,099.0	–	66.0	2,313.3	1,183.0	1,151.8	6,813.1

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 property, plant and equipment category.

Capital grants received during the year and credited to deferred income were nil (2022: £0.7 million).

[1] Disposals include the write down of redundant assets no longer in beneficial use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

9. Property, plant and equipment (continued)

Assets held for sale

As at the balance sheet date, Scottish Water Horizons Ltd is in the process of selling its Low Carbon Heat schemes, which hold a net book value of £7.9 million as at 31 March 2023. The sale is expected to be completed within the first half of the financial year ending 31 March 2024 at a value higher than the carrying value of the assets. Under IFRS 5 - Non-current assets held for sale and discontinued operations, assets are held for sale at the lower of net book value and fair value; consequently, they have been presented within the financial statements at their book value.

	Note	Specialised operational properties and structures £m	Non-specialised operational properties £m	Infrastructure assets £m	Plant machinery and vehicles £m	Assets under construction £m	Total £m
Company Cost							
At 1 April 2021		3,372.2	96.8	2,823.9	2,877.6	932.8	10,103.3
Additions		(2.5)	–	–	–	583.8	581.3
Disposals[1 3]		(3.1)	(3.6)	–	(128.7)	–	(135.4)
Reclassifications[3]		74.3	4.4	90.9	193.0	(369.2)	(6.6)
At 31 March 2022		3,440.9	97.6	2,914.8	2,941.9	1,147.4	10,542.6
Additions		–	–	–	–	644.4	644.4
Disposals[1]		(77.3)	(1.1)	–	(95.8)	–	(174.2)
Reclassifications[3]		111.4	9.9	131.2	222.1	(480.6)	(6.0)
Group Asset Transfer	11	24.7	0.2	–	84.8	–	109.7
Disposal of IFRIC 12 assets		(34.4)	–	–	(74.4)	–	(108.8)
At 31 March 2023		3,465.3	106.6	3,046.0	3,078.6	1,311.2	11,007.7
Accumulated depreciation							
At 1 April 2021		1,293.7	33.1	580.7	1,708.6	–	3,616.1
Charge for the year		65.1	2.1	20.8	200.3	–	288.3
Disposals[1]		(2.7)	(3.6)	–	(128.6)	–	(134.9)
At 31 March 2022		1,356.1	31.6	601.5	1,780.3	–	3,769.5
Charge for the year		65.4	2.5	21.8	215.8	–	305.5
Disposals[1]		(77.3)	(1.1)		(95.6)	–	(174.0)
Group Asset Transfer	11	17.7	0.1		58.2	–	76.0
Disposal Cost of IFRIC 12 assets		(14.5)		–	(60.1)	–	(74.6)
At 31 March 2023		1,347.4	33.1	623.3	1,898.6	–	3,902.4
Net book value							
At 31 March 2023		**2,117.9**	**73.5**	**2,422.7**	**1,180.0**	**1,311.2**	**7,105.3**
At 31 March 2022		2,084.8	66.0	2,313.3	1,161.6	1,147.4	6,773.1

[1]Disposals include the write down of redundant assets no longer in beneficial use.

[2]During the year all software assets previously recorded as plant, machinery and vehicles have been reclassified and are disclosed in note 10.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

9. Property, plant and equipment (continued)

Included within specialised operational properties and structures and plant, machinery and vehicles are the following PFI assets which are held under finance leases. These assets are included within the previous tables for both the Scottish Water group and company.

	Group	Company
	Total £m	Total £m
Cost		
At 31 March 2021 and 2022	492.7	568.8
Disposal of IFRIC 12 assets	(32.7)	(108.8)
At 31 March 2023	460.0	460.0
Accumulated depreciation		
At 1 April 2021	284.4	330.9
Charge for the year	13.0	15.3
At 31 March 2022	297.4	346.2
Charge for the year	12.1	13.2
Disposal of IFRIC 12 assets	(24.7)	(74.6)
At 31 March 2023	284.8	284.8
Net book value		
At 31 March 2023	**175.2**	**175.2**
At 31 March 2022	195.3	222.6

10. Intangible assets

Investment intangible assets relate to the acquisition of the non-household customer base of Southern Water Services Limited in April 2017 and, in October 2019, of the non-household customer books of Yorkshire Water Business Services and Three-Sixty, both part of the Kelda Group. The investments are treated as having a finite life and is being amortised on a straight-line basis over the expected useful life, currently set at 8 years. The cost, additions, amortisation charge and carrying value are shown in the table below.

Software intangible assets relate to implementation costs associated with cloud computing software that meet the definition of an intangible asset under IAS38 and software that is controlled by Scottish Water and/or its subsidiaries. Software intangible assets are amortised on a straight-line basis over a period of 3-5 years. The cost, additions, amortisation and carrying value are shown in the table below.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

10. Intangible asset (continued)

Group	Software £m	Investments £m	Total £m
Cost			
As at 1 April 2021	125.8	22.7	148.5
Additions	9.5	0.5	10.0
Disposals	(58.0)	–	(58.0)
At 31 March 2022	77.3	23.2	100.5
Additions	8.4	–	8.4
Disposals[1]	(6.9)	–	(6.9)
At 31 March 2023	78.8	23.2	102.0
Accumulated amortisation			
As at 1 April 2021	107.4	11.1	118.5
Amortisation charge	11.4	2.6	14.0
Disposals	(58.0)	–	(58.0)
At 31 March 2022	60.8	13.7	74.5
Amortisation charge	10.3	2.5	12.8
Disposals*	(6.8)	–	(6.8)
At 31 March 2023	64.3	16.2	80.5
Net book value			
At 31 March 2023	**14.5**	**7.0**	**21.5**
At 31 March 2022	16.5	9.5	26.0

