ANNUAL REPORT & ACCOUNTS 2020/21: PERFORMANCE AND PROSPECTS

Scottish Water

Trusted to serve Scotland

CONTENTS

Please note: some photographs which appear within the Annual Report 2020/21: Performance & Prospects were taken before the Covid-19 pandemic.

OVERVIEW

Our Annual Report & Accounts 2020/21:

OUR ANNUAL REPORT & ACCOUNTS 2020/21: PERFORMANCE AND PROSPECTS

This Annual Report & Accounts 2020/21: Performance and Prospects provides an open and transparent view of Scottish Water's performance in 2020/21. We explain what we have done well, where we fell short of what we planned to deliver and provide an overview of our future direction. Scottish Water seeks to learn from the past to drive improvements for the future. This report also sets out a clear view of the lessons we have learned and what we intend to do differently in future.

In February 2020, we published our strategic plan Our Future Together, which contains three new strategic ambitions: Service Excellence; going Beyond Net Zero Emissions; and delivering Great Value and Financial Sustainability. Although these ambitions relate primarily to the next regulatory period and beyond, this Report describes our performance and prospects in these three areas.

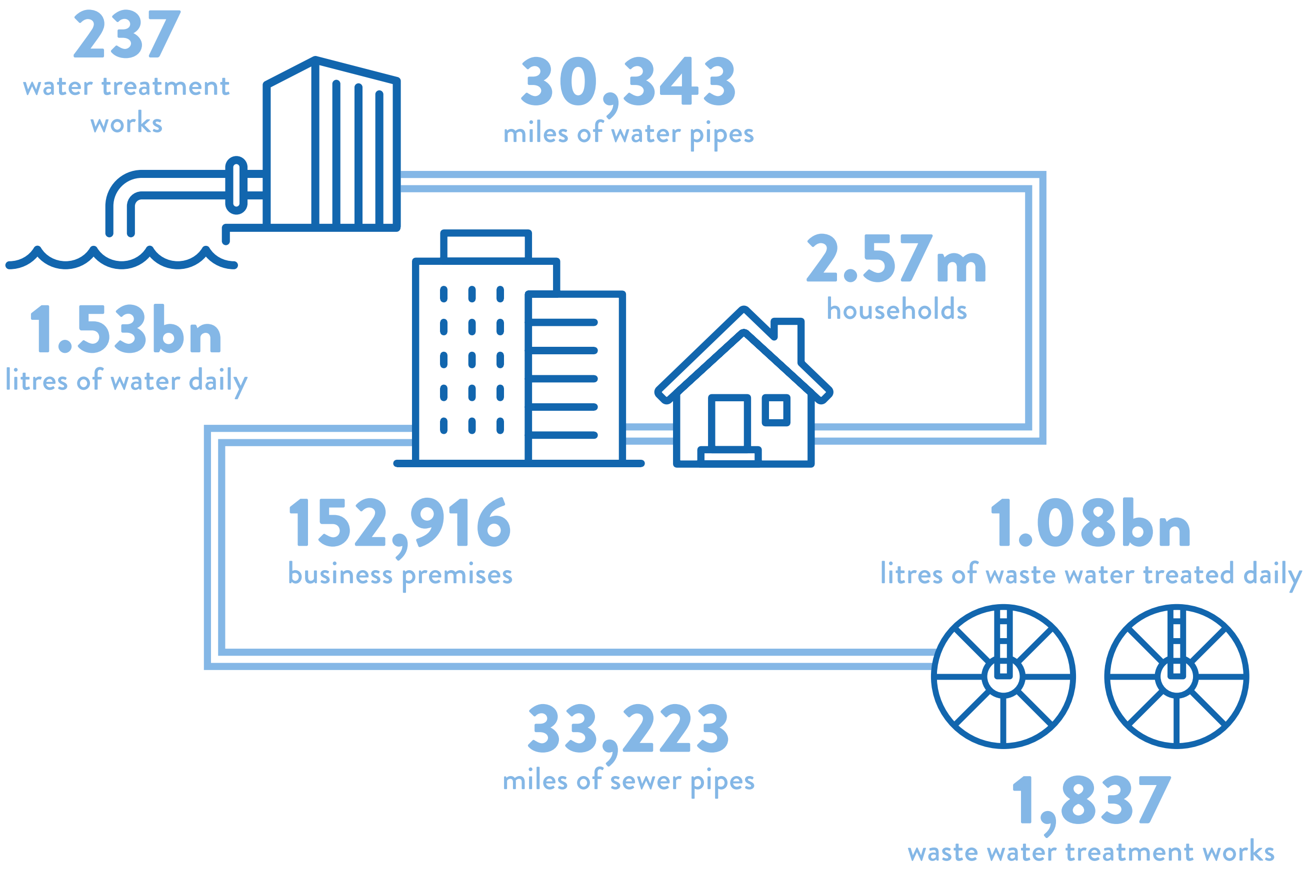
SCOTTISH WATER'S VITAL ROLE

Every day we:

- deliver 1.53 billion litres of clear, fresh drinking water; and
- remove 1.08 billion litres of waste water which we treat, recover resources from and return safely to the environment.
- Our services support 2.57 million households and 152,916 business premises across Scotland.

Over the six year period from 2015 21, we have invested £3.7 billion in managing our assets and making further improvements to drinking water quality, protecting the environment and contributing to the Scottish economy. In 2020/21, the sixth year of the regulatory programme, we invested £612 million.

OUR VITAL ROLE COVERS:



THE STORY OF 2015-21

Scottish Water's priorities between 2015 and 2021 were to provide continuous high quality drinking water, invest in future water services, support Scotland's economy and communities and protect and enhance the natural environment.

	2015/16	2020/21
Overall Performance Measure	393 points	404 points Above target of 385 points
Household Customer Experience Measure	84.3 points	88.45 points
Non-household Customer Experience Measure[1]	77.5 points	88.36 points
Customer contacts	291,401	305,000
Written complaints	1145	613
Drinking water quality	99.93% compliant	99.947% compliant[2]
Leakage	500 ML/D	463 ML/D
New connections	15,098	23,267

	2015/16	2020/21
Internal sewer flooding incidents	393	347
Environmental pollution incidents (EPIs) - Category 1 and 2[3]	10	5
Sewer blockages	36,966	35,975
Sludge recycling	67,896 tonnes	117,000 tonnes
Investment	£482.6 million	£612 million
Total investment	£3.7 billion invested	
Charges increased marginally below inflation during 2015-21	CPI – 0.1%	
Top Up Taps		44 installed[4] - Equivalent of 419,612 single-use plastic bottles saved

[1] Non-household Customer Experience Measure started from 2017/18.
[2] See page 43 for further details on the 2020/21 result.
[3] Category 3 EPIs not included
[4] Top Up Taps installed from 2018/19 to 2020/21.

CUSTOMER SERVICE PERFORMANCE 2020/21

RANKED TOP WATER COMPANY IN UK
INSTITUTE OF CUSTOMER SERVICE

Our customers

2.57m
HOUSEHOLDS

152,916
BUSINESS PREMISES

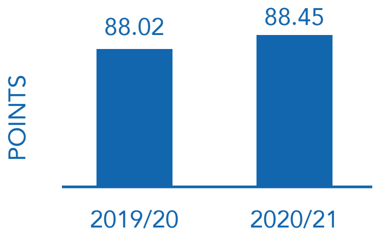
Customer contacts

305,000
SERVICE ISSUE CONTACTS

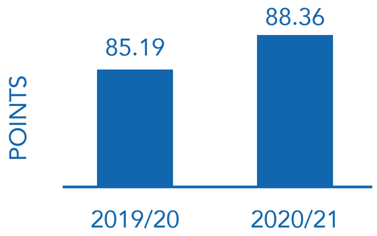
106,000
WERE RECEIVED IN JAN-MAR 2021
due to impact of severe weather on water network

Improved customer experience

Household Customer Experience Measure (hCEM)



Non-household Customer Experience Measure (nhCEM)



Water supply

EVERY DAY WE DELIVER
1.53bn
litres of clear, fresh drinking water to taps

HIGH WATER QUALITY MAINTAINED

Waste water service

WE REMOVE AND TREAT
1.08bn
litres of waste water every day to help protect the natural environment

Customer charges

2020/21:

LIMITED **+0.9%** HIGHER

AROUND **£3**/YEAR HIGHER

2021/22:

INCREASE BY **2.5%**[5]

AROUND **£10**/YEAR HIGHER[6]

WITH OVER
400,000
CUSTOMERS
benefitting from additional support

INCREASE BY AN AVERAGE OF **0.9%**

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

[5] for those that pay full charges
[6] for a Band C household

INVESTING IN OUR ASSETS

Where we are now

Large asset base

237	30,343	1,837	33,223
WATER TREATMENT WORKS	MILES OF WATER PIPES	WASTE WATER TREATMENT WORKS	MILES OF SEWER PIPES

One of the biggest critical infrastructure investors

£3.7bn	£612m
2015-21	IN 2020/21[7]

[7] £118m less than planned due to Covid-19

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

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

TOP THREE CONSTRUCTION INDUSTRY INVESTOR

OPERATIONAL AND INVESTMENT EMISSIONS CALCULATED INCLUDING FROM OUR SUPPLY CHAIN

2020/21

2% Reduction in operational greenhouse gas emissions

40GWh of on-site self-generated renewables

1GWh 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 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

[8] Includes around £290m to complete outstanding investment commitments made in 2015-21.

[9] Consumer Price Index

CHAIR'S STATEMENT
DAME SUSAN RICE

If I had to describe the past year in one word, looking through the lens of Scottish Water, it would be care. We at Scottish Water, like so many communities and families, lost colleagues and friends in the Covid-19 pandemic. Everyone has had to find a way through the stresses and strains of lockdowns and different caring responsibilities. It has perhaps never been so important to keep our water and waste water services flowing for all our customers, the length and breadth of the country.

We cared for each other in the most difficult of circumstances. And we cared for our customers and communities by continuing to provide clean water and sanitation services, so essential to good health and hygiene. We implemented our business continuity plans, delivering seamlessly the services that people rely on us to provide.

As Chair of Scottish Water, I'm exceptionally proud of our achievements over the last year and would like to thank every one of my colleagues for their contribution to help keep our essential services running and the steps they took to support our partners and customers. I know they do this because they care. I'm just as proud of the appreciation shown by our customers and communities for the work we do. Once again, the water sector in Scotland has come top of the annual Which? consumer trust survey, with a year-on-year increase in trust. The research[10] found a greater proportion trusted the water industry in Scotland than in the rest of the UK. We are also the highest ranked water company in the UK in the Institute of Customer Service's Customer Satisfaction Index and we've made it into the Top 50 companies for the first time.

[10] Consumers in Scotland 2021 report

Considering the challenges of the past year, these achievements – delivering the essential services our customers rely on and attracting increased levels of trust and satisfaction – are truly remarkable.

We need only look elsewhere around the world to see that those services cannot be taken for granted. The impact of climate change and ageing infrastructure on water and power supply - so essential to everyday life - is not something we are immune to in Scotland. Those issues made up a lot of what we discussed within the Board especially as we looked ahead to future decades.

The Covid-19 pandemic has also posed challenges to one of our subsidiary businesses, Business Stream, which supplies water and waste water services to customers in the competitive non-domestic market. Like Scottish Water, Business Stream has also managed its operational activities well and gone the extra mile to support customers who have been impacted most by the pandemic. Supporting customers as we recover from the impact of the pandemic will continue to be Business Stream's focus for some time to come.

Business Stream acted responsibly and swiftly to provide a wide range of measures to help alleviate the financial pressures on customers, including the relaxation of payment terms introduced by the industry regulators. As anticipated, this has impacted its own cashflow and profits but current financial scenario forecasts are within the formal funding support facility put in place last year to meet the shorter-term liquidity impacts associated with the pandemic.

Coming out of an extraordinary year, I'm so grateful to the members of the Scottish Water Board for their work in leading and guiding our organisation through such a difficult time. And for their parallel stewardship as we face into a new regulatory undertaking, a changed world of work, and the urgency of our commitments to climate change.

I would like to record my gratitude to Matt Smith, who steps down from the Board after serving two terms, for his dedicated and thoughtful service, and to Paul Smith, who also leaves us after being a Board member for almost five years, during which time he brought rigorous and valuable challenge to our work. I am delighted welcome Steven Dickson who joined the Board in May. Together, the Board, the executive team and all our colleagues at Scottish Water will continue to ensure we deliver our services and our promises to customers, communities and stakeholders next year and beyond.

Coming out of an extraordinary year, I'm so grateful to the members of the Scottish Water Board for their work in leading and guiding our organisation through such a difficult time.

CHIEF EXECUTIVE'S REPORT
DOUGLAS MILLICAN

The last 12 months have been dominated by the biggest threat to our health and wellbeing, and that of our friends and family, in our lifetimes: the Covid-19 pandemic. The virus and our governments' response to it have dramatically altered how we all live and work. The significance of this pandemic may not be fully known for many years to come as all the consequences come to light and we better understand the long-term impacts on health, wellbeing, the economy and our way of life. But it is already clear that the near future, like our recent past, will also be defined by Covid-19.

In Scottish Water the impacts of the pandemic have been very significant. Our role in providing people with the clean and safe water and waste water services needed for good health and hygiene, means our responsibilities have never been more important. Interruptions to water supply, sewer flooding and our other day-to-day challenges have had a heightened importance and urgency this year because of our responsibility to help people wash their hands and stay safe. It is against that backdrop that I am proud to say that Scottish Water has had a strong year in 2020/21, in some of our toughest ever circumstances.

Responding to Covid-19

Over the last year our first responsibility has been to maintain services to customers, primarily a clean, safe supply of water for health, hydration and hygiene and the effective collection and treatment of waste water. But just as importantly, we have also had to ensure the health and safety of our employees, particularly our frontline operational colleagues. To do this, many new ways of working have been introduced including social distancing, face coverings, additional Personal Protective Equipment (PPE), and minimising contact with colleagues and members of the community.

We are fortunate to have had relatively few absences from work due to Covid-19. However, the stress this has placed on our people is very significant and I would call out the courage and strong sense of duty they have shown to deliver services to customers.

'We are fortunate to have had relatively few absences from work due to Covid-19. However, the stress this has placed on our people is very significant and I would call out the courage and strong sense of duty they have shown to deliver services to customers.'

While our office-based employees may not have faced the same work-related risks as their operational colleagues, they have also seen major changes to their ways of working. With the announcement of lockdown in March 2020, we turned our office workforce into a home-based workforce almost overnight. Thankfully prior investment in digital technology meant we were able to do this quickly and effectively. This change required a roll-out of new laptops and other equipment and fundamental changes to many of our work processes. The impact of these changes on our employees has also been profound with increases in mental health and wellbeing issues due to work changes, lack of social contact, caring responsibilities and other factors. We have worked hard to support our colleagues through these challenging times and will continue to do so.

Our capital investment programme was also impacted by the pandemic and suspended for over three months as a result of the Scottish Government's shutdown of construction sites in spring 2020. This means that many projects, needed to maintain or improve service to customers or the environment, are behind where we and our regulators expected they would be. As we restarted capital projects with new Covid-19 safe ways of working, there has been an inevitable impact on productivity adding around 4% - 8% to project costs depending on the type of investment activity. With the pausing of our investment programme, our overall level of investment for 2020/21 at £612 million is less than planned. However, following changes to government restrictions last summer, we returned to the majority of capital investment sites. Excellent progress was made in the latter part of the year, delivering previously expected levels of monthly investment despite the Covid-19 related challenges.

During the last year, we took additional steps to support businesses impacted by the pandemic by making payments to suppliers as soon as practicable and extending £59 million of working capital support to Licensed Providers (LPs) through the suspension of prepaid wholesale charges.

Like everyone else I am hoping that the vaccine programme will mean that the next 12 months are easier on us all and that Scottish Water's work is less impacted. We will continue to monitor and adapt how we work as restrictions change. We will prioritise the provision of clean, safe water and the waste water services needed for good sanitation.

We will ensure that our future plans and our services remain robust to Covid-19 or other challenges.

Delivering for Customers 2020/21

Considering the various difficulties of the pandemic, our performance during the financial year 2020/21 has been strong. Much of this is due to the talent and dedication of our people as well as recent investment planning and preparation which enables us to more effectively manage service risks.

In terms of drinking water, we have had a very good year with the quality of water supplied maintained at a very high level. We were unable to take samples at customers' taps for much of the year, and instead used samples taken at service reservoirs and some employees' homes. We cannot therefore make a fully direct like-for-like comparison with previous years for water quality at customers' taps. For all other points of measurement, our results have been as good as or the best we have ever achieved. We will continue to strive to provide further improvements to water quality.

Our leakage performance over the last year was difficult to track because of the lack of business consumption data when business premises have been closed. Nevertheless, strong focus on reducing leakage and managing the significant impact on water losses from burst pipes during the six-week period of very low temperatures in January and February, resulted in a small further reduction in leakage. Across the year, our leakage was 0.4% lower than in 2019/20 at 463 million litres per day (ML/D). Across the regulatory period, leakage control has been a consistent success story, outperforming the economic level of leakage target in every single year. As we look to the future, we are committed to continuing to achieve an underlying trend of year-on-year reductions in leakage.

We believe that our waste water performance has been generally good but we didn't have the full normal independent waste water sampling arrangements in place during the spring 2020 lockdown. Last summer was a challenging period for cases of external and internal sewer flooding. While it's possible to put this down to extreme weather at that time, the impact of climate change means these weather patterns are increasingly common and we face a growing problem of sewer flooding. This, together with the greater interest in open water swimming, is also leading to a growing area of customer and community complaints and stakeholder requests for action. In response we are piloting new approaches to provide more immediate solutions and it will remain a challenging issue. This will most effectively be resolved by working over the long term to improve sewer system monitoring and reduce the volume of surface water entering our sewers.

Our OPA (Overall Performance Assessment) score for the year has been impacted because of Covid-19 restrictions, and government advice on social distancing, resulting in a number of changes to normal sampling and monitoring regimes. However, we calculated each OPA element (where there was any degree of uncertainty) in a fair, reasonable and robust manner. Overall, we have calculated the OPA score as 404, another year of excellent performance. Across the 2015-21 period our average OPA score was 401, significantly exceeding our Delivery Plan target for the period.

Our customer service performance reached record levels for both household and non-household customers. For non-household customers, this may be, in part, due to reduced business activity in the year. We had especially strong performance in our customer experience surveys in the early part of the year, possibly attributable to a ‘halo-effect’ around essential workers. However, there was a reduction in experience for many customers attached to the difficulties caused by the January and February weather. Community relations also improved this year, however a small number of long-standing issues continue to generate engagement and contact. There were very few community concerns about the restart of the capital investment programme, despite it often involving employees and contractors travelling across Scotland to deliver projects.

Financially, the pandemic has placed a number of pressures on our income and costs, impacting the level of surplus we can reinvest. This was caused by a number of factors including less water used by businesses and extra costs incurred due to Covid-19, including the stand-down and restart of the capital programme. Steps we took to maintain services during the extreme weather of January and February further added to our costs. Fortunately, the strong cash position with which we entered this year has enabled us to weather the Covid-19 pressures while we complete our commitments from the 2015-21 regulatory period.

Before the pandemic, we had determined we should hold a minimum cash balance of £100 million, albeit our cash position was usually greater than this in practice[11]. In light of the pandemic, we have now determined we should always hold a minimum cash balance of £200 million, equivalent to approximately eight weeks expenditure.