Company	Software £m	Investments £m	Total £m
Cost			
As at 1 April 2021	124.7	–	124.7
Additions	6.6	–	6.6
Disposals	(58.0)	–	(58.0)
At 31 March 2022	73.3	–	73.3
Additions	6.0	–	6.0
Disposals*	(6.9)	–	(6.9)
At 31 March 2023	72.4	–	72.4
Accumulated amortisation			
As at 1 April 2021	107.4	–	107.4
Amortisation charge	11.3	–	11.3
Disposals	(58.0)	–	(58.0)
At 31 March 2022	60.7	–	60.7
Amortisation charge	9.3	–	9.3
Disposals*	(6.8)	–	(6.8)
At 31 March 2023	63.2	–	63.2
Net book value			
At 31 March 2023	**9.2**	–	**9.2**
At 31 March 2022	12.6	–	12.6

* Disposals include the write down of redundant assets no longer in beneficial use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

11. Investments

	Company	
	2023 £m	2022 £m
Cost and net book value		
At 1 April	37.6	37.6
[Movements during the year]	–	–
At 31 March	**37.6**	**37.6**

Investment in subsidiaries

Principal subsidiary undertakings	Country of incorporation	% of Ordinary shares and votes held	Principal activity
Scottish Water Horizons Holdings Limited (SWHH)	Scotland	100.0	Holding company
Scottish Water Business Stream Holdings Limited[1]	Scotland	100.0	Holding company
Scottish Water Business Stream Limited[2]	Scotland	100.0	Licensed water and waste water services
Scottish Water Horizons Limited[1]	Scotland	100.0	Commercial non regulated water and waste water services
Scottish Water International Limited[1]	Scotland	100.0	Non trading
Aberdeen Environmental Services Limited (AES)[3]	Scotland	100.0	Non trading
Scottish Water Services (Grampian) Limited[1]	Scotland	100.0	Waste water services operator
Bandwidth Energy Limited[5*]	Scotland	100.0	Heat from waste water projects
Aberdeen Environmental Services (Holdings) Limited[4]	Scotland	100.0	Non trading
Aberdeen Holdco Limited[1]	England & Wales	100.0	Non trading

[1] owned by Scottish Water Horizons Holdings Limited
[2] owned by Scottish Water Business Stream Holdings Limited
[3] owned by Aberdeen Environmental Services (Holdings) Limited
[4] owned by Aberdeen Holdco Limited
[5] owned by Scottish Water Horizons Limited

Scottish Water owns shares in a further 8 companies which did not trade during the year ended 31 March 2023. The companies' financial statements have not been consolidated as permitted by Section 405 of the Companies Act 2006, as they did not trade during the year and the issued share capital is immaterial. The companies are:

Scottish Water Ltd
Scottish Water Retail Ltd
Scottish Water Technology Ltd
Scottish Water Utilities Ltd
Scottish Water Wholesale Ltd
OneSource Infrastructure Services Ltd
Water Solutions Ltd
Business Stream Ltd[6]

[6] owned by Scottish Water Business Stream Limited

*Bandwidth Energy Limited is exempt from the requirement of the Companies Act 2006 relating to the audit of accounts under Section 479A of the Companies Act 2006.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

11. Investments (continued)

Principal activity changes in the year

From the 1st October 2022 the activities of the Aberdeen PFI companies were absorbed into the regulated activities of Scottish Water. AES, Aberdeen Environmental Services (Holdings) Ltd and Aberdeen Holdco Ltd ceased trading from that date. The corresponding contracts for PFI services to Scottish Water also terminated on the same date.

To acquire the entities, and to establish a "hold harmless" position for SWHH, Scottish Water paid a consideration to SWHH of £19.7 million for £16.9 million of net assets in AES. The loss of £2.8 million has been recognised within administrative costs within the Company income statement. This has been eliminated within the consolidated income statement from the resulting gain in SWHH. SWHH acquired the four Aberdeen PFI companies for £16.2 million in December 2018 and continued to provide funding to Scottish Water Services (Grampian) since that date. In the six months since the acquisition by the regulated business savings of £5.4 million were achieved from reduced service fee payments.

The table below provides an additional analysis of the values presented on the cashflow statement for the company:

	£m
Intercompany loan to AES to enable settlement of external debt	(30.9)
Consideration paid to SWHH for net assets in AES	(19.7)
Cost of acquisition	(0.2)
Cash absorbed into SW from AES net assets	15.5
Acquisition of assets and liabilities of subsidiary per cash flow	**(35.3)**
Property, plant and equipment absorbed into regulated activities	32.2
non cash impact of acquisition of assets and liabilities of subsidiary	**(3.1)**

As the transaction relates to a business combination under common control it therefore falls outwith the Scope of IFRS 3 - Business Combinations. Therefore, no goodwill has been recognised within the balance sheets of both the Company and Group and assets have transferred into the company at their carrying values.

12. Inventories

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Raw materials and consumables	4.8	4.4	4.4	4.0
Less provision held	(0.3)	(0.2)	(0.3)	(0.2)
	4.5	**4.2**	**4.1**	**3.8**

All inventories will be recovered within 12 months.

During the year to March 2023, inventories recognised within cost of sales were £1.9 million (2022: £1.8 million).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

13. Trade and other receivables

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Trade receivables	26	689.7	658.2	528.9	511.8
Less provision for impairment of trade receivables	26	(516.5)	(503.4)	(466.2)	(454.4)
Net trade receivables		173.2	154.8	62.7	57.4
Other receivables		40.1	32.2	35.6	27.7
Prepayments and accrued income		93.9	78.1	15.6	13.7
Amounts due from subsidiaries		–	–	(0.1)	1.1
		307.2	**265.1**	**113.8**	**99.9**
The following table shows the development of the provision for impairment of trade receivables:					
Balance at 1 April		503.4	491.1	454.4	430.7
Charge for the year		30.4	24.2	19.0	27.7
Amounts written down during the year		(17.3)	(11.9)	(7.2)	(4.0)
Balance at 31 March		**516.5**	**503.4**	**466.2**	**454.4**

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

14. Cash and cash equivalents

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Cash at bank and in hand	252.1	162.3	155.5	21.1
Short-term bank deposits	234.8	494.8	234.8	494.8
Cash and cash equivalents per the statement of cash flows	**486.9**	**657.1**	**390.3**	**515.9**

The fair values of cash and cash equivalents are not different from those disclosed above.

In Business Stream, during November 2021, letters of credit to the value of £14.1 million (2021: £12.7 million) were renewed in relation to ongoing wholesale prepayments made to English wholesalers.

15. Trade and other payables

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Current					
Trade payables		59.0	47.6	10.5	6.5
Non trade payables and accruals		133.9	105.7	131.7	105.3
Accruals		202.6	210.3	150.6	142.3
Payments received in advance		71.9	88.3	70.6	61.8
Other payables		42.5	31.9	1.0	0.7
Deferred income		5.5	6.6	1.6	1.1
Other taxes and social security		4.9	4.7	4.5	4.2
Amounts due to subsidiaries		–	–	36.0	34.6
		520.3	**495.1**	**406.5**	**356.5**
Non-current					
Payments received in advance		76.0	62.4	66.6	55.9
Deferred income		16.5	19.1	7.8	10.0
Other financial liabilities - interest rate swap	26	–	3.4	–	–
		92.5	**84.9**	**74.4**	**65.9**

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

16. Deferred taxation

The following are the deferred tax liabilities and assets recognised by Scottish Water and the movements thereon during the current and prior reporting periods:

	Note	Accelerated capital allowances £m	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
Group						
At 1 April 2021		498.2	(42.1)	(6.0)	(14.6)	435.5
Charge/(credit) to income statement	8	175.7	(26.1)	4.2	(3.8)	150.0
Charge to reserves	8	–	55.2	–	0.4	55.6
At 31 March 2022		673.9	(13.0)	(1.8)	(18.0)	641.1
Charge/(credit) to income statement	8	36.3	(8.5)	(6.6)	(2.7)	18.5
Charge to reserves	8	–	28.3	–	0.9	29.2
At 31 March 2023		**710.2**	**6.8**	**(8.4)**	**(19.8)**	**688.8**
Company						
At 1 April 2021		495.0	(39.7)	(3.5)	(15.6)	436.2
Charge/(credit) to income statement		174.3	(25.3)	3.5	(2.7)	149.8
Charge to reserves	8	–	54.3	–	–	54.3
At 31 March 2022		669.3	(10.7)	0.0	(18.3)	640.3
Charge/(credit) to income statement		40.3	(8.2)	(8.5)	(0.5)	23.1
Charge to reserves	8	–	25.1	–	–	25.1
At 31 March 2023		**709.6**	**6.2**	**(8.5)**	**(18.8)**	**688.5**

Certain deferred tax assets and liabilities have been offset, including the asset balances analysed in the tables above. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Deferred tax assets	(1.8)	(3.6)	–	–
Deferred tax liabilities	690.6	644.7	688.5	640.3
At 31 March 2023	**688.8**	**641.1**	**688.5**	**640.3**

The Members believe that the deferred tax assets will be recoverable against projected taxable profits over the foreseeable future in the companies to which they relate.

No deferred income tax is provided on temporary differences arising on investments in subsidiaries because, in each case, the timing of the reversal of the temporary difference is controlled by Scottish Water and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of temporary differences associated with investments in subsidiaries for which a deferred tax liability has not been recognised is £170.6m (2022: £128.6m) for both the Company and the group. No tax is expected to be payable in this regard.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

17. Provisions for liabilities

	Income uncertainty provision £m	Restructure and other provision £m	Total £m
Group			
At 1 April 2021	15.4	0.8	16.2
Charged to the income statement	7.5	0.1	7.6
Utilised during the year	(2.5)	(0.1)	(2.6)
At 31 March 2022	20.4	0.8	21.2
Charged to the income statement	1.2	–	1.2
Utilised during the year	(1.1)	–	(1.1)
At 31 March 2023	**20.5**	**0.8**	**21.3**
Company			
At 1 April 2021	21.5	0.4	21.9
Charged to the income statement	6.6	–	6.6
Utilised during the year	(3.4)	–	(3.4)
At 31 March 2022	24.7	0.4	25.1
Charged to the income statement	2.1	–	2.1
Utilised during the year	(3.3)	–	(3.3)
At 31 March 2023	**23.5**	**0.4**	**23.9**

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Analysis of total provisions				
Current	12.1	11.9	13.9	14.4
Non-current	9.2	9.3	10.0	10.7
	21.3	**21.2**	**23.9**	**25.1**

The income uncertainty provision relates to non-household revenues. The reconciliation process, through the Central Market Agency (CMA), relating to each financial year will normally be finalised 18 months after the end of the relevant financial year. It is expected that the provision will be utilised over 2024 and 2025.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

18. Other loans and borrowings

	Group		Company	
	2023 £m	2022 £m	2023 £m	2022 £m
Current				
Non-government loans	–	5.2	–	–
Obligations under finance leases	22.3	21.1	22.3	24.6
	22.3	**26.3**	**22.3**	**24.6**
Non current				
Non-government loans	–	25.6	–	–
Obligations under finance leases	153.7	175.9	153.7	208.7
	153.7	**201.5**	**153.7**	**208.7**
Total				
Non-government loans	–	30.8	–	–
Obligations under finance leases	176.0	197.0	176.0	233.3
	176.0	**227.8**	**176.0**	**233.3**

(i) Non-government loans

The full value of non-government loans of £30.8m was repaid in September 2022 as part of the decision to fold the Aberdeen Environmental Services Group of companies into Scottish Water's waste water operations. This debt will be replaced by Scottish Government borrowing. In 2022/23 the amount replaced was £5.2 million with the balance expected in 2023/24. This is appropriate given that, at the time of acquisition by SWHH in December 2018, Scottish Water's gross borrowings were reduced to reflect the external bank debt being included within Scottish Water's borrowing cap.