Scottish Water’s cash balance at 31 March 2021 was £428 million but around £290 million of this is already committed to complete outstanding investment from the 2015-21 investment programme with the balance required to contribute towards our planned long-term level of minimum cash holdings to manage residual business risks.

Delivering for Customers 2015-21

2020/21 was the final year of our six-year regulatory period, with performance scores completing the picture for the whole period. Because of the long-term nature of what we do, some of our performance can only be fully understood over a longer timescale. Through a six-year lens, our performance has been strong and stands in good comparison against other water companies.

Our levels of investment mean we are consistently one of the biggest investors in critical national infrastructure and a major provider of jobs, particularly in engineering and construction sectors. Our investment levels significantly increased over the period from 2015/16 to 2019/20 albeit in the last year they decreased slightly due to Covid-19. Our investment has been spread across the range of our assets from large treatment works to local networks but has all contributed to improving customer service, asset resilience or protecting the environment.

Our levels of investment mean we are consistently one of the biggest investors in critical national infrastructure and a major provider of jobs, particularly in engineering and construction sectors.

As I mentioned earlier, one of the key successes of the period has been the level of reduction in leakage from our networks. It is often a cause for concern for customers and communities who recognise this as waste and often raise concerns about safety and environmental impacts. In the first year of the regulatory period we placed a strong focus on tackling leakage and as a result achieved our regulatory target in the first year. This was an excellent achievement and set us up for further reductions in leakage in subsequent years. Our leakage levels are now 15% lower than they were before the start of the 2015-21 period.

[11] Further information available in the Financial Sustainability section of the report.

15% LOWER

Our leakage levels are now 15% lower than they were before the start of the 2015-21 period.

An area of focus for us in the last two years has been the efficiency of capital programme delivery, with benchmarking against other companies highlighting a number of areas which can be improved. These include cost forecasting and management and on-site delivery. One example of improvement is the "get to site in half the time" initiative which has set targets to reduce time taken by 50% and cost by 30% to get projects included in the initiative to site. We are still piloting this and as we scale this initiative more broadly, efficiency of delivery of our capital programme will remain a focus as our investment levels increase yet further in the next six years.

Over the six years of the regulatory period, operational performance in water, waste water, customer service and community relations have all been maintained at high levels or steadily improved. Standout successes include customer service, where we are now the best performing water company in the UK, according to the Institute of Customer Service survey of customer satisfaction[12], and water quality, particularly cryptosporidium detections. We have also shown strong financial performance, which has helped us respond to the challenges caused by Covid-19, generating regulatory financial out-performance of £202 million across the period. This out-performance is being invested largely in improvements to water quality, water supply and environmental protection.

However, over the last few years we have also faced significant challenges, sometimes impacting services, including many caused by the age and condition of our assets, and customer charging anomalies that must be resolved. Every year, we gain greater insight into the performance of our assets and how these can be optimised, which will enable them to be managed as effectively as possible. This will help us realise our transformation plans.

[12] UK CSI January 2021. The UKCSI is the national barometer of customer satisfaction published twice a year by The Institute of Customer Service since 2008. It is an independent, objective benchmark of customer satisfaction on a consistent set of measures on over 250 organisations and organisation types in 13 sectors. The UKCSI provides a unique way of tracking and comparing customer satisfaction performance across the UK economy. An organisation's inclusion in the UKCSI is unrelated to membership of The Institute. The UKCSI is designed to give an objective view of the state of customer satisfaction in the UK. For more read Customers and Communities.

Delivering for Customers 2021-27

The new regulatory period started in April 2021. In our Strategic Plan: Our Future Together, published in February 2020, we call out the twin challenges of ageing assets and climate change and set out how we will address them through our three strategic ambitions: Service Excellence, Beyond Net Zero and Great Value.

Since the launch of Our Future Together and our Net Zero Routemap, our economic regulator, the Water Industry Commission for Scotland (WICS), has published its Final Determination of charges. This set out the available financing that will support a substantial increase in the level of investment we will make over the next six years and the associated expectations.

However, it will take more than increased investment alone to achieve our strategic ambitions, it will also require nothing short of a transformation of Scottish Water. Since being set up in 2002, Scottish Water has done well to continually improve service levels and invest for the future. But what was successful in the past will not be sufficient for the future and we require to reshape Scottish Water to meet the challenges ahead. This transformation will be as significant as any challenge ever faced by Scottish Water and vital to our future success.

We have been working on a plan for the transformation of Scottish Water over the next few years. We have been inspired by, and learned from, transformation stories in diverse organisations; from mass transit systems in Asia to car manufacturing in Europe. These insights have informed what could be possible as we consider our key areas of focus: asset intelligence, efficient processes, partnerships, investment prioritisation and customers and communities. We are also determining how we strengthen our organisation as we consider our approach to leadership, skills development, performance enhancement, and ways of working. We have gained valuable insights from over 2,800 of our employees who have given their views about the strengths of Scottish Water we need to build on, as well as areas they can see for improvement. I am encouraged by the belief among our people that there is much we can do to improve how Scottish Water operates and delivers to serve our customers and support a flourishing Scotland. We are now working on a range of initiatives which will shape the changes required to meet our future ambitions. We will publish our Transformation Plan in the Autumn, setting out the details, and will consult with stakeholders on their views and ideas prior to implementation.

Many of the changes required will take years to implement. For example, the development of the capabilities to ensure decisions are fully based on robust analysis of relevant information. But we are also keen to make significant changes quickly in the areas most important for the delivery of our future ambitions.

Achieving Net Zero Emissions

Climate change remains the biggest threat to the long-term health of the planet and remains the responsibility of all of us, both personally and as an organisation. That is why in September 2020 we launched our plan to reach Net Zero emissions by 2040 across our operational and investment activities. Our plan is the most ambitious one we could credibly put forward and achieving it will be an enormous challenge over the next two decades. It will require us to take actions to reduce our emissions levels, to adapt, innovate and transform, radically changing how we work. It will also require us to have similar levels of ambition and investment to maximise the potential of our land for natural carbon storage, energy generation and biodiversity.

While we are only nine months on from the launch of our plan, we are moving ahead with some early wins, including energy efficiency measures and more renewable energy generation. There has been a significant reduction in mileage driven by our people throughout the pandemic and this positive consequence is something we are working to maintain to secure future carbon benefits.

The biggest challenge to reducing our emissions will be in the investment decisions we take, ensuring that we maximise our carbon-saving opportunities while also delivering new assets, or maintaining old ones, in ways that efficiently deliver the service our customers need. This will require new ways of thinking about how we appraise and prioritise investment decisions that will be challenging to us, and in some cases the communities we serve. But I am clear that achieving Net Zero emissions will be the yardstick by which our success will be largely judged in 20 years time. Long after many of us will have retired, the delivery of plans we are making this year will define Scottish Water for the next generation.

In September 2020 we launched our plan to reach Net Zero emissions by 2040.

The impacts of climate change are increasing, causing more extreme weather events and changing the water environment. This is challenging our ability to deliver services in the same way, and we must increasingly adapt our assets and how we operate to take account of these changes. This is about more than our own Net Zero ambitions; these changes are the result of climate change and require an appropriate local, as well as global, response if we are to mitigate the impacts. We will watch with interest the discussions at COP26 in Glasgow in November and potential further agreement on global actions to mitigate climate change.

Our Future Prospects

The start of a new regulatory period is also a good point to look further into the future, beyond the next year or two.

Providing water and waste water services has always been a long-term business and addressing the key challenges of achieving Net Zero emissions and tackling our ageing assets likewise require long-term thinking. We are also seeing shifts in the expectations of customers, communities and stakeholders that will require time to fulfil.

To help us with our long-term view we have recently renewed our purpose as an organisation: to support a flourishing Scotland. This is taken directly from the Scottish Government key future planning tool, the National Performance Framework, which is in turn linked to the United Nations' Global Goals.

Our intention is that our purpose will guide everyone in Scottish Water, as well as our partners and stakeholders, in how we serve our customers, communities and protect the environment. We will continue to do that through the provision of safe and reliable water and waste water services, as that's our unique public responsibility. We must play our part in helping Scotland achieve success in many different areas, for example in the continued development of renewable energy projects.

To do this, and also tackle our ageing asset and Net Zero challenges will require the continued support of our customers, communities and stakeholders. In some instances that will mean the help of communities, for example to reduce their water consumption or work with us keep surface water out of waste water systems. It will also require their support for higher charges and increased levels of investment.

This is new territory for us. After a decade of real-term reductions in customer charges, we recognise the significance of increasing charges by more than inflation. Annual household water and waste water charges increased by an average of 0.9% from April - however over 400,000 customers will pay less overall because of the Water Charges Reduction Scheme being expanded over the next six years. Customers who pay the full charge levels will pay 2.5% more over this year. The announcement, in accordance with WICS Final Determination and with the support of the Scottish Government, was made transparently and received some media coverage and political comment. While we've no wish to cause controversy, it is important that customers and stakeholders understand why we've had to increase charges and that we will need to continue to increase them in future years.

Thank You

I'd like to finish by thanking my colleagues at Scottish Water, our partners, customers, communities and stakeholders for their contributions to our remarkable success over the last year. Reflecting on 2020/21, I am exceptionally proud of the people of Scottish Water for all that they've achieved during a global pandemic and appreciative of the support and insight from Scotland's wider water sector. I am confident that we will continue to rise to future challenges together.

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. Consequently, Scottish Water does not have shareholders. This ownership model allows the surplus generated to be reinvested in the provision of services to our customers.

Scottish Water's core services are covered by the Water Industry (Scotland) Act 2002. Under that, the charges for these services have to be approved annually by the Water Industry Commission for Scotland (WICS). In delivering these services effectively, Scottish Water has to make use of its resources to achieve the 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 water 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.

What We Do

Scottish Water's vision is to support a flourishing Scotland through being trusted to care for the water on which Scotland depends.

Scottish Water supplies water and waste water services to households and is also the wholesaler to the 29 LPs who operate in the water retail market for business customers in Scotland.

Using Scotland's natural resources, our assets and the skills of our people, Scottish Water is committed to improving our services for customers and communities while protecting and enhancing the environment of Scotland.

Our customers expect us to provide excellent customer service by delivering high levels of water quality and environmental performance, all for an affordable price.

Details of the Scottish Water group structure, strategic frameworks and financial frameworks are provided in the following sections: Scottish Water Group (pages 84 to 87), Scottish Water – regulated services (pages 87 to 95), Business Stream (pages 95 to 96) and Non-regulated businesses Trading Subsidiaries (pages 97 to 98).

OUR VISION AND STRATEGY

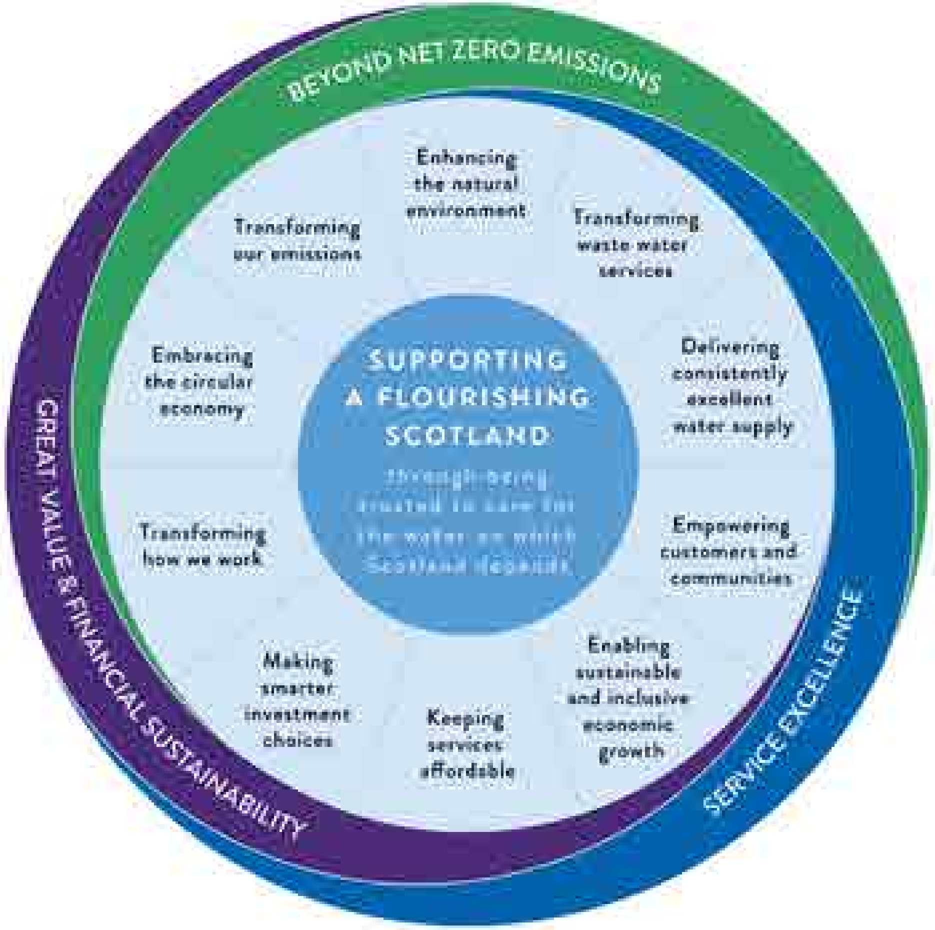
In 2020, we launched our strategic plan Our Future Together. As well as our new purpose, our plan highlights the big challenges we will face in providing essential services to homes and businesses across Scotland: the impact of climate change, ageing assets, and reducing the emissions that contribute to the climate crisis.

Our Future Together also sets out three strategic ambitions for the next 25 years:

SERVICE EXCELLENCE

BEYOND NET ZERO EMISSIONS

GREAT VALUE AND FINANCIAL SUSTAINABILITY



DELIVERING MINISTERIAL OBJECTIVES IN THE 2015-21 REGULATORY PERIOD

Scottish Ministers set objectives for Scottish Water. This report looks at our performance during the sixth and final year of the regulatory period 2015-21 and the completion of these objectives. Listed on the following page are also objectives for the next regulatory period.

Ministerial Objectives 2015-21:

- Helping to sustain better and more efficient public services by ensuring assets are maintained and improving services to customers.
- Helping people sustain and improve their health through the provision of continued, high quality drinking water and improving resilience.
- Contributing to improvements in Scotland's natural and built environment and the sustainable use and enjoyment of it.
- Supporting the delivery of the Government's priorities in rural communities with a view to improving water and waste water provision in rural areas.
- Servicing demand for new strategic capacity to meet all new housing development and the requirements of commercial and industrial customers.
- Improving Scotland's resilience to climate change by identifying possible impacts and, where appropriate, investing to manage these impacts.
- Contributing to Scotland meeting its climate change obligations of reduced greenhouse gas emissions.
- Taking all necessary steps to fulfil duties and obligations set out in the Flood Risk Management (Scotland) Act 2009.

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, 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 sewerage.
- 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 sewerage 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 please visit: www.gov.scot/publications/scottish-water-directions-2020/

OUR APPROACH TO RISK MANAGEMENT

Overview

Strong and systematic risk management is integral to achieving Scottish Water's ambitions and the delivery of Ministerial objectives. Risks, both positive (opportunities) and negative (threats) exist and have the potential to impact the routine operations we undertake, and services we provide to our customers. They can ultimately affect the achievement of our business ambitions, objectives, strategy and purpose.

Scottish Water's risk management framework encompasses subsidiaries, Scottish Water Horizons, Aberdeen Environmental Services and Scottish Water Services Grampian.

In line with the Water Industry (Scotland) Act 2002: Scottish Water Governance Directions 2009, the framework excludes Business Stream's operational risk management. The Board of Scottish Water Business Stream Holdings Ltd oversees the financing risks associated with Business Stream, while Business Stream's Board is responsible for its own risk management.

Risk Control Assurance

Scottish Water operates a formal governance structure to manage risk. While everyone in the organisation has a responsibility to support the identification and management of risk, the Scottish Water Board, supported by the Audit Committee and the Executive Leadership Team, has overall accountability for the risk management framework.

Regular reviews of the most significant risks are undertaken with appropriate mitigation strategies developed, implemented and monitored.

To efficiently and effectively manage opportunities and threats across Scottish Water, we embrace a systematic and structured approach to risk management. Our approach is based on the principles of the International Standard 31000 Risk Management (ISO 31000) and is tailored to meet the needs of our business and the environment in which we operate.

Our approach is designed to provide assurance that the opportunities and threats facing the business are understood; and that all necessary information is reported to senior managers and escalated to the Executive Leadership Team, Audit Committee and Board as appropriate to inform business decisions.

Risk Management Approach

Scottish Water has an established Risk Management Policy which was refreshed in August 2017. It is subject to periodic reviews, with the next review due in 2021. The policy sets out a clear and consistent approach to the management of risk and defines our risk appetite. This is enabled by the Corporate Risk Register and a number of supporting risk management processes and activities.

Our systematic and structured risk management framework enables the identification, assessment and effective management of business risks, both individually and in aggregation. The consequence and likelihood of these risks are determined and ranked using a scoring matrix which is aligned to our risk appetite. This ensures a consistent approach is taken when assessing the overall impact to Scottish Water and our customers.

When forming this assessment, we consider risks aligned to five risk appetite perspectives. These are 'Managing our Assets', 'Working with People', 'Managing External Influences', 'Developing the Business' and 'Scottish Water Subsidiaries'.

The current, or projected, level of risk is compared to the Board's risk appetite to ascertain whether further action is required. This is to ensure the achievement of service delivery and business objectives in line with our ambitions and appetite for risk.

Culture

The Board recognise that successful risk management is dependent on having an effective culture within Scottish Water; this ultimately encompasses the knowledge, beliefs and attitudes of our people. We aim to continually cultivate a risk-aware culture throughout the business by promoting a consistent tone from the top.

This is undertaken by outlining clear responsibilities and accountabilities for those managing risk, and recognising individuals who manage risk effectively, share, escalate and report risk information in a timely manner. Recent work on the design and communication of Scottish Water's Character has been done with cognisance of our requirements to maintain and further build a healthy and supportive risk culture.