Other loans are repayable as follows:

	Book Value		Fair Value	
	2023 £m	2022 £m	2023 £m	2022 £m
Non-government loans	–	30.8	–	33.9

(ii) Finance lease liabilities - PFI liabilities

Group

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2023 £m	2022 £m	2023 £m	2022 £m
Amounts payable:				
Within one year	32.7	32.7	22.3	21.1
Between one and 5 years	113.1	120.8	105.8	107.1
After 5 years	83.5	108.4	47.9	68.8
Present value of minimum lease payments including finance charges	229.3	261.9		
Less future finance charges	(53.3)	(64.9)		
Present value of minimum lease payments	176.0	197.0	176.0	197.0

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

18. Other loans and borrowings (continued)

Company

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2023 £m	2022 £m	2023 £m	2022 £m
Amounts payable:				
Within one year	32.7	38.4	22.3	24.6
Between one and 5 years	113.1	143.7	105.8	128.8
After 5 years	83.5	125.6	47.9	79.9
Present value of minimum lease payments including finance charges	229.3	307.7		
Less future finance charges	(53.3)	(74.4)		
Present value of minimum lease payments	176.0	233.3	176.0	233.3

PFI - Service concession arrangements

Upon its creation in April 2002 Scottish Water inherited 9 concession contracts which had been entered into with 9 private sector consortia (PFI Cos) by its 3 predecessor authorities (i.e. East of Scotland Water Authority, North of Scotland Water Authority and West of Scotland Water Authority). Scottish Water acts as the client body to the 9 private sector consortia that provide waste water and sludge treatment and disposal services to Scottish Water.

These contracts are based over a wide geographic area including the Aberdeen, Dundee, Edinburgh, Glasgow and Inverness conurbations as well as the Ayrshire, Fife and Moray coasts. On 19 December 2018, the companies operating the contract for Aberdeen were acquired by Scottish Water Horizons Holdings Limited, with Scottish Water remaining a client under the contract and on 1 October 2022 the activities of the Aberdeen PFI companies were absorbed into the regulated activities of Scottish Water (see note 11).

Characteristics of the arrangements

Description

The length of these contracts varies between 25 and 40 years with expiry dates ranging from May 2022 through to October 2040. Under the terms of these contracts the private sector have either upgraded or built new waste water and sludge treatment assets, and, in certain circumstances, network assets (e.g. sewers and pumping stations) in order to meet Scottish Water's legal obligations in respect of the treatment and disposal of these products. These consortia are also responsible for the operation and maintenance of these assets over the lifetime of each contract.

Significant terms

The key terms relate to the basis upon which Scottish Water pays for the services provided by the PFI Cos. The levels of such payments are predominantly dependent upon the volume of waste water and sludge treated, although in a minority of contracts there is either a partial availability payment element or some part of the payment is linked to the strength of the waste water. Scottish Water also has the power to levy payment deductions where the level of service falls below pre-determined standards, primarily linked to the quality of the treated waste water.

The contracts are structured such that either party may seek to amend the basis upon which the service is provided, primarily where driven by a change in law. This is subject to a formal variation procedure and is ultimately dependent upon the parties reaching agreement on the contractual changes required to give effect to the specific variation.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

18. Other loans and borrowings (continued)

Nature and extent of rights and obligations

Scottish Water's primary obligations are to deliver waste water to the PFI Cos and thereafter pay for the treatment services provided, making the appropriate deduction where the PFI Cos fail to meet the appropriate performance standards. The PFI Cos provided the initial construction services through a sub-contract and also entered into a separate sub-contract for the operation and maintenance of these assets once satisfactorily commissioned. All such projects are now in their operational phase.

A majority of the contracts have limited extension options. However, termination during the contractual period can arise for a number of reasons including default (by either the PFI Co or Scottish Water), force majeure, uninsurable events or voluntary termination by Scottish Water. Each contract contains a formula from which termination compensation payable by Scottish Water is derived.

Other than each party's unilateral right to propose an amendment to a contract, the most likely circumstance which would give rise to the re-negotiation of a contract is as a result of a change in law which requires the manner in which the treatment and disposal service is delivered to be changed, in order to ensure it meets the requirements of such legislative changes.

The contracts also stipulate a range of handback conditions linked to the remaining life of certain assets.

19. Government loans

	Group and Company	
	2023 £m	2022 £m
Government loans	4,508.7	4,383.6

Scottish Water's borrowing powers are defined in Section 42 of the Water Industry (Scotland) Act 2002.

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

a. Analysis of borrowings by type and maturity

Group and company	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Over 10 years £m	Total £m
Scottish Consolidated Fund	42.1	85.5	224.0	337.7	3,359.1	4,048.4
National Loans Fund	94.0	82.4	95.0	165.0	12.5	448.9
Public Works Loan Board	1.0	0.7	7.0	2.2	0.5	11.4
At 31 March 2023	**137.1**	**168.6**	**326.0**	**504.9**	**3,372.1**	**4,508.7**
At 31 March 2022	122.5	137.1	398.1	478.3	3,247.6	4,383.6

b. Fair values

The carrying amounts and fair value of the Government borrowings are as follows:

	Book Value		Fair Value	
	2023 £m	2022 £m	2023 £m	2022 £m
Scottish Consolidated Fund	4,048.4	3,885.7	3,266.1	4,610.9
National Loans Fund	448.9	480.9	498.3	592.0
Public Works Loan Board	11.4	17.0	13.7	21.3
	4,508.7	4,383.6	3,778.1	5,224.2