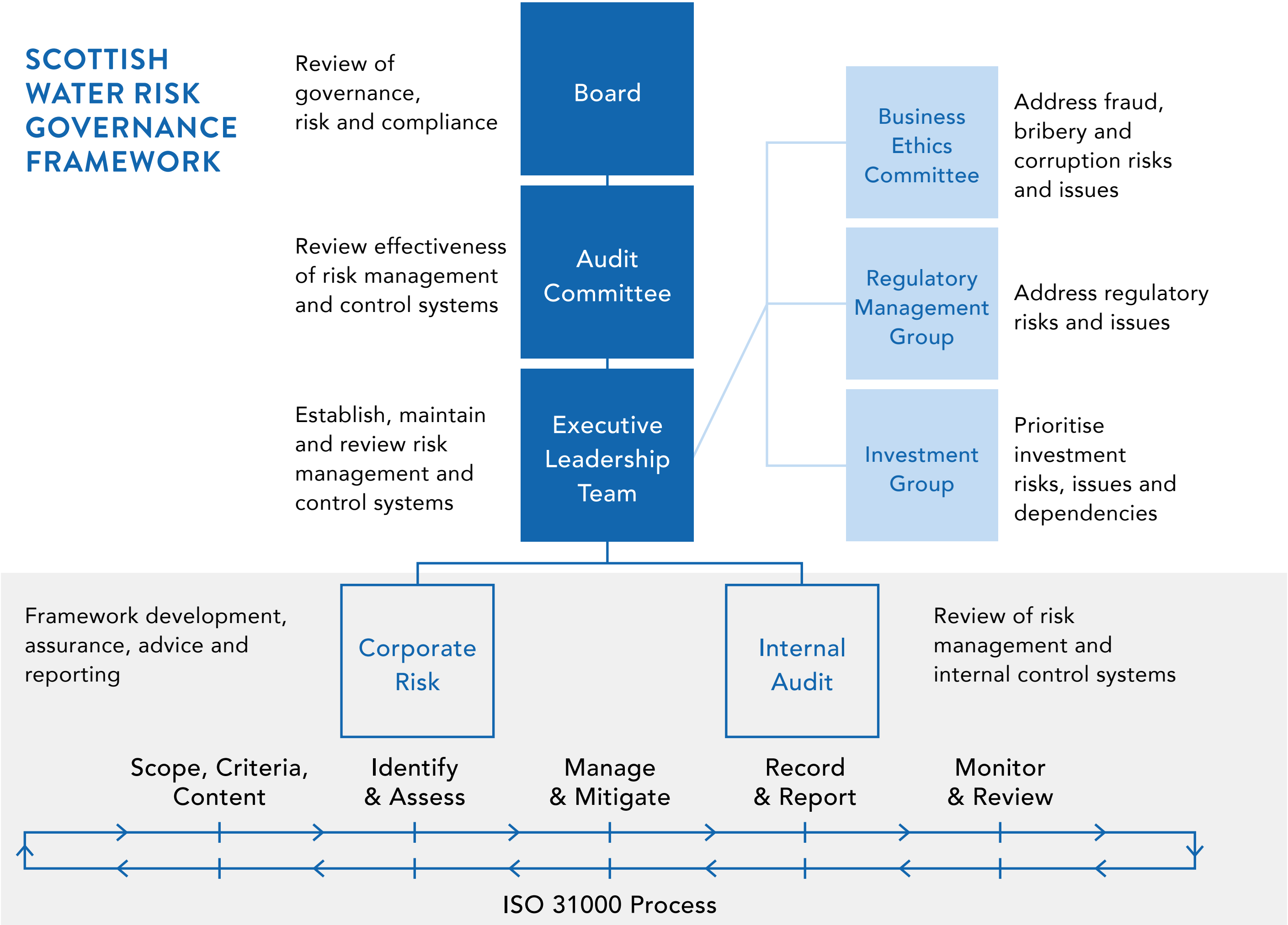
Risk Appetite

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. As Scottish Water embarks on our next regulatory period; 2021-2027, we have increased our four risk appetite perspectives to five through the addition of 'Scottish Water Subsidiaries', alongside the introduction of an overarching risk appetite statement reflecting our interlinked ambitions; Service Excellence', 'Beyond Zero Emissions', and 'Great Value and Financial Sustainability'.

We have established Risk Appetite Statements for key business areas and beneath 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 reports to the Executive Leadership Team, Audit Committee and the Board. The appropriateness and effectiveness of the mitigating actions is determined in accordance with the risk appetite for the respective business areas.

SCOTTISH WATER RISK GOVERNANCE FRAMEWORK



Board

The Board has overall responsibility for reviewing governance, risk and compliance. The Board receives two risk reports per year, supplemented by a further two summary reports, which review the principal risks and uncertainties, including the mitigating actions being undertaken and their effectiveness.

Audit Committee

The Audit Committee has responsibility for the risk management framework on behalf of the Board, reviewing the effectiveness of risk management and supporting control systems. The Committee receives two risk reports per year, supplemented by a further two summary reports.

Executive Leadership Team

The Executive Leadership Team is responsible for establishing, maintaining and reviewing risk management and supporting control systems. The Executive Leadership Team receives regular risk reporting. A number of executive sub-committees assist with oversight of specific risk areas; the Business Ethics Committee which meets quarterly to address fraud and corruption risks and issues, the Regulatory Management Group which meets monthly to address regulatory risks and issues, and the Investment Group which also meets monthly to address investment risks, issues and dependencies.

Corporate Risk

Scottish Water has a Corporate Risk Function. This is headed by a General Manager, reporting to the Finance Director, who leads and manages the risk management framework and processes, and is responsible for risk reporting and advice to the Executive Leadership Team, Audit Committee and the Board.

Audit

In the context of risk management, a range of audit activity is undertaken by 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. The three lines model further illustrates this process.

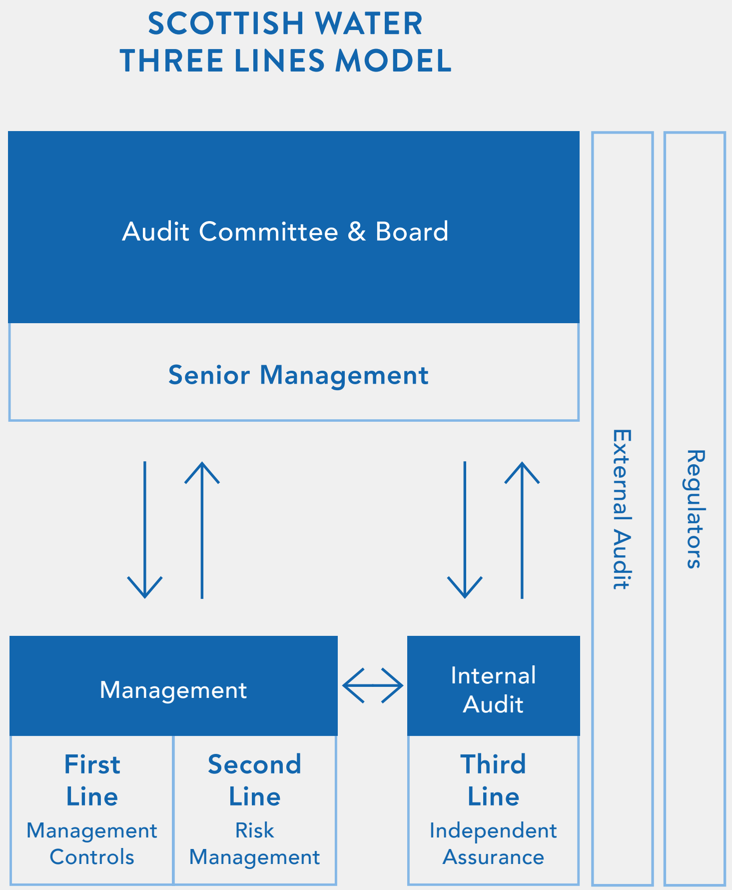
The Three Lines Model

Scottish Water operates a three lines model with clearly defined roles and responsibilities. This model ensures the effectiveness of the risk management framework by providing key governance groups with appropriate assessment, monitoring and assurance at three different points. This aligns with the Institute of Internal Auditors' model changes published in July 2020.

1. **First line** – Each business area is responsible for the identification and assessment of risks; both threats and opportunities, understanding and adopting appropriate controls and activities.

2. **Second line** – Risk management provides support and challenge on the completeness and accuracy of risk assessments, considers the adequacy of mitigation plans and delivers risk reporting. This line also considers risk from a business-wide perspective.

3. **Third line –** Internal audit, through a risk-based approach, provide independent and objective assurance of the robustness of the risk management framework, effectiveness of risk management across the organisation, and the appropriateness of internal controls. Further assurance is provided through external and regulatory audits.

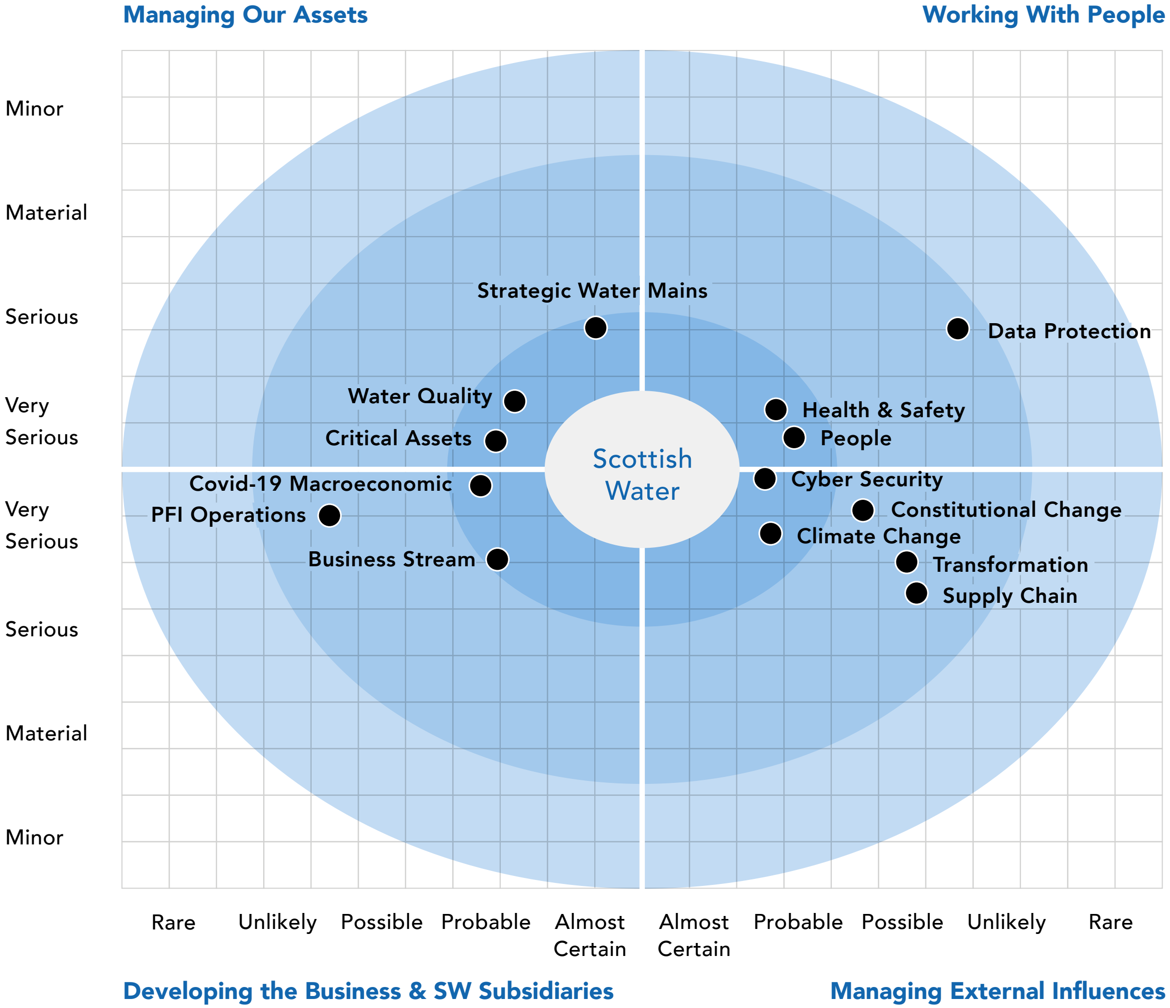


Principal Risks and Uncertainties

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 reverse stress testing and scenario modelling, and qualitative scenario testing. These risks, both opportunity and threat, are those we consider to be the most material to our business and our performance, including those that could threaten the business model, future performance within our regulatory settlement, and short and long-term financing of Scottish Water.

Our principal risks, which centre around: the criticality of our national infrastructure; the importance of our people and health and safety in our service delivery; external threats such as the ongoing Covid-19 pandemic, cyber security and climate change; and the wider economic and Covid-19 impact on our subsidiary Business Stream are all detailed in the link in the menu on the next page.

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



A fuller description of each of the principal risks is provided using the menu opposite. This section also considers the movement of each risk across 2020/21 and the future outlook, alongside Scottish Water's risk appetite position and key mitigations being undertaken.

In addition to the risks detailed, we also actively manage several other notable high consequence but lower likelihood risks. These include reputational and financial risks arising from damage to critical national infrastructure managed by third parties, such as; oil/gas transmission pipes and/or railway networks; risk to revenue; risk of water shortage; evolving regulatory processes; and a service and financial risk arising from contractors not fulfilling their obligations/liabilities.

We have also outlined our current view of potential future risks in the Emerging Risks section, which can be viewed by using the menu opposite.

GOING CONCERN AND VIABILITY STATEMENTS

Scottish Water is well placed to withstand the challenges presented by the Covid-19 pandemic.

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 statement is set out on page 34.

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 21 to 114. The principal risks and uncertainties are described on pages 99 to 114.

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 2021, Government loans totalled £4.1 billion and Scottish Water group held cash and cash equivalents of £570.4 million.

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 of the Covid-19 pandemic. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. They also consider the risks associated with the Covid-19 pandemic including the impacts in relation to reduced cash collection levels (up to a maximum of 2%) and the reduction of water consumption by business customers (up to a maximum of 20%) over the period of review.

Under all of the scenarios, Scottish Water will be able to operate within its available facilities and is well placed to withstand the challenges presented by the Covid-19 pandemic.

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, 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 the six-year period is appropriate because it is consistent with the period covered by the Final Determination published by the WICS in December 2020 which ensures sufficient funding for the core of the group's activities to March 2027. Consequently, 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 2027.

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, risks associated with the Covid-19 pandemic and the level of the capital investment programme. They considered the potential impacts, in severe but plausible scenarios, of the principal risks, set out on pages 99 to 114, 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. Scottish Water subsequently set out its Delivery Plan for the period to March 2023. In addition, Scottish Water had published its 25-year Strategic Plan. Business planning is an annual process which forecasts the performance and liquidity of the group over the regulatory period but with a detailed focus on the first 3 years of any planning period. The plan 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 and regulatory financial ratios. Reverse stress testing[13] has also been carried out for certain financial risks.

[13] Reverse stress testing is a process of identifying and quantifying severe but plausible risks to current business models as a consequence of a significant event, e.g. the Covid-19 pandemic.

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 six-year period to March 2027.

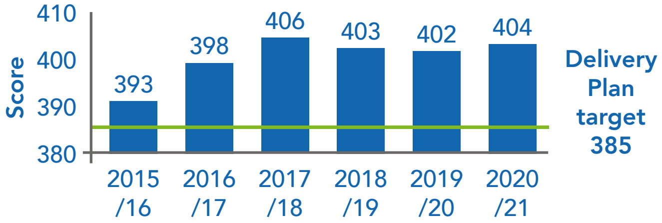
SERVICE EXCELLENCE

Overall Performance Measure

Evaluating how we deliver water and waste water services to our customers is critical to understanding how we are performing as a business. The OPA is a regulatory points-based measure which drives our service across multiple activities to ensure customers receive the best possible service.

As a result of changes to the way sampling and monitoring have taken place during 2020/21, in agreement with SEPA and the Drinking Water Quality Regulator (DWQR), there are limitations in calculating the OPA score in the usual robust manner. These limitations occurred because of modest reductions to our normal extensive regulatory sampling arrangements due to Covid-19 restrictions in the spring 2020 lockdown and the imperative of minimising entering customers' homes to avoid catching or spreading Covid-19.

Consequently, we have taken a cautious approach to determining our OPA score to ensure it still reflects a fair, reasonable and robust assessment of performance, including external audit. On this basis, OPA performance is calculated at 404 for the year. This is a near record performance and is the fourth year in a row in which we achieved a score of above 400 points.



CUSTOMERS AND COMMUNITIES

Overview

Maintaining a clear focus on customers and communities underpins all activities and decision-making. The importance of ensuring customer service meets needs and expectations, enabling access to excellent quality clean, safe water and sanitation has never been greater than during a year of global pandemic.

As a publicly funded organisation, customers' views help shape the delivery of services with clear commitments to improve, understand when things could have been done better and to engage earlier wherever possible.

We aim to deliver consistently excellent service for customers and ensure water is available at taps and waste water is taken away and cleaned safely.

Although most people do not experience disruption to supplies, services can be interrupted for many reasons and customers contact us to ask what we are doing to return to normal service.

Reasons for a loss of service can include infrastructure failure and weather conditions. At all times we try to minimise the impact for customers and have rigorous targets to meet for resuming normal services. On a small number of occasions throughout the year customers' services may be interrupted for longer than we would target.

2020/21 Performance

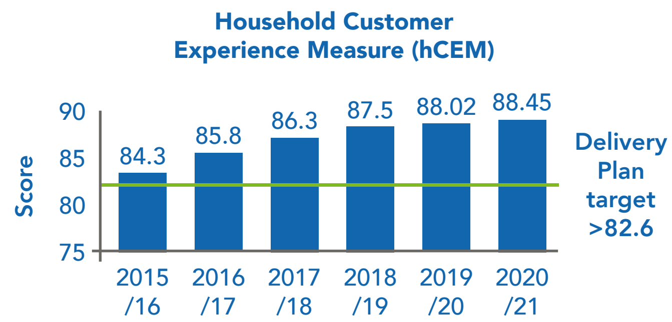
Customer Experience

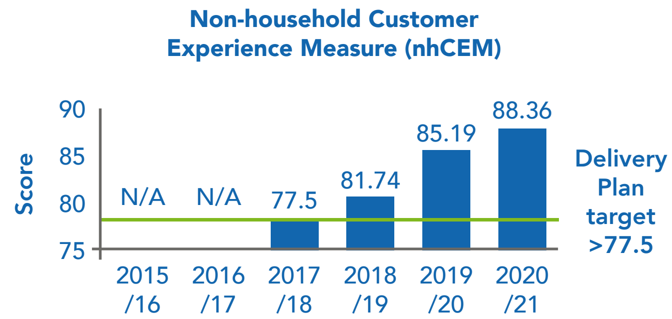
Customer experience is a key performance measure.

Over the past 12 months a strong focus on customer experience was maintained, recognising the need to maintain supplies and minimise disruption given the ongoing health emergency.

Despite challenging circumstances around working practices caused by the pandemic and weather conditions which impacted on our network, record performance has been achieved on both household and non-household customer experience.

The 2020/21 Household Customer Experience Measure (hCEM) was 88.45 - exceeding the previous year's 88.02 - highlighting further improvement and a strong focus on customer service.





Despite the Covid-19 restrictions, throughout 2020/21 we have maintained a high level of service to our wholesale customers, maintaining water and waste water services and promptly responding to LPs and business customers' charging, billing and service enquiries.

The 2020/21 Non-household Customer Experience Measure was 88.36 and improved on the 2019/20 performance score of 85.19, which is significant given the challenges of the past 12 months in the wholesale sector. While Covid-19 may have impacted the number of contacts from business customers and LPs, the level of reduction of those contacts was slightly less than in the previous two years.

The winter weather across Scotland was the most challenging in a decade, with January being the coldest since 1985. The sustained cold spell continued into February and resulted in issues with assets and more frequent service interruptions across Scotland.

Over the course of the year there were 305,000 service issue contacts from customers received by our Customer Engagement Centre. Of those, 106,000 were received in the three months between January and March 2021, an indicator of the impact of severe weather on the water network.

Complaints and Feedback

Complaints are treated seriously, and resolution is a priority in parallel with carrying out root cause analysis to improve future service.

During the 2015-21 period there was a sustained reduction in the number of written complaints received from customers, albeit this trend was reversed slightly this year.

While written complaints during the last 12 months increased slightly, with 613 in total received, analysis has highlighted that this was due to a number of Covid-related factors. These included different working patterns, with more people at home during the day, and an increased demand on the water supply needed for good health and hygiene. There were no upheld regulatory complaints from the Scottish Public Services Ombudsman or DWQR in 2020/21.

On a number of occasions, we have responded to customers who were charged for services they did not receive or where they were charged incorrectly. On these occasions we have aimed to rectify the charging position quickly and apologise to customers affected. This is an area that we will proactively work on as we continue to improve our knowledge of our asset base.

There were 1252 Go The Extra Mile (GEM) customer nominations made during the last 12 months for employees, which provide valuable positive feedback on the way service is delivered.

Championing Customers in Vulnerable Circumstances

Water is important to all – but some customers rely on it more than others, whether business or household - and interruptions to service can impact on them more significantly. We are working to recognise those customers and their needs for additional communications, access, or safety measures.

We also recognise that some businesses are wholly reliant on uninterrupted supplies from Scottish Water to deliver their product or service, ranging from hospitals, to petrochemical companies to distilleries and brewing businesses.

We have defined vulnerability as being 'significantly less able to cope or manage than a typical customer.' In support, Citizens Advice Scotland (CAS) defined customers in vulnerable positions as "people who cannot choose or access essential products or services which are suitable for their needs or cannot do so without disproportionate effort/cost/time". We have developed additional support categories which currently include customers with a critical water dependency (such as dialysis), customers with strict hygiene practices, mobility issues and young children under 5.

In 2020, a new vulnerability strategy went live.

There are four elements to the strategy:

Developing a tailored support package

Using data to proactively engage customers

Making it easy to access additional support

Establishing partnerships to enhance our support.

Early in 2020, our Priority Services Register (PSR) was relaunched and we have worked closely with other utility operators in Scotland including a collaborative project to launch a dedicated PSR Scotland website.

Tailored training has been delivered to all our customer service teams and is being rolled out to others. Customer Engagement Centre employees also completed further training to support customers who may have heightened distress and anxiety during the pandemic.

A new partnership with Age Scotland has helped support older customers, with engineers trained to signpost to support or advice beyond their water and waste water services.

On social media, we have promoted accessible channels customers can use to interact with us including an online interpreting service which allows sensory-impaired customers to communicate with our advisors.

Benchmarking

Customers' experience of us is regularly benchmarked, allowing us to review how we did and for changes or improvements to take place.

The UK Institute of Customer Service carried out research which indicated that, as well as being ranked the top water and traditional utility company, we were included in the top 50 companies in the UK across all sectors.

Which? also published findings of a review which concluded that the water sector in Scotland, led by Scottish Water, was the most trusted by consumers.

Customer and Community Involvement

Due to the pandemic our annual programme of face-to-face engagement events to gather insights from our customers and communities was cancelled or postponed.

To help address current and future engagement needs we have developed virtual communication tools to engage the public in a more flexible and accessible way. One example was our Annual Consultative Meeting which was hosted online for the first time. This resulted in greater levels of engagement from customers and stakeholders, with more than 600 views of online content and 39 questions submitted. This compares to previous events in 2019 with 18 attendees and 4 questions submitted and 26 attendees in 2018 with 4 questions sent in. This experience will help shape future events.

Customer Engagement in Decision Making

We are committed to involving communities earlier in our approach to delivering solutions for water and waste water infrastructure investment. Early Community Engagement pilot projects resulted in a new process to build their feedback into the investment appraisal process and this has already been applied to high value and complex projects. Ultimately this process will be aligned to engaging customers on projects where they can have the biggest influence. As the process expands, we expect both understanding and application to develop over time.

CASE STUDY
PITTENWEEM

In Pittenweem, Fife, we have been working with the community on a project to help prevent internal sewer flooding. We presented the community with possible solutions early on in the process and following feedback looked at a number of alternative options. We are continuing to engage with the community as our options evolve and we are amending designs, where possible, to try and ensure the delivery of a solution which is understood by the local community and sensitive to local needs.

Your Water Your Life and Top Up Taps

There are now 44 Top up Taps operational across Scotland where people can access free mains water at our distinctive blue filling points. To date, 138,472 litres of water have been taken from the taps – the equivalent of 419,612 standard size single-use plastic bottles.

The taps were temporarily offline between March and August 2020 to allow operational and sampling teams to focus on priority demand. An enhanced cleaning and inspection regime was implemented from August after they were switched back on and the DWQR made further recommendations which were acted upon.

The target to have 70 installed by the end of March was not met due to the pandemic, planning delays and severe winter weather. The programme is being broadened with more taps to be installed beyond the original 70.

The campaign has continued to positively impact on customers' perceptions of tap water and encourage use of refillable bottles on the go to stay healthy, hydrated and reduce waste.

Analysis over time shows positive results in terms of trust in Scottish Water, attitudes to water and behaviours: 76% of people surveyed said they trusted us; 600,000 more adults carry a reusable bottle when outside and 86% of people said they thought Scottish tap water was world class.

Your Water Your Life partnerships included supporting WaterAid Scotland and the work of a mental health charity through a link-up with an Edinburgh-based tea blend firm. The campaign was recognised with two marketing awards.

Learn to Swim

The partnership with Scottish Swimming, extended into its fourth year, supports over 105,000 children to learn to be safe and confident in and around water through lessons delivered by leisure trusts and aquatic providers countrywide.

Scottish Swimming worked closely with partners, sportscotland and the Scottish Government to enable the safe return of Learn to Swim lessons during the pandemic. Guidance for pool operators, Learn to Swim providers and swimming teachers ensured swimming pools and lessons were safe and could return safely in line with Government guidance from late August.

By November up to 85% of leisure trusts resumed lessons. Lesson capacity was lower and varied regionally due to pool sizes, physical distancing measures and reduced changing facilities. In some areas, providers resumed almost 80% of their original capacity. With further restrictions in December, only island areas such as Orkney were able to continue with lessons.

We support over 105,000 children to learn to be safe and confident in and around water.

Learning and Education

Two new online education hubs were launched to enable pupils, parents, carers and teachers to continue to learn about the water cycle. The downloadable resource aligns with Science and Social Studies in the Scottish Government's Curriculum for Excellence. Content includes lesson plans, games, resource materials and links to further learning. Areas of focus include what happens when a toilet is flushed, the importance of water to our bodies and mind and the environment.

Enabling Access

Many of Scotland's reservoirs have seen increased numbers of visitors over the past year due to restrictions urging people to stay local. In some cases, issues of anti-social behaviour including littering, vandalism, property damage and inconsiderate parking were experienced. Work is underway to understand how to improve visitor management aspects of reservoirs, which remain part of our working water supply infrastructure, but are popular places for many people. Partnership working is ongoing with a range of agencies and local groups, including residents, to ensure all interests can be effectively managed.

To help enable responsible access at our assets and connect people to their local environment, over the next two years we will conduct a pilot at six popular Scottish Water reservoirs, engaging with users of the sites and communities of interest to develop our plans.

Community Empowerment Act

The impact of the pandemic on the ability of community groups to organise and progress transfer meant no asset transfers were completed under the Community Empowerment (Scotland) Act 2015. A small number of requests are currently on hold. Support continued for groups enquiring about assets for potential transfer and it is anticipated there will be more substantive activity in the coming year.

Freedom of Information

There were 741 Freedom of Information (FOI) requests made during 2020/21, the most received in a year since the introduction of legislation in 2002 and a 60% increase since the start of the 2015-21 period. Requests span a wide range of subjects including commercial, financial, environmental and operational aspects of activity. There were two appeals received as the result of declining to release information.

Prospects

The Customer Forum provided Scottish Water with significant support and challenge throughout the 2021-27 Strategic Review process overseen by the WICS.

Operating within the context of Ethical Business Regulation and Ethical Business Practice, the Strategic Review process was dynamic. The Forum was instrumental in moving to a long-term vision and strategy; the central role given to tackling climate change and its impacts; and identifying the needs and aspirations of customers and communities in relation to services, strategic issues, delivering value and broader public benefit.

A new Independent Customer Group has been established for the next regulatory period which will help to ensure the needs and expectations of customers and communities are identified and articulated as the transformation of services continues.

DELIVERING CONSISTENTLY EXCELLENT WATER SUPPLY

Overview

Access to reliable, high quality water is essential to everyday life.

Viewed by the World Health Organisation as essential for health and hygiene, the pandemic has heightened both awareness and appreciation for the important role water plays as a vital resource, for healthy, flourishing communities.

We strive to deliver consistently excellent and reliable water supplies while balancing the need to protect the environment on which the water cycle depends.

2020/21 Performance

99.947%[14]

TOTAL WATER QUALITY COMPLIANCE

SERVICE RESERVOIR SAMPLE FAILS

↓ 72
54

There were 54 coliform sample fails at service reservoirs, compared to 72 in 2019.

WATER TREATMENT WORKS SAMPLE FAILS

↓ 39
24

There were 24 sample fails at water treatment works, compared to 39 in 2019.

CRYPTOSPORIDIUM DETECTIONS

↓ 8
6

There were 6 cryptosporidium detections not mitigated by UV treatment, a continued reduction from 8 in 2019.

ANNUAL LEAKAGE

↓ 464
463

There was an annual average leakage level of 463 ML/D, a continued reduction from 464 ML/D in 2019.

[14] See page 43 for further details on the 2020/21 result.

Summary

2020/21 was one of our most challenging years as a water supplier. The pandemic drove changes to patterns of water use, supply trends and our sampling programme, while prolonged periods of both hot and cold weather placed further pressure on the network and distribution to customers.

Following government guidance to stay at and work from home where possible, there were significant shifts in water usage patterns amongst both household and business customers. While there was an increase in the amount of water distributed through the network to reach household customers' taps, the temporary closure of non-essential business premises meant a reduction in workplace usage. During the first month of the pandemic, an additional 85 million litres per day were required to meet household consumption.

The pandemic also brought about restrictions in working practices. This meant we were no longer able to access customers' homes and taps, from which samples would normally be taken, for testing.

In the summer, we experienced a prolonged dry and warm spell which was then followed by record low temperatures during the winter.

These challenges meant that our services needed to rapidly adapt whilst using the same infrastructure, some of which is ageing and struggled to cope with these sudden new demands.

Drinking Water Quality

Water quality has been maintained at a very high level over the span of the regulatory period on the standards set out in both Scottish and EU legislation and overseen by the DWQR.

Water quality monitoring was maintained throughout the pandemic. When it became clear that access to customer homes would be lost for sampling, a new testing approach was developed with the DWQR. This involved taking samples further upstream in our network at water treatment works, service reservoirs and from the homes of sampling employees, volunteers and commercial premises. While tests taken during 2020 showed compliance of 99.947%, it is not possible to make a direct year-on-year comparison for results from customers' taps.

For the 2021-27 period, the primary measure for water quality will be 'total compliance', reflecting performance at water treatment works, service reservoirs and customers' taps.

The issues experienced in 2020/21 have allowed us to improve business continuity practices and sampling processes. Of 49,482 samples taken from service reservoirs, there were 54 failed coliform samples, a reduction of 18 from 2019/20. At water treatment works, of 25,854 samples taken, there were 24 failures, a reduction of 15 from 2019/20. A programme of service reservoir inspection and remedial works and improvement plans to maximise performance of existing water treatment processes is ongoing.

CASE STUDY
KATRINE AQUEDUCT INVESTMENT

The Katrine Aqueduct has played a major part in providing wholesome water to the public in parts of Greater Glasgow and Central Scotland since the Victorian era. In early spring 2021, a major upgrade of this vital infrastructure was completed.

The £20 million project will help improve the security of the water supply to customers, via two of the country's biggest water treatment works from Loch Katrine, for generations to come.

The investment was the latest phase of the biggest upgrade to the megastructure since it was built in 1859. It included concrete and masonry repairs on 17 miles of tunnel sections and masonry and metalwork repairs on 10 bridge sections and a survey to feed into a 25-year management plan for the asset.

17 MILES
OF TUNNEL SECTIONS

Water Supply and Weather

Twice during the year water production reached its highest ever levels, equal to that experienced during 2018's prolonged hot weather.

During May and June 2020, demand peaked at 2.04 billion litres a day, around a fifth higher than average. This increase was driven by warm weather conditions and more people being at home during the day when they would normally be at places of work.

Due to mains conditioning, where pipes become accustomed to a particular volume of flow, in some areas such as Fife this increase in demand disrupted sediment resulting in discoloured water. Overall last year there was a rise in the number of complaints about discolouration, from 7111 in 2019/20 to 9495. We recognise the need to reduce these events. To do this we need to improve forecasting capabilities to better predict demand peaks and improve how we proactively manage the network through dynamic modelling, enhanced pressure management and cleaning programmes.

To help reduce demand from peaks of over 200 litres per person per day, circa 20% higher than average, water efficiency messages were issued during early summer to encourage customers to use only what they needed and to waste less.

Recognising the cost and energy savings of water efficiency we worked with the Energy Saving Trust and Home Energy Scotland, 56,826 water saving packs have been distributed to homes across the country, including 13,252 last year.

Sustained cold conditions in January and February impacted on the network. Our team worked tirelessly to minimise problems from frozen intakes at water treatment works to burst pipes in our distribution network. Nevertheless, in January alone there were 38,362 service issue contacts into the Customer Engagement Centre, nearly double the normal volume. A "freeze" incident team coordinated and managed the response across the whole country to ensure customer issues were resolved quickly and that leakage was minimised.

In mid-February, as freezing temperatures and snowfall continued, there was another spike in water production of 2.02 billion litres a day this time due to bursts which caused leaks across the network.

Operating a resilient network which can withstand extremes of weather over the course of several months is a priority focus and work is underway to understand where further improvements can be made to minimise future disruption.

28 TANKERS
DEPLOYED TO SUPPORT MAINTAINING SUPPLIES TO CUSTOMERS

CASE STUDY
GREENOCK

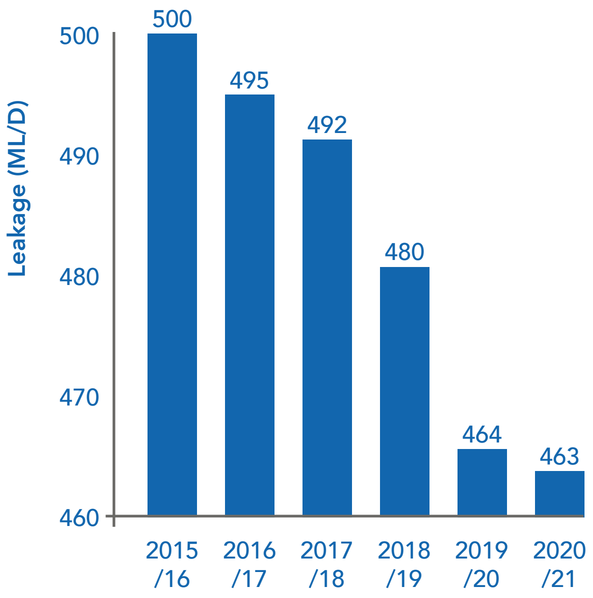
Ice blocking the raw water intake at Loch Thom supplying Greenock water treatment works led to a loss of supply for customers. An incident team was established to mitigate customer impacts and recover raw water flow to the works.

Mitigation plans included network adjustments, the deployment of 28 tankers to support maintaining supplies to customers and the set-up of a muster point and three Covid-19 compliant bottled water stations.

The bottled water distribution stations were staffed by a mixture of operational employees, and volunteer Incident Responders, supported by contractors. Incident support caravans were also deployed supporting distribution points for bottled water and 17 customer support vehicles delivering supplies to additional support customers.

Leakage

The past 12 months presented challenges for leakage management. Water lost from the system is calculated by measuring water balance, which was made more difficult than normal due to changing water use patterns within homes and Covid-19 restrictions pausing access to business premises to measure consumption data. A robust measurement process was maintained of the individual items which contribute to the water balance and provide confidence in the values reported. Extreme and sustained cold temperatures experienced in January and February 2021 led to an increase in burst pipes and resultant water losses. A co-ordinated response across the organisation helped to recover the position to secure an overall reduction to 463 ML/D, almost 2 ML/D lower than 2019/20. New approaches are being developed which will further improve our ability to forecast when weather events may occur and be prepared to mitigate and deal with the impacts.



Lead

Removing lead from water pipes to reduce any risk from its presence in the supply network remains an important activity. The pandemic led to a pause in the sampling programme in customers' homes however surveillance continued in a programme commissioned by the DWQR in independent schools and nurseries. Samples were taken at over 3400 taps and investigations have been completed at 60% of identified premises.

Industry Operating Standards

Ensuring water production meets the highest possible standards relies on the skills and knowledge of employees as much as the effective operation of assets and management of resources. The water industry competency assessment body, Energy & Utility Skills, provided employee certification last year for achievement of high standards of practice in water quality and operation. Assessment involves a rigorous audit, examines levels of operational excellence, good practice, compliance and training.

2015-21

Improving the reliability, resilience and quality of water supplied to customers was a focus throughout 2015-21. Standards set by the DWQR drove improvements across the water supply process to ensure customers receive only the best quality water at their taps. Over the past six years, a combined programme of work focused on strategic improvements to infrastructure, leakage reduction, inspection and cleaning activity and steps to increase compliance around microbiology and discolouration. New water treatment sites in both rural and urban communities helped improve water supplied to customers and meet DWQR standards. Reliability for isolated water supplies in the north was also addressed. Overall, there has been out-performance in water quality compliance and leakage throughout the period.

Large scale resilience schemes, reducing the number of interruptions to supply and strengthening the overall network capability, were launched in several locations, the largest being in South Edinburgh and Ayrshire.

The Ayrshire Strategic Resilience Scheme is connecting the regional supply network to Greater Glasgow, improving service for 200,000 customers to meeting all water quality and environmental standards, and increasing resilience to drought, raw water contamination, loss of treatment and strategic mains failure events. The complexity of various aspects of the project led to significantly increased costs and timescales, although most of the scheme is now complete. Processes for delivering such large-scale projects were fully revised after a review of circumstances around the project in tandem with the development of the Investment Planning and Prioritisation Framework (IPPF). It found areas which could be improved to reduce delivery risks in future investment periods.

Click here to read more about our Capital Investment Programme.

Prospects

Ensuring that evolving drinking water quality standards are met will be a priority in the coming years. The recast Drinking Water Directive (rDWD) came into effect in January 2021, one of the first directives to be introduced following Britain's exit from the EU, and work is ongoing to transpose it into Scottish regulations.

The rDWD brings in additional measures to protect human health from the adverse effects of any contamination of water intended for human consumption by ensuring that it is wholesome and clean. It addresses concerns about access to water, the emergence of new substances such as microplastics, the need for greater resource efficiency – including leakage measures and customer use – and information about drinking water quality and costs.

A series of activities are underway to ensure compliance, capability and continuing confidence in the country's public water supplies. Working with the DWQR, an improvement plan has been developed and agreed for each supply system and accreditation for our risk management by 2023.

Several water supply systems have been identified as a priority to consider options including improvements in disinfection and enabling auto-shutdowns. Appraisals are already underway for 45 systems with interrelated needs where drinking water quality is an immediate priority or a longer-term consideration alongside asset replacement, economic growth or supply resilience. We have committed to the DWQR to progress delivery of four priority system needs and to bring forward appraisals for a minimum of a further three in 2021/22. Water Operational Systems Plans will be in place by 2023 to maximise the capabilities of our existing treatment works.

TRANSFORMING WASTE WATER SERVICES

Overview

The water cycle depends on the operation and performance of an extensive network of assets and infrastructure which facilitates the removal, treatment and recycling of waste water entering sewers.

Waste water treatment is energy intensive and increasingly affected by climate change. Assets need increasing levels of investment to keep them running effectively and meet our Net Zero ambition. We must also ensure there is sufficient waste water treatment capacity to enable economic growth.

2020/21 Performance

INTERNAL SEWER FLOODING

↑ 472
599

There were 347 incidents causing 599 properties to be affected by internal sewer flooding. Properties affected has increased from 472 in 2019/20.