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

20. Analysis of net debt

	Note	As at 1 April 2022 £m	Decrease in cash £m	(inc)/dec in debt £m	As at 31 March 2023 £m
Group					
Cash and cash equivalents	14	657.1	(170.2)	–	486.9
Government loans	19	((4,383.6)	–	(125.1)	(4,508.7)
Other loans	18	(30.8)	–	30.8	–
Net debt		**(3,757.3)**	**(170.2)**	**(94.3)**	**(4,021.8)**
Company					
Cash and cash equivalents	14	515.9	(125.6)	–	390.3
Government loans	19	(4,383.6)	–	(125.1)	(4,508.7)
Net debt		**(3,867.7)**	**(125.6)**	**(125.1)**	**(4,118.4)**

21. Retained earnings reserve

	Note	Retained earnings excluding actuarial gains/ (losses) £m	Actuarial gains/ (losses) on pension obligations £m	Retained earnings including actuarial gains/(losses) £m
Group				
At 1 April 2021		1,728.0	(86.1)	1,641.9
Retained deficit for the year		(67.2)	–	(67.2)
Actuarial gain net of deferred taxation	22	–	163.5	163.5
At 31 March 2022		**1,660.8**	**77.4**	**1,738.2**
Retained deficit for the year		40.5	–	40.5
Actuarial gain net of deferred taxation	22	–	85.0	85.0
At 31 March 2023		**1,701.3**	**162.4**	**1,863.7**
Company				
At 1 April 2021		1,574.2	(78.8)	1,495.4
Retained deficit for the year		(80.2)	–	(80.2)
Actuarial gain net of deferred taxation	22	–	158.4	158.4
At 31 March 2022		**1,494.0**	**79.6**	**1,573.6**
Retained deficit for the year		41.1	–	41.1
Actuarial gain net of deferred taxation	22	–	75.2	75.2
At 31 March 2023		**1,535.1**	**154.8**	**1,689.9**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

22. Pensions

Employees of Scottish Water participate in the North East Scotland Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund, which are part of the Scottish Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively. The schemes provide defined benefits based on career average pensionable pay. Actual pension costs for the year for each fund, as a % of pensionable pay, were 18.2% (2022: 18.2%), 20.7% (2022: 20.7%) and 19.3% (2022: 19.3%) respectively.

The principal risks to Scottish Water impacting the pension liability are the longevity assumptions, statutory changes to the scheme, structural changes to the scheme, changes to inflation, bond yields and the performance of the equity investments held by the three funds. These are mitigated to a certain extent by the statutory requirements to charge to the Consolidated Income Statement any increase in the present value of liabilities expected to arise from employee service in the period and the net interest cost as described in the accounting policies note..

Employee pension contributions are determined according to the level of an employee's full-time equivalent pensionable pay. A key feature of the pension arrangements is that contribution rates are applied in tiers ranging from 5.5% to 12% depending on the employee's rate of pensionable pay on 31 March. It is anticipated that this approach to employees' contribution rates will ultimately result in a 2:1 ratio between Scottish Water's contributions and employees' contributions in a fully funded scheme.

A full actuarial valuation was carried out at 31 March 2020 for all 3 funds and updated at 31 March 2023 by a qualified independent actuary, to take account of the requirements of IAS 19.

The major assumptions used by the actuaries were:

	2023 %	2022 %
Rate of increase in pensionable salaries	2.90	3.30
Rate of increase in pensions payment	2.90	3.30
Discount rate	4.75	2.70
CPI inflation rate	2.90	3.30

Actual asset returns for period from 1 April 2022 to 31 March 2023:

North East Scotland Pension Fund	-4.15%
Lothian Pension Fund	2.17%
Strathclyde Pension Fund	-1.60%

The mortality assumptions used to calculate the scheme liabilities as at 31 March 2023 are consistent with those used for the actuarial valuations of the Funds at 31 March 2020 with the exception of the longevity improvement assumptions. These have been updated at March 2023 on advice from the actuaries with longevity improvements reflecting the CMI 2021 model with a weighting of 10% to begin to allow for the potential implications of Covid-19. The impact has caused a slight reduction in the longevity improvement assumptions reflected in the 31 March 2020 actuarial valuation.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

22. Pensions (continued)

The average future life expectancies at age 65 are shown in the table below:

	North East Scotland Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2023			
Male	21.2	20.1	19.5
Female	24.0	23.1	22.5
Retiring at 31 March 2043			
Male	22.4	21.5	20.9
Female	25.8	25.0	24.5

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

Assumption	Change in assumption	Approximate Impact on IAS 19 liability %	Approximate Impact on IAS 19 liability £m
Rate of increase in pensionable salaries	+/- 0.1% per annum	Increase / decrease by c. 0.29%	Increase / decrease by c. £4m
Discount rate	+/- 0.1% per annum	Increase / decrease by c. 1.73%	Decrease / increase by c. £27m
CPI Inflation rate	+/- 0.1% per annum	Increase / decrease by c. 1.45%	Increase / decrease by c. £22m
Rate of increase in pensionable salaries	+/- 0.1% per annum	Increase / decrease by c. 3.00%	Increase / decrease by c. £46m
Discount rate	+/- 0.1% per annum	Increase / decrease by c. 18.67%	Increase / decrease by c. £288m
CPI Inflation rate	+/- 0.1% per annum	Increase / decrease by c. 15.40%	Increase / decrease by c. £238m
Longevity	Increase life expectancy by 1 year	Increase by c. 3.02%	Increase by c. £47m

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

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Total fair value of assets		2,141.0	2,170.4	2,093.9	2,123.7
Present value of scheme liabilities		(1,545.3)	(2,222.3)	(1,513.9)	(2,166.6)
Gross pension liability		**595.7**	**(51.9)**	**580.0**	**(42.9)**
Adjustment in respect of asset not recognised		(568.6)	-	(555.4)	-
Pension asset / (liability) recognised		**27.1**	**(51.9)**	**24.6**	**(42.9)**
Related deferred tax (liability) / asset	16	(6.8)	13.0	(6.2)	10.7
Net pension asset / (liability)		20.3	(38.9)	18.4	(32.2)

Assets are valued at fair value. Liabilities are valued on an actuarial basis using the projected unit method which assesses the future liabilities of the fund discounted to their present value.