ENVIRONMENTAL POLLUTION INCIDENTS

↓ 223
193

We reported 193 waste water EPIs, a reduction from 223 in 2019/20.

SEWER BLOCKAGES

↓ 36,458
35,975

We recorded 35,975 sewer blockages, a reduction from 36,458 in 2019/20.

FAILING TREATMENT WORKS

↓ 3
2

We reported 2 failing waste water treatment works in 2020/21, a reduction of 1 works compared to 2019/20.

ODOUR COMPLAINTS

↓ 390
187

We received 187 odour complaints direct to Scottish Water, a reduction from 390 in 2019/20.

BIOSOLIDS

↓ 125,000
117,000

We produced over 117,000 tonnes of biosolids in 2020, a reduction from 125,000 tonnes in 2019/20.

Waste Water Collection

Sewer Flooding

We face a growing problem with sewer flooding, affecting properties both internally and externally. Summer 2020 was a particularly challenging period where extreme weather, causing significant and widespread flooding, resulted in a high level of customer contacts and stakeholder requests.

In 2020/21, 347 incidents caused 599 properties to be affected by internal sewer flooding, compared with 472 properties affected following 367 incidents in 2019/20. Although there was a slightly lower total number of internal flooding incidents in 2020/21, the number of properties affected by internal flooding increased due to the extreme nature of the rainfall experienced, particularly in August.

Although the summer months of June, July and August tend to have a higher than the 12-month monthly average incident rate, rainfall patterns in August 2020 resulted in a total of 141 incidents, compared to 83 in the same month the previous year.

Reducing flood risk remains a priority for Scottish Water. It will remain a challenging issue for many years to come with longer-term, sustainable solutions resulting in the overall reduction of surface water entering our sewers.

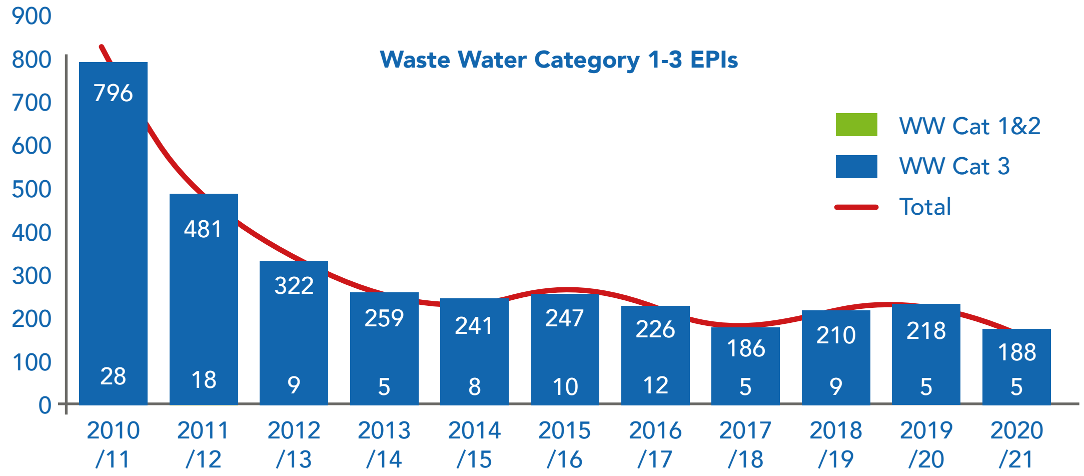
Environmental Pollution

In 2020/21 we reported 193 waste water Environmental Pollution Incidents (EPIs), down 30 from the previous year and again well below our 2015-21 period commitment of no more than 330 per year. Remaining consistent with 2019/20, five of the EPIs were in the more serious Category 1 and 2 incidents.

Whilst the general direction of EPIs over the regulatory period has been downward, numbers have plateaued compared to the scale of reductions between 2010-2013.

To improve, there will be a shift of focus from above-ground assets such as pumping stations and treatment works to the performance of underground infrastructure like sewer pipes. This will require investment in real time network monitoring to help adjust our response from being largely reactive, relying on SEPA or customers to inform us of issues, to proactive. In 2020/21, we piloted network monitoring to investigate the role it could play in predicting blockages and pollution risks. Scaling up this technology would enable us to more readily identify problem areas to take pre-emptive action.

Further investment is also required to promote responsible behaviours and raise awareness of the role the customer plays, particularly in terms of what they release down drains and toilets. Network monitoring will support this work by identifying where targeted campaigns could be used to influence and inspire impactful behaviour change.



Managing Surface Water

The Meteorological Office (Met Office) records confirm that the UK rainfall total for 2020 was 1308mm, 114% of the 1981-2010 average.

Edinburgh, Fife, Perth and Aberdeen were hit particularly hard overnight on 11 August 2020 when over a month's rain fell in the space of a few hours. This overwhelmed the public sewer systems and urban drainage systems resulting in widespread surface water and sewer flooding and the highest ever number of reported sewer flooding incidents and subsequent investigations relating to a single rainfall event.

Changing patterns of rainfall and the effects of climate change are being felt across the country. Managing the volume of surface water which enters the public sewer network is becoming an increasing challenge. We recognise the urgent need to do more to reduce this, working with partner organisations.

In February 2021, the Scottish Government published its policy framework for Water Resilient Cities: surface water management and blue-green infrastructure. This framework sets out a vision for the future and a coherent framework to support water resilience. It highlights that successful management of surface water relies on collaboration across responsible parties, including the general public. While the outcome will be more robust, it may take longer to implement and come at a higher cost.

We are actively playing our part through a number of local drainage partnerships with others under development.

CASE STUDY
STORM WATER OPPORTUNITIES

The local community in the Douglas area of Dundee secured Lottery funding for the redevelopment of a brownfield site, formerly school grounds. The project aims to deliver a Community Park and provide a new landscaped space.

The creation of the Park, and proximity to the Dighty Water, provides an opportunity to retrofit blue green infrastructure measures for road and roof drainage in the surrounding area. We are currently developing storm water management opportunities, in collaboration with Dundee City Council, which will reduce demand on the sewer network and support multiple national agendas for blue/green infrastructure, sustainability, net zero emissions, wellbeing, and creating better places to live.

THE PROJECT AIMS TO DELIVER A
COMMUNITY PARK
AND PROVIDE A NEW LANDSCAPED SPACE

Protecting our Network

Sewer blockages can cause a range of issues on our network and impact on customers, including internal flooding and environmental pollution. Last year there were a total of 35,975 sewer blockages. Although this has reduced over a decade from a high of 45,500 blockages in 2011, the rate of reduction has slowed and continues to be an issue which is challenging to address. Annually it costs £7 million to respond to and clear these with 80% caused by inappropriate disposal of unflushable items to the toilet and pouring fats, oils and grease down the drain.

We continue to refresh our customer-focused campaigns to encourage responsible behaviour in the home on appropriate disposal of wipes and other bathroom waste items. Policy development combined with customer awareness will help to protect the sewer network, maintain its performance and reduce any risks to communities and the environment.

Engagement continues with UK and European stakeholders to promote effective labelling of non-flushable products, as well as product substitution and the banning of single-use plastics where appropriate.

In 2020 a response was submitted to the Scottish Government consultation "Tackling Scotland's throw away culture" in relation to single-use plastics, in which strong support was highlighted for the consideration of a ban on wet wipes containing plastics. The response stated that every product likely to be inappropriately disposed of down the toilet containing plastic should be properly labelled to deter inappropriate disposal. The Fine to Flush water industry specification – which indicates that a wet wipe does not contain plastic and will not cause a block in the sewer system - was also supported by Scottish Water.

Improvements have been made in the maintenance of Combined Sewer Overflows, with asset inspection policies being introduced to drive better performance.

ANNUALLY IT COSTS
£7 MILLION
TO RESPOND TO AND CLEAR BLOCKAGES

CASE STUDY
RIVER ALMOND

Concerns were raised by the local community who noticed items such as wet wipes and sanitary products appearing in the River Almond, West Lothian, following instances of storm overflows from the nearby East Calder Waste Water Treatment Works. We are engaged directly with the local community and there are plans for a stakeholder group to be formed to ensure a continued constructive relationship with the local community, interest groups and elected representatives. A range of options are being developed to monitor the operation of the treatment facility and associated Combined Sewer Overflows, with further development of housing being planned in the area. Customer-focused communication will continue to encourage only the 3Ps – pee, poo and toilet paper – to be flushed away to prevent sewage-related debris entering the water environment.

Waste Water Treatment and Recycling

Waste Water Treatment Works Compliance

During April–June 2020 we suspended the formal Operator Self-Monitoring sampling in agreement with SEPA as a result of Covid-19 restrictions. Thereafter, our normal sampling regime continued. While we worked hard to maintain compliance, we have reported two failing waste water treatment works at the end of the year.

As a result of lockdown measures, flow patterns changed overnight as more people stayed at home during the day. Following this shift, final effluent at several locations struggled to maintain the normal high standard of treatment. Analysis established a connection between changes to daily patterns, particularly at times of day when large numbers of people would normally be en route to their workplaces. Adjustments had to be made to treat effluent to the normal consistently high standard.

Odour

During the past year, following a review by Internal Audit, improved processes were implemented to enable better capture and tracking of contact from customers concerning odour. There are currently 412 waste water treatment works and 20 PFI works subject to odour management plans and one site, Seafield in Edinburgh, has an improvement plan in place. We established an odour action group, building on involvement in a UK-wide odour management user group. The group will enable a more focused and co-ordinated approach than previously adopted.

Odour complaints made directly to Scottish Water decreased during the year to 187, down by 203 from 2019/20. Complaints at waste water treatment works operated by PFIs totalled 801, up 365 from 2019/20.

New homes in Scotland are built with recognition that they connect to the waste water network and that capacity exists to receive materials. However, in some cases the increase in odour contacts was as the result of new homes being built close to the boundary of existing waste water treatment works. There are several locations where plans for housing next to these sites are being taken forward and it is reasonable to expect further contact from customers on odour.

IN 2020 WE ANNOUNCED A
£10 MILLION
INVESTMENT

CASE STUDY
SEAFIELD

Odour remains an issue at Seafield, Scotland's largest waste water treatment works, which is operated as a PFI, with 340 complaints received in 2020/21. In response, in 2020 we announced a £10 million investment at Seafield to support greater resilience and sludge processing. Developing necessary changes to our operational practices will also be essential and we have already applied greater focus to avoid the emptying and cleaning of tanks with an onshore wind.

The implementation of such practices reduced the number of complaints received in the Autumn. We will maintain our focus on reducing issues with odour, at Seafield and other sites across the country, working with stakeholders and local communities.

Recycling Sludge

Scottish Water's sludge treatment centres (STC's) produced over 117,000 tonnes of biosolids in 2020. We aim to dispose of biosolids in a manner that balances cost, greenhouse gas emissions and our circular economy aspirations. 59% of our bioresource was recycled to agricultural land and 15% used for land reclamation. Less than 1% was sent to landfill where there was no viable alternative. The remainder was transformed into dried pellets and used as a fuel by third party. We are continuing to work with STC stakeholders to increase the volume of biosolids that can be used for agriculture.

73%
OF THE SITE'S ELECTRICITY
IS GENERATED THROUGH THE ANAEROBIC DIGESTION OF SLUDGE

CASE STUDY
MAXIMISING VALUE

At Nigg Waste Water Treatment Works, 73% of the site's electricity is generated through the anaerobic digestion of sludge. Since the introduction of the new digester mixing system in 2018, along with other measures such as ensuring a constant feed and installing new heat exchangers, biogas production has increased by approximately 30%. With the aim of becoming net positive in our energy generation at Nigg, we are investigating bringing sludge from other treatment works for processing at Nigg.

While Covid-19 slowed progress, we continue to develop our waste recovery maximisation strategy. Nigg provides an important insight into the role anaerobic digestion could play in our long-term objective of operating all assets using renewable power.

Covid-19 Monitoring

A programme of waste water sampling was carried out in partnership with SEPA and the Roslin Institute, giving insight into the prevalence of Covid-19 in the community and likelihood of where further infection clusters might occur. The approach tested for genetic material from the coronavirus in waste water. Most people infected with the coronavirus are believed to shed it in their faeces even if they have no symptoms, so waste water analysis has helped to identify local outbreaks ahead of a rise in hospital admissions.

The monitoring regime became operational in January 2021. The data, via over 200 waste water samples per week from over 80 locations, has informed heath boards and local authorities to deliver community testing and help government track the success of the vaccine roll-out. Analysis on concentrated areas of population in cities has taken place to enhance understanding of the virus spread and shape effective public health suppression efforts.

CASE STUDY
BEER AND MILK SURPLUS

During the two lockdown periods, we responded to the urgent need of over 1,200 business customers to dispose of surplus beer and milk supplies which they were unable to sell. Treated as trade effluent, these liquids contributed to a new demand on our treatment works.

In response, we shortened the application process allowing customers to apply to Scottish Water directly. We also worked closely with brewers to simplify consent processes while also ensuring surplus liquids did not have a negative impact on our assets or the environment.

Bathing Waters

2020 was an unusual year for bathing water quality. While the bathing water season traditionally runs from 1 June to 15 September, in response to the pandemic, the Scottish Government did not declare a bathing water season until mid-July.

The late declaration and Covid-19 restrictions meant that SEPA operated a much reduced sampling regime. As a result, bathing waters classification for 2020 was not possible. With classification due to return for 2021, provided SEPA are able to take the necessary samples, results will continue to be based on a four-year rolling classification average.

Operating within Government guidelines, we have continued to invest in bathing water quality improvements with three key projects currently being delivered at Belleisle Golf Course CSO, Drongan and Mauchline Waste Water Treatment Works in Ayrshire.

2015-21

Reducing the risk to customers and properties from sewer flooding has been a high priority. Approximately £130 million was invested to reduce the risk of sewer flooding to customers at highest risk and those who have experienced repeat internal sewer flooding events. We removed 337 properties from our Internal Sewer Flooding At Risk Register. At the start of 2015-21 there were 302 properties on the register, with 314 by the end of the six years.

Investment at waste water treatment works delivered discharge improvements, enhanced real time information, predictive capability and our first low chemical, low energy Nereda treatment plant at Inverurie.

70% of the total regulatory energy reduction programme target was met through the waste water operations energy intervention programme, which has delivered 19.32GWh since 2015.

In terms of EPI performance, we committed to have no more than 330 environmental pollution incidents and no more than five failing waste water treatment works per year and have achieved this consistently.

Prospects

As our climate changes, we already are seeing how intense rainfall will increasingly overwhelm many of our sewers. This will only get worse over the coming decades and we recognise our approach needs to change. We will work with government agencies, communities and developers to begin to change Scotland's approach so that it plans for the removal of surface water from sewer systems at every opportunity. We will develop three further drainage partnerships across the Aberdeen, Dundee and Perth areas focused on jointly planning the management of surface water.

We will develop long-term plans[15] for all our waste water catchments by 2023 to improve our understanding of the risks and opportunities. We will work with SEPA to focus our investment on the highest impact intermittent discharges from our networks. We expect to undertake appraisals in 23 catchments over the next two years so they can be considered as part of our investment prioritisation.

Today, much of our waste water is treated at assets operated by PFI partners. The Highland PFI contract expires in 2022 and after analysis we have concluded the best value is to take responsibility for ownership and operation rather than extend the contract. By 2023 we will finalise the evaluation of options for the Daldowie PFI and commence planning for the maturing of the Dalmuir waste water treatment PFI, both of which are scheduled to expire in 2026.

[15] Drainage and waste water management plans

ENABLING SUSTAINABLE AND INCLUSIVE ECONOMIC GROWTH

Overview

Our investment programme enables economic activity and growth which go beyond core service delivery, bringing benefits through employment, skills development and innovation. The 2020 Hydro Nation report stated that the water sector, including Scottish Water, is worth £1.7 billion to the economy.

Working with our supply chain

2020/21 Performance

GOODS AND SERVICES

£670m
SPENT

In 2020/21, we spent £670 million on goods and services through 203 agreements and 452 suppliers, 338 of which are based in Scotland.

OUR SUPPLY CHAIN

70%
SMEs

Of the approximately 450 suppliers in our supply chain, over 70% are Small Medium Enterprises (SMEs) and more than 90% of our spend is focused on organisations with locations in Scotland.

2020/21 was the final year of the 2015-21 £3.7 billion investment programme. This has laid the foundations for the next period of investment, which will see more spent on the capital programme, repair and maintenance, infrastructure replacement and new delivery approaches.

While the full economic impact of the pandemic remains unclear at present, our relationship with a wide range of sectors and organisations has been key to maintaining focus throughout 2020/21. This was particularly so in terms of how the service we provide enables everything from housebuilding and economic development to enhancing our water and waste water infrastructure.

Working with construction and alliance delivery partners meant the response to the pandemic was swift and we were able to recover quickly and confidently from the temporary shutdown period and re-shape working practice in line with restrictions. This also supported a wider national economic re-start.

As the end of the 2015-21 regulatory period concluded, key contractual partnerships were prepared and extended which will provide continuity and capacity for maintaining, repairing and replacing assets as well as having a significant economic impact.

Our water and waste water network and associated assets continue to support new housing development across the country, although that sector too was impacted temporarily by pandemic restrictions.

Click here to read about how we worked with our supply chain to respond to Covid-19 and the impact the pandemic had on our capital investment programme.

Alliance Partners 2021-27

Two key capital alliance partnerships were extended after their initial six-year period concluded at the end of the 2015-21 period. The work valued at more than £1 billion helps to underpin jobs, skills and economic viability in a key sector as well as being vital for the future capacity of our assets. A joint venture between MWHT and Galliford Try, Efficient Service Delivery (ESD), worth circa £700 million, will deliver water and waste water design and build solutions between April 2021 to March 2027. The contract will support the capital delivery functions of Scottish Water, providing process design and build solutions for water and waste water treatment works. Caledonia Water Alliance also secured a six-year contract extension to deliver £600 million of water and waste water infrastructure works.

These will better support future capital investment and refurbishment requirements, for example in ageing infrastructure. Procurement across the wider supply chain also took place which will support our ambitions in working to reduce emissions.

2015-21

At the end of the period, our overall supply chain engagement score is 93%, an increase of over 9% over the period, reflective of our focus on building strong relationships with partners.

Through championing investment in talent and capability within the industry, over 360 Modern Apprentices and 399 Graduates were employed by our suppliers to work on Scottish Water projects. Scottish Water also signed up to, and received recognition from, the 'Procurement Skills Accord', an initiative aimed at using procurement practices to drive investment in skills throughout the UK construction industry.

While engagement with the supply chain around net zero commenced during 2015-21, we recognise the need to continue working together to minimise embodied and construction carbon and support our target to achieve net zero emissions by 2040.

Prospects

The Transforming Our Future Delivery (TOFD) programme will enable effective and efficient delivery of increasing levels of investment supporting service excellence, beyond net zero ambitions and help achieve value for money for customers. With more demand for repairs, refurbishment and replacement of existing and ageing assets, continued investment is needed to help reduce emissions and support growth. New ways of working both across the organisation and with supply chain partners are being developed. TOFD will embed a new operating model for the delivery of capital investment.

Through collaborative working, the most effective and efficient processes, procedures and governance will be developed to ensure the greatest value is achieved from the repair, refurbishment and replacement of our assets and capital maintenance investment.

The procurement of the Delivery Vehicle (DV2) supply chain will provide a long-term focus on asset repair, refurbishment and replacement. The procurement will be one of the biggest ever undertaken in Scotland, valued at between £4.3 billion to £5.2 billion.
A re-shaped Regional Services Contract procurement, engaging small and medium enterprises, worth £530 million is also being secured.

Our future programmes to upgrade, maintain and replace where necessary vital infrastructure will be supported by extensions to existing partnerships, which were renewed in the last year. This will support our service delivery for customers as well as jobs and skills and provide significant input to the economic prospects of various sectors of the economy.

The procurement will be one of the biggest ever undertaken in Scotland, valued at between £4.3 billion to £5.2 billion.

Working with developers

2020/21 Performance

CUSTOMER SATISFACTION

↑ 62.8%
73.93%

Customer satisfaction score was 73.93%, up by 11.13% from 2019/20.

CUSTOMER ESCALATIONS

↓ 17
12

Customer escalations dropped from 17 in 2019/20 to 12 in 2020/21.

NEW CONNECTIONS

↓ 24,853
23,267

The total number of new connections for the year was 23,267, 1,586 less than in 2019/20.

Despite development sites being closed for a significant part of the year, followed by challenges of reopening sites with additional Covid-19 measures, development activity has remained high throughout 2020/21. Overall, there was only a 10% drop in properties connected and an increase of 3% in the number of applications received within the same period. This demonstrates how well the development community has reacted and sought to recover from the impacts of the pandemic.

This year, we maintained our focus on building stronger relationships with the development community. As a result, we saw an increase in our development customer service metrics which indicate an increase in satisfaction.

This progress was driven through various improvements including the extension of a remote inspection app and roll out of a new online portal for development customers. These provide self-service capabilities and end-to-end visibility of applications and on-site activity.

The Development Forum, an annual engagement event bringing together senior Scottish Water leaders, house building companies, local authorities, consultants, and key agencies, was hosted online and welcomed 221 unique views and 661 video views. In 2019 146 attended in-person.

We remain committed to further improving our services including web-based information and web chat functionality.

2015-21

Overall, since April 2015, 140,176 new households and businesses connections have been made, 16,444 first time wholesale meters have been installed and 72,169 replaced.

Focused on working to meet our Delivery Plan commitments, we have delivered year-on-year service experience improvements, strengthening the relationship with Scotland's development community and building on the inter-dependencies which exist. Enhanced service levels were driven by an improvement plan which addressed concerns about interactions between developers and our services. This resulted in reductions in escalations and complaints as well as improved service metrics, achieved through activities such as the establishment of a Vesting team, development of Strategic Network Impact Assessments and the introduction support of Apps.

Prospects

Across Scotland we have water and waste water assets which have capacity for future development and many already at or beyond capacity. We want to encourage development where we have available capacity and will continue to provide decision makers in government, local authorities, and the developer community visibility of where capacity is available. Where it is not, we will invest to support development and from April 2021 we will take the lead in increasing capacity in our existing network infrastructure to support widespread growth.

To support this, we will introduce a new Developer Experience Measure to focus on driving down unwanted service contacts and complaints and increasing developers' satisfaction.

PEOPLE

Overview

Employees play a vital part in delivering the water and waste water services which people use every day. They enable a complex organisation to function successfully and perform well.

Fostering a positive culture for employees is a priority. We want our people to feel they belong to an organisation which cares about their safety, health and wellbeing and helps them to thrive.

2020/21 Performance

Our people rose to the challenge of delivering essential services during the pandemic. They have adapted to difficult circumstances with commitment.

The field force – employees who carry out vital operational work on assets in communities – ensured the network was able to operate and serve customers effectively. As designated key workers they provided a critical frontline response to incidents such as burst mains, leaks and flooding.

Offices closed in line with government restrictions to help suppress the spread of the virus, with all office-based employees other than those working in the Intelligent Control Centre (ICC) and laboratories working remotely from home. Digital enablement was an essential element of making this approach a reality for employees. One of the most notable changes involved the full-scale redeployment of Customer Engagement Centre employees from their normal base in Edinburgh to home working without any loss of service to customers.

Although employee survey results remained positive, the risk of a gap developing between field-based personnel – who were necessarily required to be at assets and other key locations - and office-based employees working at home, was noted and work on this will continue to address this.

At the start of the pandemic, we adapted our people related policies and practices as events developed. No Scottish Water employees were furloughed during the pandemic.

Safety, Health and Wellbeing

There has been an increased focus on the health and wellbeing of employees during the last regulatory period. From improvements to safety at work practices, to the introduction of mental health first aiders in the workplace, many support initiatives and programmes have been introduced.

During the past year, 26 Scottish Water Cares wellbeing bulletins have been issued and weekly workforce pulse surveys conducted with employees. These have allowed for quick-time assessment of sentiment and morale as well as the ability to respond to issues being reported.

Absence rates have been closely monitored throughout the pandemic and are lower than anticipated. Whilst some employees have required to isolate, attendance at work was not adversely impacted when compared to previous years.

Additional steps were taken to keep employees safe, especially those in the field force likely to encounter the public. Measures included the implementation of additional PPE and the introduction of voluntary testing for employees working in laboratories in Edinburgh and Inverness.

Learning from our experience during the pandemic, we have begun to consider our future workplace model, looking at business need, employee sentiment and circumstances, and protecting the health of all. As the organisation transforms a key issue will be ensuring all employees are involved, engaged, and enthusiastically committed.

Safety underpins everything we do. Health and safety at work policy and practice has been developed over the course of the regulatory period and we have constantly sought to learn and improve.

Lost Time Accidents and RIDDOR[16] Incidents

		Lost time accidents	RIDDOR incidents
Scottish Water	2020/21	5	4
	2019/20	15	9
Contractors	2020/21	16	8
	2019/20	20	9
Total	2020/21	21	12
	2019/20	35	18

At a hearing at Edinburgh Sheriff Court in August 2020, Scottish Water was fined £140,000 following a breach of health and safety legislation in relation to an incident at a sewage pumping station which occurred in 2017. An employee fell from height and sustained serious injuries. The breach was admitted and led to a wide-ranging review of risk management processes and practice to protect employees carrying out their work.

[16] Reportable Injuries Diseases Dangerous Occurrences Regulations

Diversity and Inclusion

As part of our duty under the Equality Act 2010, a new Public Sector Equality Duty (PSED) Report was published in April 2021 setting outcomes until 2025 to ensure a fully diverse and inclusive organisational culture, practice and policies.

We will focus on four specific key areas aimed at enhancing approaches to diversity and inclusion in the workplace. These include the representation of women, including at leadership level, ethnic minorities, young people and people with disabilities and retention of employees with protected characteristics.

These outcomes will focus improvements in the organisation and create opportunities more widely across Scotland. We recognise the need to do more to encourage and support under-represented groups to apply for roles and enjoy fulfilling careers in the water industry.

You can read our PSED Report on our website at: www.scottishwater.co.uk/equalitydutyreport

Our new Equality Outcomes:

OUTCOME 1
Be renowned for creating opportunities for young people, particularly from areas of social deprivation.

OUTCOME 2
Increase representation in our workforce of women, ethnic minorities, young people and those with a disability.

OUTCOME 3
Increase diversity of our leadership bench across all under represented groups.

OUTCOME 4
Achieve high levels of engagement and retention among those employees with underrepresented protected characteristics.

Graduate and Modern Apprentice recruitment offers the greatest opportunity to change workforce demographics. Our average female representation for graduate cohorts for the past three years is 43% with the highest level of female representation in 2019 (72%). For modern apprentices the equivalent figure for the past years is 21%, again with the highest level of female representation in 2019 (24%).

Job Grade	Female	Male
Chief Executive	0%	100%
Director	14%	86%
General Manager	17%	83%
Business Manager	34%	66%
Team Leader	31%	69%
Team Member	28%	72%

Although a significant amount of work has taken place in benchmarking recruitment processes to improve representation - including recognition with employer awards - progress has not been as rapid as anticipated. Talent acquisition and development will be reviewed to change workforce demographics and develop a fully diverse and inclusive environment.

Information on gender pay gap has been published in our Public Sector Equality Duty Report[17].

CASE STUDY
FLEXIBLE WORKING

Our approach to operating an agile workplace was recognised when the organisation was placed in the top 10 companies in Scotland for flexible working arrangements. The Flexibility Works Employers Awards celebrate the way in which we operate our buildings, workspaces, policies, and recruitment. We were placed in the top 10 following a submission which highlighted how we responded to the pandemic, the benefits of flexible working and the introduction of a Remote Working Charter.

CASE STUDY
BELONGING AT SCOTTISH WATER

Employee-led Belong groups support Diversity and Inclusion and helped maintain connections throughout periods of restriction during the pandemic. Normally members of the LGBT+A Belong group would attend Pride events but instead celebrated with an online event. The Armed Forces Belong Group received gold-level recognition in the Armed Forces Covenant Employer Support Scheme. As the result of many challenges faced by parents during the past year, a new group formed - Parents Supporting Parents – with initiatives including postcode matching helping employees who live near each other providing mutual support.

[17] Click here to view our Public Sector Equality Duty Report.

Women in Scottish Water

Gender equality remains an area of focus with 28.5% of the workforce being female. The Women in Scottish Water group enables women to flourish and realise potential through events, mentoring and engagement. During the year, members of the group participated in the Remarkable Women Leadership programme with a further 2021 cohort ready to participate and also produced a series of videos to celebrate International Women's Day.

Young Person's Guarantee

Scottish Water supported the Young Person's Guarantee, introduced by the Scottish Government, to increase opportunity for all 16–24-year olds in the wake of the pandemic. Employers who support the initiative will help prepare young people for the world of work, create opportunities, enhance skills, and develop inclusive workplaces.

Our Character

A new organisational character was launched underpinned by four key characteristics – Bold, Responsible, Inspiring and Caring. These will be the foundation for all activities – from how we deal with customers, developing skills, nurturing talent, and developing leadership. The aim is that our customers and stakeholders recognise these characteristics as they engage with the organisation and that all employees understand how to apply our characteristics in their daily activities.

Digitally Supporting Employees

New HR and Learning Management systems, Workday and Cornerstone, have been implemented in the past 12 months, increasing accessibility to self-service HR processes and to a wide range of online learning resources. These resources have supported improved digital knowledge and understanding across the organisation and a Digital Skills Academy was also established to further enhance skills. Using virtual systems has also allowed for a more flexible approach to recruitment. Roles which might otherwise have been location-based may not need to be in the future as we continue to adapt to a different working dynamic.

Bribery and Corruption Prevention

We review all policies on a cycle of at least every two years and this includes Anti-Slavery; Code of Ethical Conduct; Whistleblowing; Anti-Bribery and Fraud Management and Response.

A Policy Awareness Communication plan is rolled out annually and is used to ensure all employees are aware of their rights and obligations. For topics such as Fraud and Bribery and Corruption, mandatory training is routinely undertaken by appropriate role-holders. All significant frauds are reported to Audit Scotland.

An externally operated whistleblowing facility is operated on a confidential basis. This facility is open to employees, supply chain and customers.

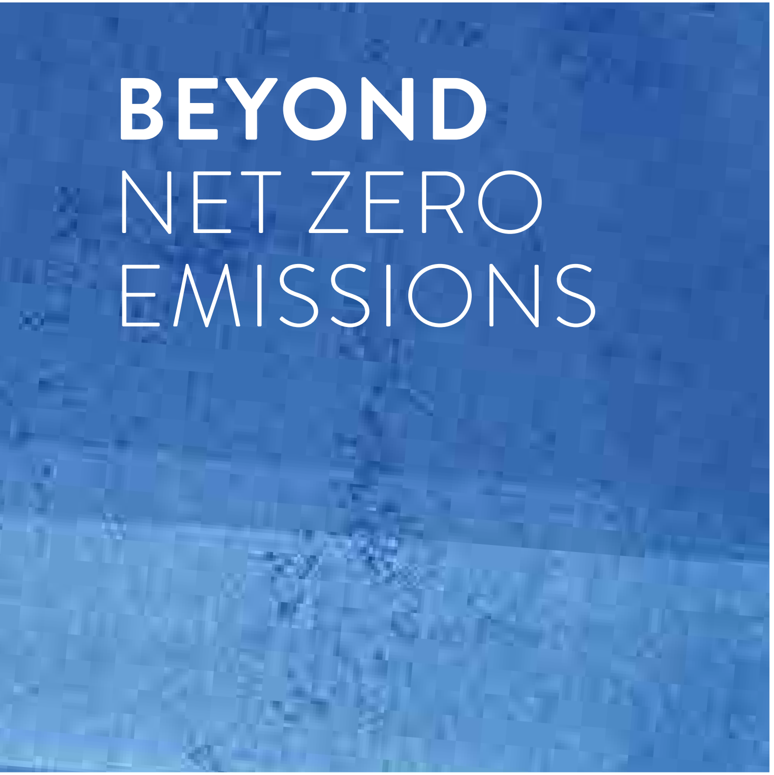
Human Rights, Dignity and Respect

Scottish Water remains committed to respecting human rights. We expect and require all those who work for and with us to show dignity and respect at work and to adhere to our zero-tolerance approach to slavery and human trafficking.

We work to provide and maintain a working environment that ensures everyone is treated with dignity and respect. Bullying, harassment, discrimination and victimisation are unacceptable behaviours and are not tolerated.

We promote an open and honest relationship between management and employees and commit to treating all allegations promptly, seriously and confidentially. Breaches may result in disciplinary action, however the primary aim is to highlight issues and prevent all forms of unacceptable and inappropriate behaviour which do not support dignity at work for all.

BEYOND NET ZERO EMISSIONS



Reducing our Carbon Emissions

Scottish Water is one of the country's biggest electricity users and one of the three largest construction sector investors. Our assets need significant amounts of energy to operate, and significant greenhouse gas emissions are produced through supply chain activities such as maintenance and construction, as well as the running of our buildings, fleet and treatment processes.

Our industry-leading Net Zero Emissions Routemap committed us to become net zero by 2040 and then go beyond. It will help reduce our impact on the environment, end our contribution to climate change and safeguard water and waste water services for future generations.

Success depends on higher levels of investment, new partnerships and leading-edge innovation to achieve the reductions required.

2020/21

Our operational greenhouse gas emissions continued to reduce and our 2020/21 carbon footprint (CFP) was 249,000tCO_2e, a 2% reduction on the previous year.

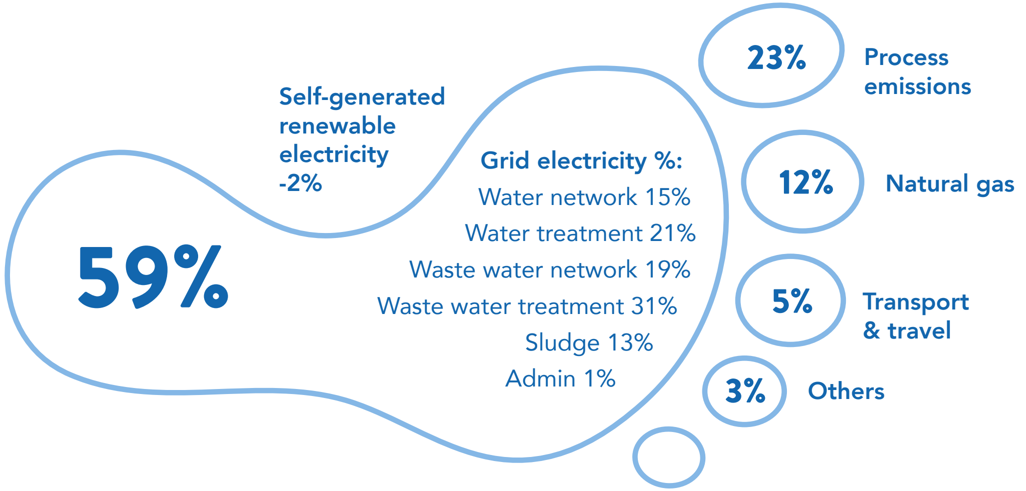
There have been both increases and decreases across the different carbon footprint categories this year.

The most significant increase was caused by a change to the way process emissions from waste water treatment are calculated in the UK Water Sector's agreed accounting method. The revised methodology would apply retrospectively to all years and is therefore considered a baseline change rather than a genuine increase.

The majority of the decrease was due to the reduction in emissions from grid electricity, thanks to the greening of the grid. Reductions have also been made through less travel and fewer buildings being open due to Covid-19 combined with more renewable projects coming on-stream and being commissioned enabling us to reduce our use of grid electricity.

Over the next two years we expect to see a reduction in operational emissions of up to 30% contributing significantly to our 2030 target.

GREENHOUSE GAS EMISSIONS FOOTPRINT BY SOURCE 2020/21



2015-21

The period marked a turning point across the world for climate change awareness and action, although we have been reducing emissions since 2007. Our operational emissions at the end of the 2015-21 period were around 50% lower than our 2007 baseline year.

In April 2019, Scotland declared a climate emergency which further emphasised the need for Scottish Water to be ambitious, leading to our commitment to deliver net zero across our operational and investment emissions by 2040, five years ahead of the national target.

To help drive and support the pace of change at a senior level, following the declaration of the climate emergency, a dedicated Net Zero team was established along with two expert panels on net zero and construction emissions to support our work.

Net Zero Emissions

Our Routemap

Our Net Zero Emissions Routemap was published on 14 September 2020.

It is one of the most ambitious plans in the industry due to its scope and scale. It targets operational emissions which are under our control, as well as those emissions embedded in our investment programmes and supply chains which we have influence over. It is a genuine net zero plan which does not include the purchase of carbon credits.

The Routemap explains how we will reduce our emissions, embrace the circular economy and enhance the natural environment. Through this we will maximise our contribution to renewable energy generation supporting the greening of the grid and increasing our ability to capture and store emissions in our land.

By the end of 2027, we will be 35% through the timeline to our target, emphasising the need to change behaviours and processes at pace.

In recognition of this, we have developed an ambitious target to achieve net zero operational emissions by 2030, 10 years ahead of our overall net zero emissions target of 2040.

To achieve the ambitious 2030 target, we will look to:

- Become more energy efficient (seeking a 20% reduction in energy use).
- Use lower carbon energy products, with a goal to operate 100% of our assets using renewable energy (through generation or hosting).
- Maximise the energy from bioresource.
- Store more carbon than we produce – through increased sequestration in landholdings.
- Further installation of vehicle charging points, 34 are already operational.

Working with Suppliers

We will work with our supply chain and the wider UK water sector and other industries to grow our understanding of investment emissions and how we might reduce them.

Our Capital Carbon Accounting Tool helps us understand how best to reduce emissions in our supply chain. This is being built into our Benefits Framework to support decision making.

To help our suppliers, large and small, understand their own emissions and improve their carbon performance, we have launched our supply chain portal and our Carbon Academy, which enables collaborative sharing of knowledge and resources. This will ensure benefits will ripple across the wider construction sector.

Many of the technologies and approaches required to meet our net zero target are in their infancy and will need to be piloted, adapted, and adopted quickly. We will work to support our supply chain partners in developing and adopting these technologies at pace.

Fleet

In 2020/21, our people drove around 18.8 million miles on business, a reduction of around 4.9 million miles mainly due to the impact of the pandemic on ways of working.

We are transitioning our fleet to electric vehicles in line with Scottish Government targets to phase out the need to purchase new fossil fuelled light commercial vehicles by 2025 and all fossil fuelled commercial vehicles by 2030. We have now moved to an electric vehicle only policy for cars and by 2025 we will not run any petrol or diesel cars.

Electric construction equipment such as excavators is being trialled, reducing emissions and noise.