Reconciliation of opening and closing retirement benefit liabilities and assets.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

22. Pensions (continued)

	Note	Group 2023 £m	Group 2022 £m	Company 2023 £m	Company 2022 £m
Movements in liabilities during the year:					
Opening value of total liabilities		(2,222.3)	(2,273.8)	(2,166.6)	(2,217.1)
Total service cost	5	(73.7)	(75.3)	(71.5)	(72.8)
Interest on pension scheme liabilities	7	(60.4)	(44.6)	(58.8)	(43.5)
Contributions by members		(10.6)	(9.7)	(10.3)	(9.4)
Actuarial gain		763.9	124.0	735.7	119.3
Benefits paid		57.8	57.1	57.6	56.9
Closing value of total liabilities		**(1,545.3)**	**(2,222.3)**	**(1,513.9)**	**(2,166.6)**
Movement in assets during the year:					
Opening fair value of total assets		2,170.4	2,051.9	2,123.7	2,008.0
Interest on pension scheme assets	7	58.3	39.7	57.0	38.9
Contributions by members		10.6	9.7	10.3	9.4
Contributions by the employer		41.5	31.5	40.5	30.9
Actuarial loss / gain		(82.0)	94.7	(80.0)	93.4
Benefits paid		(57.8)	(57.1)	(57.6)	(56.9)
Closing fair value of assets		**2,141.0**	**2,170.4**	**2,093.9**	**2,123.7**
Gross surplus / (deficit) in the schemes at 31 March		**595.7**	**(51.9)**	**580.0**	**(42.9)**
Adjustment in respect of asset not recognised		(568.6)	-	(555.4)	-
Recognised gross surplus / (deficit) in the schemes at 31 March		**27.1**	**(51.9)**	**24.6**	**(42.9)**

Return on assets

As required by IAS 19, the expected return on assets for all asset categories is equal to the discount rate. It is assumed that assets with higher volatility will no longer generate higher returns.

	Note	Group 2023 £m	Group 2022 £m	Company 2023 £m	Company 2022 £m
Actual return on pension scheme assets		(23.7)	134.4	(23.0)	132.3
Actuarial gain in other comprehensive income in the consolidated statement of comprehensive income					
Variance between pension fund actuarial assumptions and actual experience		681.9	218.7	655.7	212.7
Adjustment in respect of asset not recognised		(568.6)	-	(555.4)	-
Gross actuarial gain recognised in the pension fund		113.3	218.7	100.3	212.7
Deferred tax movement	16	(28.3)	(55.2)	(25.1)	(54.3)
Net actuarial gain recognised in other comprehensive income in the consolidated statement of comprehensive income	21	**85.0**	**163.5**	**75.2**	**158.4**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

22. Pensions (continued)

Amounts recognised in the consolidated income statement

		Group		Company	
	Note	2023 £m	2022 £m	2023 £m	2022 £m
Total service cost	5	73.7	75.3	71.5	72.8
Interest cost on pension scheme net liabilities (see above)	7	2.1	4.9	1.8	4.6
		75.8	80.2	73.3	77.4

The unpaid contributions outstanding at the year end included in other payables (note 15) was £0 million (2022: £0 million). It is estimated that Scottish Water will make contributions of £40.3 million to the pension funds in financial year 2023/24.

History of experienced gains and losses

	2023 £m	2022 £m
Group		
Difference between the expected and actual return on scheme assets:		
Amount	(82.0)	94.7
Fair value of assets	2,141.0	2,170.4
Experienced gains on scheme liabilities:		
Amount	(89.5)	0.6
Present value of liabilities	1,545.3	2,222.3
Changes in demographic assumptions underlying the present value of scheme liabilities:		
Amount	21.5	-
Changes in financial assumptions underlying the present value of scheme liabilities:		
Amount	831.9	123.4
Adjustment in respect of asset not recognised	(568.6)	-
Total variance between pension fund actuarial assumptions and actual experience	**113.3**	**218.7**
Gross surplus / (deficit) in the schemes at 31 March	595.7	(51.9)
Adjustment in respect of asset not recognised	(568.6)	-
Recognised gross surplus / (deficit) in the schemes at 31 March	**27.1**	**(51.9)**

	2023 £m	2022 £m
Company		
Difference between the expected and actual return on scheme assets:		
Amount	(80.0)	93.4
Fair value of assets	2,093.9	2,123.7
Experienced gains on scheme liabilities:		
Amount	(87.5)	0.7
Present value of liabilities	1,513.9	2,166.6
Changes in demographic assumptions underlying the present value of scheme liabilities:		
Amount	21.1	-
Changes in financial assumptions underlying the present value of scheme liabilities:		
Amount	802.1	118.6
Adjustment in respect of asset not recognised	(555.4)	-
Total variance between pension fund actuarial assumptions and actual experience	**100.3**	**212.7**
Gross surplus / (deficit) in the schemes at 31 March	580.0	(42.9)
Adjustment in respect of asset not recognised	(555.4)	-
Recognised gross surplus / (deficit) in the schemes at 31 March	**24.6**	**(42.9)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

22. Pensions (continued)

An actuarial gain of £681.9 million has been calculated resulting in a pension asset of £595.7 million at 31 March 2023. This is as a result of a higher discount rate and a lower expectation of long term CPI growth than forecast at 31 March 2022, reducing the pension liabilities. This is partially offset by lower than forecast asset returns to 31 March 2023 than originally forecast at 31 March 2022.

To comply with IFRIC 14 and IAS 19 the pension asset is restricted to reflect the amount the employer is entitled to as an unconditional refund of the surplus or reduction in future contributions to the pension fund. Management review of the Local Government Pension Scheme regulations concluded that there are no likely circumstances which would result in the Employer having an unconditional right to a refund in the event of a fund surplus. Actuarial advice was sought in relation to the benefit to the Employer in the form of reduced future contributions. IAS 19 defined this to be the present value of future service costs, less the present value of projected future contributions (in respect of benefit accrual). If this is positive then this is the maximum value of the pension asset that the Employer can recognise. This has been calculated as £27.1 million in total being £24.6 million in relation to Strathclyde Pension Fund for Scottish Water and £2.5 million for Business Stream. No asset is recognised in respect of Lothian or North East Scotland Pension Funds.

As such the full pension asset of £595.7 million is not recognised but is restricted by £568.6 million to a pension asset of £27.1 million with an actuarial gain of £113.3 million.

23. Commitments

a. Capital commitments

Scottish Water has contracted capital commitments of £536.1 million (2022: £455.6 million) relating to property, plant and equipment at the balance sheet date. These commitments are expected to be settled within the following two financial years.

b. Operating lease commitments

Scottish Water leases various operational properties and offices under non-cancellable operating lease agreements. The lease terms are between 1 and 99 years, with the majority of lease agreements being renewable at the end of the lease period at market rates.

Scottish Water also leases vehicles under cancellable operating lease agreements. Scottish Water is able to give notice at any time within the lease period for the termination of these agreements. Termination costs are incurred on early termination. The lease expenditure charged to the consolidated income statement during the year is disclosed in note 4.

The total minimum lease payments under non-cancellable operating leases are as follows:

	2023 £m	2022 £m
Within one year	2.1	2.3
Between one and five years	4.5	4.5
After five years	14.9	15.8
	21.5	22.6

24. Contingent assets and liabilities

Contingent liabilities

Scottish Water has the following contingent liabilities in respect of companies limited by guarantees:

Central Market Agency

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

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

25. Related party transactions

Scottish Water has related party relationships with the Scottish Government, with its subsidiaries (note 11), and with its Members and Executive Management. Details of transactions between the group and other related parties are disclosed below.

Scottish Government

Scottish Water is a public corporation of a trading nature sponsored by the Scottish Government. During the year Scottish Water had various material transactions with the Scottish Government, namely the drawdown and repayment of loans and associated interest charges. Details of the loans from the Scottish Government are shown in note 19.

During the year Scottish Water had various material transactions with entities for which the Scottish Government is regarded as the parent The main entities which fall into this category are the Local Authorities, the Scottish Environment Protection Agency, the Drinking Water Quality Regulator, the Water Industry Commission for Scotland and the Central Market Agency. However, as permitted under IAS 24 'Related Party Disclosures' paragraph 25, Scottish Water is exempt from the disclosure requirements of IAS 24, paragraph 18 in respect of these government related entities.

Subsidiaries

During the year Scottish Water entered into the following transactions with its subsidiaries (note 11):

	2023 £m	2022 £m
Wholesale water and waste water services to Business Stream	202.8	198.3
Sale of waste water services to other subsidiaries	0.7	0.5
Purchase of waste water services from other subsidiaries	14.1	24.3
Seconded staff costs charged to subsidiaries	3.4	2.9
Other operating costs charged to subsidiaries	1.3	1.7
Purchase of renewable development and vesting services	2.3	3.3
Aberdeen PFI absorption into regulated activities	2.8	-

Key management personnel

The key management under IAS 24 'Related Party Disclosure' is defined as those persons who have authority and responsibility for planning, directing and controlling the entity's activities, directly or indirectly. Scottish Water's key management comprises the Executive Members and Non-executive Members. The remuneration of the Members is determined by Scottish Water's Remuneration Committee in accordance with its stated policy. Further information about the remuneration and pension details of individual Members is provided in the Members' Remuneration Report on pages 109 to 123. Scottish Water's non-executive members hold additional roles within other organisations (see Members on pages 95 to 98).

26. Financial instruments and risks

The management of Scottish Water and the execution of strategy are subject to a number of risks as detailed below. All risks are reviewed by the Board and appropriate processes are in place to monitor and mitigate them. See the Strategic report on pages 18 to 93 and Corporate Governance report on pages 99 to 102.

a. Qualitative risk disclosures

Credit risk

Credit risk is the risk that Scottish Water is exposed to loss if another party fails to perform its financial obligation to Scottish Water. Credit risk arises from cash, cash equivalents and deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions. Scottish Water monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its exposure to any one party to ensure that they are within Board approved limits and that there are no significant concentrations of credit risk. The maximum exposure to credit risk for receivables and other financial assets is represented by their carrying amount.

Liquidity risk

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

Interest rate risk

All of Scottish Water's Government borrowings are at fixed interest rates. Therefore Scottish Water is not deemed to bear any interest rate risk.

Currency risk

In special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures such as foreign exchange fluctuations. As such circumstances are rare, in addition to the approval of the Scottish Water Board, approval is required from Scottish Ministers under the terms of section 42(3)(b) Water Industry (Scotland) Act 2002.

b. Categories of financial assets and liabilities and fair values

Scottish Water's financial assets and liabilities comprise trade and other receivables (note 13), cash and cash equivalents (note 14), borrowings (notes 18 and 19) and trade and other payables (note 15). No trading in derivative financial instruments was undertaken.

Basis of determining fair value

The financial assets of Scottish Water fall into the 'loans and receivables' category. The financial liabilities of Scottish Water fall into the category of 'financial liabilities measured at amortised cost'.

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

The carrying amounts of financial assets and liabilities, excluding borrowings, are equal to their fair values. Borrowings are held at cost in the balance sheet but the fair value is disclosed in notes 18 and 19.

Credit risk

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to cash. These are subject to insignificant risk of change in value or credit risk.