Renewables

This year, despite the extremes in weather, we generated a total of 40GWh of on-site, self-generated renewables, slightly above last year's performance of 39.5GWh. In addition to renewable energy we have produced, our PFI partners have generated an extra 32GWh from biogases produced by waste water treatment processes.

Wind

We generated 1.0GWh through our own assets and continue to host around 830GWh of wind power generation from private investment in renewables on our land.

Hydro

Overall, this year we generated 31.4GWh of hydro energy and made improvements to grid connections at our bigger sites which has reduced power outages that can impact energy generation.

In support of our hosting of renewables and our Flourishing Scotland initiatives, we enabled engineering specialists Torishima to build a hydro turbine asset on the compensation flow at Lower Glendevon Reservoir. Their 75kW turbine feeds green energy directly into the national electricity grid and helps in saving the equivalent of 93 tonnes of carbon dioxide a year.

Solar

Through Scottish Water Horizons, we continue to install solar photo voltaic (PV) equipment across our sites, delivering an extra 1.1GWh of capacity this year. Across all our solar PV schemes we generated 6.3GWh. We constructed six schemes this year and have a further three under construction, including our first battery and PV project at Perth Waste Water Treatment Works.

Heat from Sewage

Heat captured in our sewer systems presents an opportunity to extract value from a waste stream as sources of renewable energy.

Scottish Water is the first utility in the UK to start implementing heat from sewage schemes with examples running in Stirling and the Borders and two further schemes being delivered.

Uncertainty around the future of the Renewable Heat Incentive (RHI) meant this year was challenging for the programme especially around investment prospects. In the meantime, we continue to identify future opportunities and explore alternative technologies. We are also exploring whether hydro energy could be captured from final effluent discharges.

Energy Efficiency

In 2020/21, we delivered projects which will save an additional 1GWh of electricity in waste water treatment. Due to the pandemic, we primarily focused on heating and lighting projects, which require significantly smaller teams to deliver. These smaller efficiency activities equated to around half of the efficiency savings this year.

Enhancing the Natural Environment

Some emissions cannot be avoided or eliminated. Natural carbon sinks are being developed to capture emissions which equal those which cannot be avoided and in doing so improve the environment. We will play a significant role in supporting the Scottish Government Environment Strategy outcomes through protecting and restoring water, seas and soils, supporting biodiversity and embracing circular economy thinking.

Biodiversity

Our Biodiversity Report 2020[18] demonstrates our contribution to Scotland's Biodiversity strategy across activities such as water resource management, peatland and catchment management, and addressing invasive non-native species.

In the next two years, we will establish the biodiversity status of our land to enable us to track progress and identify potential projects. We will also work with SEPA in the development of Scotland's 3rd cycle River Basin Management Plan.

[18] Scottish Water's Biodiversity Report can be viewed on our website.

CASE STUDY
PEATLAND RESTORATION

Peatland retains water, stores carbon and contributes to keeping our source waters clean. When damaged, it can become a net emitter of carbon. One of our aims this year was to restore 300 hectares of peatland. We delivered around 45 hectares of restoration and will work more collaboratively going forward to overcome the complexities of working on land we do not own.

WE DELIVERED AROUND
45 HECTARES
OF PEATLAND RESTORATION

Maximising Benefits from our Land

Our landholdings can act as a storage sink for carbon emissions and help increase biodiversity. We are working with the James Hutton Institute to evaluate how best to maximise benefits such as creating wildlife corridors. Over the next year, we will continue to restore land and commence projects such as reforesting a former tenant farm.

Embracing the Circular Economy

Harnessing circular approaches by designing out waste and creating value helps reduce our environmental impacts.

This year, we trialled collecting grit from the waste water process and converting it into aggregate for use in products such as kerbstones, reducing the need to intensively quarry new materials and delivering 70% carbon savings.

A value assessment project is underway to embed the circular economy principles into waste management processes, policies and procedures including upcycling aluminium sludge, hydrogen generation and generating heat from sewage.

Supporting Scotland's Green Recovery

We secured around £10.4 million from the Supporting Scotland's Green Economy Fund to invest in renewables, new technologies and peat land restoration. In Prestwick, the use of blue-green solutions, such as rain gardens, to contribute to resolving long-term flooding issues are being investigated instead of building new infrastructure.

Supporting a Net Zero Economy

We want to fully play a role in supporting a net zero economy. In partnership with Stirling University and the Scottish Funding Council, a £3.5 million project to make Scotland a global leader in water research was launched. Stirling University will host the Hydro Nation Chair providing leadership across the sector to deliver solutions for sustainable water management.

Streamlined Energy and Carbon Reporting (SECR)

Streamlined Energy and Carbon Reporting (SECR) is a UK Government requirement for certain types of organisations to report their energy and carbon emissions. It aims to encourage businesses to implement energy efficiency measures to bring both economic and environmental benefits.

This method of reporting energy and carbon emissions differs from, and is not comparable to, our established annual operational carbon footprint (CFP) reporting, which we have published for the last 14 years (see page 66 for 2020/21 footprint).

Our operational CFP reports on the regulated business, which includes waste water treatment works operated on Scottish Water's behalf by Private Finance Initiatives (PFI), but excludes other parts of the Scottish Water Group[19]. It also includes more sources of emissions than the SECR, such as water and waste water process emissions. In contrast, the SECR reports on the whole Scottish Water Group of companies, but excludes PFI activities (except the North-East Scotland Waste Water PFI). The two sets of emissions are therefore not comparable.

It is a requirement of SECR to disclose which robust and accepted methods are used to calculate the required information. They are as follows:

SECR energy consumption data is dominated by electricity use by Scottish Water core business[20]. This is from metered data, properly documented and recognised as the best method of assessment, with an accuracy range of between +/- 5% and +/- 1%. Natural gas consumption and exported Renewable Energy Guarantees of Origin (REGO) electricity are similarly calculated from metered data. Fuel is predominantly used in Scottish Water core business owned and leased (Scope 1) vehicles and is from measured fuel volumes. The small amount of transport data that was unavailable last year has been captured this year.

The UK Water Industry Carbon Accounting Workbook, which we use for reporting our annual operational carbon footprint, has been updated to facilitate SECR. This calculates energy consumption (kilowatt-hours (kWh)) of fuels using the densities and net calorific values (NCVs) in the 2018 UK Government Green House Gas (GHG) Conversion Factors for Reporting; and greenhouse gas emissions using emissions factors in the 2020 UK Government GHG Conversion Factors for Reporting.

[19] This excludes North-East Scotland Waste Water PFI, Scottish Water took over ownership of this in December 2018.

[20] Scottish Water 'core business' is the regulated business excluding PFIs

Scottish Water Group	Current reporting year	Previous reporting year
	2020/21	**2019/20**
GROSS Energy Consumption (to nearest 10,000 kWh)	588,180,000	546,320,000
NET Energy Consumption (includes REGO exports) (to nearest 10,000 kWh)	563,240,000	519,270,000
Emissions from combustion of gas (tCO_2e)	2,498	2,762
Emissions from combustion of other on-site fuels (tCO_2e)	955	4,075
Emissions from combustion of fuel for Scope 1 transport (Scottish Water-owned transport and leased vehicles) (tCO_2e)	11,603	13,236
Emissions from Scope 3 business travel[21] (tCO_2e)	1,203	1,091
Emissions from purchased electricity (Scope 2, location-based accounting) (tCO_2e)	106,637	127,825
Total gross tCO_2e based on above	122,896	148,989
Intensity ratio: tCO_2e gross figure based from mandatory fields above per £1 million revenue	74	92

[21] 2020/21 data Include third party sludge tankers and rental cars or employee-owned vehicles (where company is responsible for purchasing the fuel) from all parts of SW Group. This full inclusion of data, some of which were unavailable in 2019/20, masks a dramatic fall in Scope 3 transport emissions due to Covid-19 restrictions.

Energy Efficiency Actions

In 2020/21, we have completed energy efficiency projects that will save us 1GWh annually. This included work at over 30 of our waste water assets to update heating and lighting systems and to replace air blowers.

Business Stream achieved its goal of attaining ISO 14001 certification; and surpassed its 10% energy reduction office target. The 15% energy reduction was in part due to the office being closed, but also included adjusted temperature settings in the server rooms, adjusted lights and temperature settings across the office area, new energy efficient air conditioning units, and an ongoing programme of replacement LED lighting.

GREAT VALUE & FINANCIAL SUSTAINABILITY

OUR INVESTMENT PROGRAMME

Overview

The scale of our investment programme means we are one of the largest commissioners of engineering and construction work in Scotland, consistently funding over £600 million of work annually.

Our investment is appraised and prioritised in accordance with customers and communities' needs and priorities, our Net Zero emissions objective and strategic ambitions. When planning investment, we will also consider the potential to deliver additional public benefit such as access to land for leisure.

2020/21 Performance

483

CONSTRUCTION SITES CLOSED

Supported Scotland's drive to mitigate the impact and spread of Covid-19 by stopping construction at 483 sites during the spring 2020 lockdown, starting it up safely and keeping customers informed.

£612m

INVESTMENT ACROSS SCOTLAND

Delivered £612 million of investment across Scotland to maintain and enhance existing assets and build new infrastructure, £118 million less than planned because of Covid-19 restrictions.

ACTIVITIES INVESTED IN

Sustaining existing high service for customers.

Improving drinking water quality compliance.

Reducing flooding and pollution from sewers.

Reliability.

Supporting economic development.

Investing Through a Pandemic

On 23 March 2020, Scottish Water's entire capital programme shut down in response to the Covid-19 lockdown. In total, 483 live sites closed within 24 hours. This took a major effort from us, our alliance partners and our wider supply chain.

Only when Government restrictions were relaxed in June, after three months of closure, did the programme safely and cautiously restart. We achieved this through close collaboration across our network of delivery partners, alliances and wider supply chain partners, ensuring that we protected the safety of personnel and the communities around our works at all times. This collective approach was essential in establishing how to operate in such unprecedented circumstances.

Inevitably, challenges were faced during the year and we did experience a very small number of Covid-19 outbreaks at our construction sites. As the pandemic continues, so does our focus on safety, with guidelines regularly reviewed as a result of lessons learned and changes in Government guidelines.

Delivering our Capital Programme

As a result of the impact of Covid-19, overall, we invested £612 million to maintain and enhance existing assets and build new infrastructure, approximately £118 million less than planned. However, despite three months of site closures and a cautious restart, in October levels of investment returned to between £60-65 million per month, comparable to pre-Covid-19 levels.

While the period of lockdown did not impact fixed cost elements such as materials or design, there was an inevitable impact on productivity as a result of additional time required for socially distanced working, additional safety measures and checks. Depending on the type of activity, this added around 4%-8% to overall project costs.

While we continue to show resilience in the face of the pandemic it has delayed delivery of affected projects. Prior to Covid-19 we were expecting 20 projects to continue past the end of March. This figure is now 86. While the majority of these delays are Covid-19 related, a number are due to issues with project scope, a third-party, or at project construction. Lessons from these will help us mitigate future delay risks.

CASE STUDY
IMPROVING PROJECT SCREENING

The impact of a water supply resilience project on a Neolothic-era crannog has led to significant lessons which will shape future screening on planned development work. The presence of a 5000-year old structure at Loch Bhorgastail, Isle of Lewis, was known but further investigation allowed for greater understanding of the potential impact water operations – specifically the rise and fall of water – could have on the ancient site. As a result a review took place on the suitability of the location and other source water will be investigated. Although the project timeline will be extended, it has enhanced our knowledge of operating in historically-significant sites.

Community Engagement

As we restarted our investment programme, it was vital to engage those who live locally about projects recommencing, how we planned to do so safely and provide the channels and opportunity to raise concerns. There was some unease among rural and island communities and understandable sensitivities around transient workforces moving in and out of their local area. In response, we have altered our approach to a number of projects and continue to engage and work closely with communities as the pandemic continues.

CASE STUDY
FAIR ISLE

A project to provide a new water treatment works for Fair Isle was paused from December 2020 in response to feedback from members of the island community. Although Government guidelines allowed work to resume safely, by late November there were concerns about the community's potential vulnerability in the context of rising Covid-19 case numbers. It was agreed that remaining work, which required specialist engineers to travel to Fair Isle, could be delayed until all parties felt confident that it could be managed safely. Work resumed in April 2021.

2015-21

Operating in an often complex and challenging environment, throughout the period we successfully invested £3.7 billion across Scotland, working to improve the resilience, reliability and quality of services to existing and new customers.

Over 90% of this spend is with suppliers with a Scottish base, directly enabling over 3000 supply chain jobs the majority of which being within Scotland and the UK[22]. The Office for National Statistics (ONS) average estimate of economic multipliers by water and waste water infrastructure is circa £1.55 for every pound spent. Therefore, for the 2015-21 period and investment programme of circa £3.7 billion, the multiplier effect on the economy would be estimated at an additional circa £6 billion.

At the beginning of the period, we embarked on a refreshed approach to investment focusing on the concept of 'Plan, Prepare, Deliver'. By improving our understanding of delivery risk and minimising those being realised in construction, the approach has helped us make smarter investment decisions.

However, the principles that guide our investment decision making must now go further, driven by the need to maintain our asset base with net zero emissions' solutions. This approach will underpin all future investment.

Improvements to be Delivered in the Regulatory Period.

The table on the following page summarises the improvements we have delivered for customers as part of our capital investment programme against the Delivery Plan targets for the 2015-21 period expressed in terms of "number of outputs to be achieved", noting that individual projects can deliver more than one output.

Delays in delivering individual projects may be caused by different risks being realised as outlined in the section above. These could be associated with difficulties engaging with third parties where the project requires to do so, changes in the scope of project following detailed investigations, constructions risks such as adverse weather or unforeseen ground conditions and risks associated to the impact and management of the pandemic, with the majority of delays caused by the latter.

Where possible, we have managed these risks through the acceleration of projects which were planned for completion post March 2021 which allowed us to achieve the target number of outputs while, for some programme areas, this has not been possible. However, despite the impacts of the pandemic and the realisation of the risks outlined above, we have delivered over 95% of all planned outputs and we are committed to delivering the any delayed projects as quickly as possible.

[22] The Institute of Civil Engineers (ICE) have noted in 2020 that past studies on the impact of infrastructure investment have found , for every 1,000 jobs which the construction sector gains directly through increased infrastructure spending, a further 2,053 jobs are added to the rest of the economy as indirect or induced effects."

The following colour coding is applied to the table:

- Blue: The target number of outputs set out in the Delivery Plan has been achieved
- Red: The target number of outputs set out in the Delivery Plan has not been achieved

Objective	**Quarterly monitored programme areas**	**Period end Target** (number of outputs)	**2020/21 and Period end Actual** (number of outputs achieved)
Drinking water quality and reliability	Number of water treatment works improved	26	15
	Number of zones made compliant with iron & manganese standards	61	61
	Number of improvements to reliability of supply (catchments and treatment)	42	28
	Number of improvements to reliability of supply (networks and storage)	83	66
	Distribution mains cleaned (km)	3,836	3,864
	Number of water quality etc studies to inform future periods	345	357
	2010-15 outputs planned to complete in the 2015-21 period	22	18
Drinking water security of supply	Water supply resilience strategy and improvements made	18	15
	Number of zones with improved security of supply (SOSI)	8	6
	Number of security measures and improvements to the infrastructure of critical reservoirs	685	686

Objective	Quarterly monitored programme areas	Period end Target (number of outputs)	2020/21 and Period end Actual (number of outputs achieved)
Protecting and enhancing the environment	Number of Waste Water Treatment Works improved to meet Urban Waste Water Treatment Directive (UWWTD)	26	23
	Number of waste water networks improved to meet UWWTD	42	44
	Number of improvements required to meet UWWTD - Glasgow completion	85	71
	Number of improvements required to meet the Water Framework Directive	23	5
	Studies to inform requirements under the revised Bathing Waters Directive	11	11
	Number of environmental studies to inform future periods	130	128
	Number of improvements required by the Compliance Assessment Scheme; odour reduction and sludge management	94	54
	2010-15 outputs planned to complete in the 2015-21 period	15	14
Flood risk management	Reservoirs Act - Number of improvements to dams	54	54
	Flood Risk Management Act - models and integrated catchment studies	216	218

Objective	Quarterly monitored programme areas	Period end Target (number of outputs)	2020/21 and Period end Actual (number of outputs achieved)
Supporting economic development	Number of new connections to households and businesses	Demand driven	140,176
	Delivery of new water & waste water capacity for 73,290 people	Demand driven	48,986
	Number of first time non-household meters installed	Demand driven	17,022
	Number of wholesale meters	Demand driven	75,535
Climate change	Number of climate change vulnerability assessments	110	123
Long-term cost of service	Improvements in renewable power and energy efficiency (GWh)	17.5	17.5

Prospects

We have developed new investment policies for each asset area linked to Ministers' Objectives, strategic plan commitments and our risk appetite. Over the next two years we will invest in line with these new policies, progressing larger projects through investment appraisals and learning from these experiences. During this time, we will monitor business performance, risk to service, actual levels of investment demand and costs. These insights will enable us to adjust our investment policies for subsequent years to manage service levels and risk.

To strengthen our decision making, we will mature our approach to project investment appraisals ensuring assessments of net present cost, carbon and qualitative benefits are consistent and transparent. We are developing our approach to ensure customer, community and wider stakeholder needs and expectations are understood, promoted and addressed throughout decision making.

Our current level of asset replacement is well below the rate required over the long term. We forecast that we will need to nearly double our investment over the next 20 years to provide excellent services. In our Asset Management Transformation Routemap[23], we have set out how we intend to build this evidence base and transform our approach to making smarter investment choices to maximise the benefits of investment to customers, communities and the environment.

[23] The Asset Management Transformation Routemap is our 10-year journey to improve asset management decision making and the capabilities required to support the investment planning and prioritisation.

KEEPING SERVICES AFFORDABLE

Overview

The charges household and business customers pay annually are essential to the effective operation of Scotland's public water and waste water services and investment in the network and assets.

Prices across the 2015-21 regulatory period rose by less than inflation.

Higher levels of investment are needed to continue to meet the challenges of climate change and asset repair, maintenance and replacement into the next regulatory period. This means prices will rise in future, managed in the most sustainable way, avoiding sharp annual increases.

Customer Charges

2015-21

A key focus is on price stability for customers to offer as much certainty about increases as is possible.

In 2014, the plan for the 2015-21 period was for prices to increase by 1.6% per annum subject to an overall requirement for prices over the six year period to rise by no more than inflation (as measured by CPI), minus 1.8%. 1.6% increases for households were implemented for the first five years.

As we approached 2020/21, our longer term planning had concluded that prices were likely to need to increase above inflation out to the middle of the century. Implementing the charges' cap of a maximum of inflation minus 1.8% over the 2015-21 period would have led to a reduction in charges in 2020/21 and bigger price increases thereafter. It was therefore agreed that, as a balanced position, for 2020/21 prices would increase by 0.9%. While above the original cap, this ensured that prices rose by slightly less than inflation over the 2015-21 period, while not putting undue pressure on future prices.

Prospects

Our current forecasts are that our investment will have to nearly double by 2040 with customers charges rising by 2% above inflation each year on average to finance this. These increases are necessary to meet our customers' expectations that we will maintain the quality and resilience of services and play our part in tackling climate change.

The WICS Final Determination provided flexibility as to how to phase these increases over the 2021-27 period. After engaging with customers about price preferences across the 2021-27 period, 2021/22 charges were published with an increase of 2.5% in Nominal terms, as we began the transition towards reaching a long-term sustainable level of investment and charging. Extra support was introduced for those least able to pay and as a result over 400,000 customers saw a reduction in their water charges.