The trade receivables total includes an allowance for impairment. Trade receivables comprise receivables from business customers and receivables from domestic household customers.

	2023 £m	2022 £m	2023 £m	2022 £m
Trade receivables per note 13:				
Trade receivables	689.7	658.2	528.9	511.8
Less provision for impairment of trade receivables	(516.5)	(503.4)	(466.2)	(454.4)
Net trade receivables	173.2	154.8	62.7	57.4
Analysed between:				
Household receivables	506.5	495.8	506.5	495.8
Less provision for impairment	(463.2)	(451.4)	(463.2)	(451.4)
Net household receivables	43.3	44.4	43.3	44.4
Business customer receivables	183.2	162.4	22.4	16.0
Less provision for impairment	(53.3)	(52.0)	(3.0)	(3.0)
Net business customer receivables	129.9	110.4	19.4	13.0

Household water and waste water services are billed to customers by the 32 Councils as an element of the annual Council Tax bills. The Councils are responsible for the collection and transfer to Scottish Water of the amounts due in accordance with the statutory regulations. Household charges are billed by individual financial year and are payable within the same year. Provision is made against outstanding debt, in respect of prior years, based primarily on historical collection rates and the near-term business outlook. Household water and waste water debt is a statutory debt recoverable from the occupier by the Councils. Debt since the establishment of the former Water Authorities in 1996 continues to be collected. As at 31 March 2023 trade receivables in respect of household customers totalled £506.5 million with a provision of £463.2 million (2022: £495.8 million and £451.4 million respectively).

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 (CONTINUED)

26. Financial instruments and risks (continued)

The sensitivities regarding the principal assumptions used to measure the level of the household bad debt provision are:

Assumption	Change in assumption %	Approximate impact on bad debt charge £m
Overall household collection rate	+/- 0.01%	Increase / decrease by c. £1.8m
In-year household bad debt provision charge	+/- 0.10%	Increase / decrease by c. £1.0m

As at 31 March 2023 trade receivables from business customers totalled £183.2 million (2022: £162.4 million). The ageing analysis of trade receivables from business customers and the related provisioning is as follows:

Group	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Gross receivable	183.2	47.1	59.0	41.2	35.9
Provision	(53.3)	–	(3.9)	(17.7)	(31.7)
Net trade receivable as at 31 March 2023	**129.9**	**47.1**	**55.1**	**23.5**	**4.2**
Gross receivable	162.4	47.9	46.3	23.7	44.5
Provision	(52.0)	–	(4.7)	(16.0)	(31.3)
Net trade receivable as at 31 March 2022	**110.4**	**47.9**	**41.6**	**7.7**	**13.2**

Company	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Gross receivable	22.4	15.7	1.5	2.5	2.7
Provision	(3.0)	–	(0.1)	(0.9)	(2.0)
Net trade receivable as at 31 March 2023	**19.4**	**15.7**	**1.4**	**1.6**	**0.7**
Gross receivable	16.0	10.3	2.1	2.3	1.3
Provision	(3.0)	–	(0.1)	(1.6)	(1.3)
Net trade receivable as at 31 March 2022	**13.0**	**10.3**	**2.0**	**0.7**	**–**

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

26. Financial instruments and risks (continued)

Group

Other financial Liabilities - Interest rate swap

As at the acquisition of Aberdeen Environmental Services Limited on 19 December 2018, the floating interest rate to fixed rate interest swap liability had a carrying value of £10.9 million. Any gains or losses on the effective portion of the hedging instruments are recognised within the Consolidated statement of comprehensive income or as an expense within the Consolidated income statement. The maturity of the interest rate swap coincides with the maturity of the loan (31 March 2027).

On the 1 October 2022 the activities of the Aberdeen PFI companies were absorbed into the regulated activities of Scottish Water. During September 2022 the external bank debt linked to the interest rate swap was settled in full. Therefore, the balance of the interest rate swap and the cash flow hedge reserve have reduced to £0 at March 2023 (2022: £3.4m and £2.5m respectively).

Interest rate swap - financial liability	Note	£m
Balance at 31 March 2022		(3.4)
Effective portion of changes in fair value of cash flow hedge		3.4
Balance at 31 March 2023	15	–

The fair values of these derivatives at the balance sheet date are determined by reference to their market values, which are provided by a third party.

The cash flow hedge reserve in the balance sheet, and the corresponding change in fair value recognised in the Consolidated statement of comprehensive income, reflect the movement in the interest rate swap liability net of deferred taxation.

	Cash flow hedging reserve		
	Gross reserve £m	Deferred tax £m	Net reserve £m
Balance at 31 March 2021	6.8	(1.3)	5.5
Effective portion of changes in fair value of cash flow hedge	(3.4)	0.4	(3.0)
Balance at 31 March 2022	3.4	(0.9)	2.5
Effective portion of changes in fair value of cash flow hedge	(3.4)	0.9	(2.5)
Balance at 31 March 2023	–	–	–

27. 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..

28. Regulatory information

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

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023 **(CONTINUED)**

DIRECTION BY THE SCOTTISH MINISTERS
IN ACCORDANCE WITH SECTION 45(2) OF THE WATER INDUSTRY (SCOTLAND) ACT 2002

Under the Scottish Water Governance Directions, which are available on the Scottish Government website, Scottish Water is required to disclose details of certain types of expenditure which exceed given thresholds and which are not disclosed elsewhere in the Annual Report 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	Winchburgh WwTW Public Switched Telephone Network Upgrade Highland PFI FMV payment	£25,400,000 £17,300,000 £18,800,000
Purchase of individual capital items, including land, with a life of more than one year	£1 million	None	–
Advertising	£1 million	None	–
Sponsorship	£10,000	Scottish Amateur Swimming Association	£250,000
Gifts	£200	None	–

THE WATER INDUSTRY IN SCOTLAND