We have committed to engage with customers and communities to discuss the challenges ahead with our customers, and their implications for charging. This will continue to inform our approach to the phasing of increases in charges.

Wholesale Charges

2020/21 Performance

Despite the Covid-19 restrictions, throughout 2020/21 we have maintained a high level of service to our wholesale customers, maintaining water and waste water services and quickly responding to LPs and business customers' billing and service enquiries.

Given the challenges of the Covid-19 pandemic on businesses in Scotland, we implemented a wholesale charges deferral scheme extending £59 million of support to LPs and their customers in terms of cash flow and payment flexibility. These deferral arrangements have been refreshed and a further scheme to support business customers became operational in May 2021 when the previous scheme ended.

During 2020/21, the WICS requested we applied the principles of Ethical Business Practice to develop solutions to market issues, for example in the area of LP credit management. In responding to this opportunity, we have collaborated in a new market working group along with LPs and CAS. We expect other cross-market structures and initiatives to develop over 2021/22.

2015-21

Since 2018, we have benchmarked our performance relative to the English market and focused on improving our performance measures. More qualitative measures will be developed through the 2021-27 period. These will build on improvements, including timeliness of activity, delivered in recent years.

We have also cross-referenced our customer information sets against external sources, such as those held by the Scottish Assessors Association (SAA), to help ensure that all businesses who are liable for charges are registered in the market and improve market data quality. In turn, this helps maintain charges at the lowest possible level.

Prospects

We aim to transform the quality and productivity of our wholesale service to create the best possible retail environment. Over the next two years we will transform our service to LPs. We will do this by increasing self-service capabilities to enable service tracking, delivering "right first time" resolutions, increasing collaboration and reviewing our business metering strategy.

TRANSFORMING HOW WE WORK

Overview

The WICS Final Determination for 2021-27 sets out that charges will rise, on average, by 2% above inflation for the next six years. Even with those increases we will need to innovate and improve our efficiency by at least 1% every year to rise to the significant challenges set out in our Strategic Plan.

To be successful we must transform the way we work as we invest more. That makes it more necessary than ever to understand what our customers value, retaining trust and confidence through transparency and delivery.

2020/21: Developing Our Transformation Plan

We have been developing a comprehensive Transformation Plan that will set out how we will deliver the fundamental changes required to achieve our strategic objectives. The scale of the challenge ahead has involved working with world-leading advisors, learning from international companies, engaging with the Customer Forum and employees.

We are starting from a good position, but must refocus our business, ensuring leaders and employees have the necessary skills and use the Scottish Water character and digital capacity to foster the innovative and agile culture needed. We must change to make smarter investment and operational choices, informed by strong analysis, to meet our Net Zero objective, embrace and encourage innovation and make every decision as if the customer were in the room.

Key areas of focus for the Transformation Plan, which will be published in the Autumn, will be around asset intelligence, efficient processes, partnerships, investment prioritisation and customer and community focus. We are also determining how we strengthen the underlying health of our organisation as we consider our approach to leadership, skills development performance enhancement, and ways of working.

Elements of our transformation plan are already underway with some critical foundational change activities in motion. For example;

- Field Service Transformation, will enhance customer experience by driving greater effectiveness and efficiency through new technology and an end to end focus on planning, visibility and engagement. It will also bring greater integration with our supply chain partners to transform how we work together and leverage our wider digital estate to deliver value to field teams.
- For Wholesale, we are developing a vision, target operating model and roadmap to drive service excellence and increase efficiency across all Wholesale services and continue our journey to be recognised as a Great Wholesaler.
- In our Service Delivery, automated processes are being developed to manage responsive repair and refurbishment, create capability and capacity to better manage demand the replacement of water and waste water mechanical and electrical equipment.

Digital Enablement

2020/21 provided a real test in terms of the role technology plays in how flexible working can be supported. New laptops and Windows 10 were rolled out to office-based employees to work from home and providing tablets for field teams to give them access to our platforms without access to offices.

Prior investment in digital technology, learning from instances such as the extreme weather of the Beast from the East in 2018, meant we were able to do this quickly and effectively. In addition, digital investment across 2015-21 helped position us well for this significant shift in digital reliance with our investment into cloud applications.

A continued focus on enhancing the digital literacy of our people is key to our organisational resilience and will be a key element of transformation. Digital Champions and the Digital Skills Academy will support this.

2015-21

At the start of the period we recognised a need to define our strategy and routemap to digital enablement. This led to us focusing on the development of digital partnerships.

We also focused energy into how to improve customer services. Developer Services is one area of the business that has used digital tools to cut timescales for development processes from days to hours.

Digital asset monitoring has also become an increasingly important part of our approach to intelligent asset management and replacement. Through improved analytics we have developed our understanding of data based early warnings. For example, being able to identify irregularities in energy consumption of pumping stations and intervene proactively to resolve emerging issues. Digital monitoring is now active at over 1,300 pumping stations. As we roll this out further, we expect to see both efficiency and customer benefits.

Prospects

We need to look closely at our own ways of working and ensure we are delivering efficiently and getting the most from our digital tools. This is key to meeting our demanding 1% real efficiency challenge year-on-year that we set out in the Strategic Plan.

Our cyber and data security focus will continue with planned investment moving more services to the cloud and ensuring we have modern and supported technology. We will invest to proactively address digital, data and analytic requirements while providing a transformation opportunity to automate business activities.

FINANCIAL SUSTAINABILITY

Group Overview

The principal activities during the year were the supply of water and waste water services to homes and businesses across Scotland as highlighted in the Overview on page 5.

Scottish Water's regulated business supplies water and waste water services to households and is also the wholesaler to the 29 retailers (Licensed Providers (LPs)) who operate in the water retail market for businesses in Scotland. Within the Scottish Water group, our subsidiary, Business Stream, operates as an LP, competing with other LPs in the Scottish and English markets to supply water and waste water retail services to business customers. The group also provides non-regulated and other commercial services and, since December 2018, has owned the companies that operate four waste water treatment works in North-East Scotland, under contract to Scottish Water through Scottish Water Horizons Holdings Ltd (SWHH).

This report highlights the performance over the period 1 April 2020 to 31 March 2021 for Scottish Water's group of companies.

In accordance with the Non-Financial Reporting Regulations, additional information on Scottish Water's policies and training in respect of the following items are detailed:

Human rights	**page 64**
Anti-corruption and anti-bribery	**page 64**

Group Structure

The Members of Scottish Water's Board are accountable to the Scottish Government. Details of the current Board Members are provided on pages 116 to 119.

Scottish Water's principal subsidiary undertakings, all of which are disclosed in note 11 to the financial statements, have their own Boards of directors.

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 (SWBSH) in accordance with the above code.

Strategic Framework

Scottish Water operates within a broad strategic framework set by Scottish Ministers. Engagement between Scottish Water, the Scottish Government, the WICS and other stakeholders through the Strategic Review of Charges for the 2021-2027 period was completed during the 2020/21 financial year. As a consequence, the well-established framework within which Scottish Water operates has been modified to reflect the importance of planning over a longer term planning horizon. As Scottish Water transitions into this new longer-term planning process, and completes the preparation of its transformation plan, a Delivery Plan continues to the end of 2022/23.

Sound financial management is essential to provide great value and financial sustainability in order to deliver high quality services to customers and support a flourishing Scotland.

The primary source of finance is revenue from customers but Scottish Water also has access to borrowing from the Scottish Government. Scottish Water aims to maintain a level of financial strength that ensures its income is sufficient to meet its expenditure, while achieving its objectives at the lowest reasonable cost, in line with the requirements of the Water Industry (Scotland) Act 2002. To support a flourishing Scotland, Scottish Water aims to ensure its services provide great value for its customers while Scottish Water itself is financially sustainable.

Financial Performance – Group

Financial Summary

The group surplus before tax for the year to 31 March 2021 decreased by £51.7 million to £34.0 million (2020: £85.7 million). The decrease was primarily due to increased asset maintenance costs within Scottish Water and reduced volumetric income and increased provisioning for bad and doubtful debts, required as a consequence of the Covid-19 pandemic, within Business Stream and Scottish Water. These increases were partly offset by increased profits in the non-regulated business services.

We estimate that the pandemic has reduced the surplus before tax for 2020/21 by circa £66 million (further analysis is presented within note 3 to the financial statements).

We have experienced lower customer revenue and additional costs, particularly associated with our capital investment programme. As a result of government measures imposed to limit the spread of Covid-19, we closed all our construction sites in late March 2020 until June 2020 when we started to re-open sites with additional Covid-19 measures, in line with government guidance.

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

Further coverage of the performance for the three main business areas covering regulated and non-regulated services and Business Stream is detailed on pages 87 to 98.

Consolidated revenue in the year increased by £51.3 million to £1,667.2 million (2020: £1,615.9 million) but costs increased by £107.2 million to £1,468.2 million (2020: £1,361.0 million).

In the year, consolidated net debt increased by £176.2 million to £3,613.9 million (2020: £3,437.7 million). The increase was driven by additional net new borrowing of £215.0 million, partially offset by a £38.8 million increase in cash balances to £570.4 million. The movement in cash is summarised below:

	Scottish Water group £m	Business Stream group £m	Horizons group £m	Total £m
Opening balance at 1 April 2020	391.4	92.7	47.5	531.6
Cash generated /(utilised)	37.3	2.2	(0.7)	38.8
Closing balance at 31 March 2021	**428.7**	**94.9**	**46.8**	**570.4**

Cash balances within Scottish Water increased by £37.3 million to £428.7 million due primarily to delays in our investment programme as a consequence of the pandemic. Any large infrastructure organisation that provides an essential service requires significant access to cash to maintain its activities and to respond to unforeseen events. Our cash balances each year are largely a function of when we borrow from the Scottish Government relative to when we invest and, unlike similar infrastructure businesses, we do not have access to any other form of credit facilities.

Before the pandemic, our risk appetite determined that Scottish Water should always hold a minimum cash balance of £100 million. However, in light of the increased risks faced, as a consequence of the pandemic, we have now determined that this should be £200 million for the time being, equivalent to approximately eight weeks expenditure.

Around £290 million of Scottish Water's cash will be required to complete outstanding and already committed to investment with the bulk of the cash forecast to be required over the period to March 2023. This leaves an effective residual notional cash balance of around £138 million for managing residual business risks and contributing towards our planned long-term level of minimum cash balances.

Cash balances within the Business Stream group of companies increased by £2.2 million over the year to £94.9 million, reflecting the impact of the UK-wide lockdowns on sales to business customers. Cash balances within the Horizons group of companies reduced by £0.7 million to £46.8 million.

Taxation

Scottish Water was awarded the Fair Tax Mark in December 2020. 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 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 consolidated tax charge on the income statement was £7.9 million (2020: £65.1 million). Further detail is included in note 8 to the financial statements.

Other taxes incurred by the group, and included in the cost base, totalled £86.8 million (2020: £86.2 million) and are summarised in the following table:

	2020/21 £m	2019/20 £m
National Insurance	18.2	16.8
Local Authority rates	66.5	68.0
Land fill tax	1.3	0.7
Apprenticeship levy	0.8	0.7
Normalised annual cost	**86.8**	**86.2**

Scottish Water is currently appealing the rateable value of its Water Undertaking listing but is unlikely to know the outcome of this until late 2021.

Group Pension Arrangements

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

The administering authority for each fund is required to conduct a triennial valuation of the assets and liabilities of the fund in line with SLGPS regulations. This must be conducted by a qualified actuary. The purpose of the valuation is to review the financial position of the fund and specify the employer contribution rates for the next three-year period. The last full actuarial valuations were carried out as at 31 March 2020 but were updated at 31 March 2021 by a qualified, independent actuary, to take account of the requirements of IAS 19 'Employee Benefits'.

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.

At 31 March 2021, the gross pension liability increased by £1.4 million from £220.5 million to £221.9 million. The actuarial movements, net of deferred tax, are presented in the consolidated statement of comprehensive income with all movements detailed in note 23 to the financial statements (on pages 187 to 190).

Further detail is included in note 23 to the financial statements.

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.

Principal Risks and Uncertainties

Scottish Water has established a risk policy that sets out a consistent approach to the management of risk and the Board has defined its risk appetite. Details of our approach to risk management and principal risks and uncertainties are set out on pages 99 to 114 with the specific risks as a consequence of the Covid-19 pandemic covered in the following business reports and in the Risk section in the Strategic Report.

Scottish Water – Regulated Services

Strategic Framework

Scottish Water's regulated business supplies water and waste water services to households and is the wholesaler to the water retail market for businesses in Scotland.

Scottish Water generates value for its customers by planning for, and delivering, continuous cost and carbon efficiency improvements in operational and capital investment activities associated with regulated water and waste water services. The planned efficiency improvements are referenced in the regulated charges for customers, as set out in the WICS Final Determination for the 2015–21 period. The value generated by the out-performance of these efficiency targets is retained in Scottish Water until it is returned to customers through further investment to improve services.

Financial Framework for the 2015-21 period

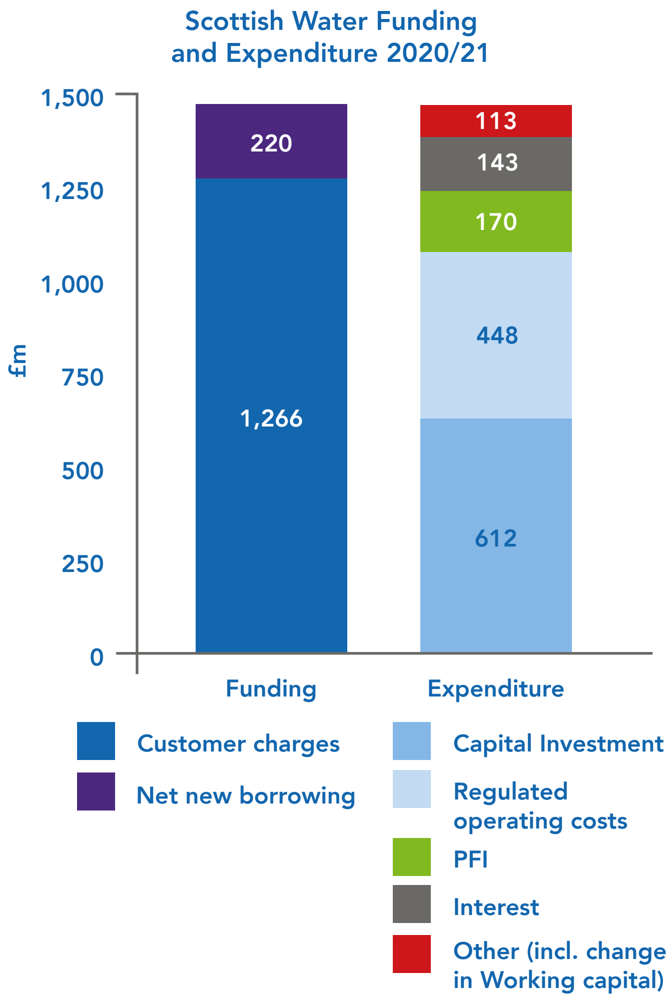
The Scottish Water regulated business is subject to incentive-based regulation by the WICS. In 2014, the WICS carried out a six-year price review for the 2015–21 period, which caps the prices that Scottish Water charge for water and waste water services. The combination of regulated price caps and constraints on borrowing from the Scottish Government creates a clearly defined limit on the financing available to Scottish Water.

Within this financial framework, Scottish Water has an agreed Delivery Plan with Scottish Ministers that sets out its planned level of investment to deliver the required improvements and the expenditure to run the operation in respect of core water and waste water services. Scottish Water's aim is to out-perform the targets set out in the Delivery Plan and thereby out-perform the regulatory contract.

The Funding and Expenditure Model for Scottish Water's Regulated Services

Scottish Water's regulated services are funded through revenue raised from customer charges and borrowing from the Scottish Government. These finance Scottish Water's investment programme, operating costs, Private Finance Initiative service fees and interest charges on loans.

The diagram opposite illustrates Scottish Water's funding and expenditure for the year ended 31 March 2021. The surplus made by Scottish Water is reinvested in the provision of services to customers. Commentary and analysis of the financial performance of Scottish Water's regulated services is provided on pages 89 to 95.



Financial Performance Review

Financial Summary

The financial performance of Scottish Water's regulated activities is measured on a regulatory accounting basis. The following tables and commentary have therefore been presented on that basis. Where appropriate, reconciliations to Scottish Water's company results (as detailed in the Financials section on pages 158 to 194), including cross-references to the relevant notes to the financial statements, have been provided.

The Regulated Income Statement table below presents the results of Scottish Water's regulated business activities, on the regulatory accounting basis. The regulated surplus before tax in the year was £76.9 million (2020: £128.0 million). This surplus is reinvested towards funding the capital investment programme and customer service improvements, as demonstrated in the chart on page 88.

The second table, Reconciliation to retained surplus, provides the reconciliation of Scottish Water's regulated surplus before tax to the Scottish Water company retained surplus for the year taken to reserves on an IFRS basis.

Regulated Income Statement	Note	2020/21 £m	2019/20 £m	Change £m
Turnover	2	**1,266.2**	**1,254.4**	**11.8**
Operating costs		(447.9)	(419.8)	(28.1)
PFI operating costs	4	(131.2)	(126.0)	(5.2)
Infrastructure maintenance costs		(151.1)	(126.3)	(24.8)
Depreciation & amortisation charges		(299.8)	(290.1)	(9.7)
Total costs		**(1,030.0)**	**(962.2)**	**(67.8)**
Operating surplus before interest		**236.2**	**292.2**	**(56.0)**
Finance costs - net		(142.8)	(146.3)	3.5
PFI finance charges		(16.5)	(17.9)	1.4
Regulated surplus before tax		**76.9**	**128.0**	**(51.1)**

Reconciliation to retained surplus	Note	2020/21 £m	2019/20 £m	Change £m
Scottish Water:				
Regulated surplus before tax (per table above)		**76.9**	**128.0**	**(51.1)**
Non-regulated surplus before tax		–	0.2	(0.2)
Retirement benefit obligation ([24]):				
Operating costs		(24.0)	(24.7)	0.7
Finance costs		(5.8)	(6.3)	0.5
Taxation		(11.3)	(66.1)	54.8
Retained surplus for the year (IFRS basis)	21	**35.8**	**31.1**	**4.7**

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

Revenue

Regulated revenue for the year totalled £1,266.2 million (2020: £1,254.4 million) and is analysed by category in the table opposite.

Operating Costs

On a regulatory accounting basis, total costs increased by £67.8 million or 7.0% to £1,030.0 million (2020: £962.2 million).

Operating costs increased by £28.1 million, or 6.7%, to £447.9 million (2020: £419.8 million) which included the net cost impact of the pandemic at £13.2 million, £8.0 million of which related to increased provisioning for bad and doubtful debts. After adjusting for specific cost movements and the impact of RPI inflation, like-for-like operating costs reduced in real terms by £1.3 million or 0.3% as listed in the table opposite.

The increase in incident and weather-related costs was due to the severe winter weather experienced in January and February 2021 which caused a significant increase in water main bursts and the freezing of supply intakes at some reservoirs. These necessitated the need for increased road tankering of water to maintain supplies and additional leakage response action.

Regulated revenue	Notes	2020/21 £m	2019/20 £m	Change £m
Household		920.9	903.7	17.2
Wholesale		332.8	338.2	(5.4)
Other		12.5	12.5	–
Total regulated revenue	2	**1,266.2**	**1,254.4**	**11.8**

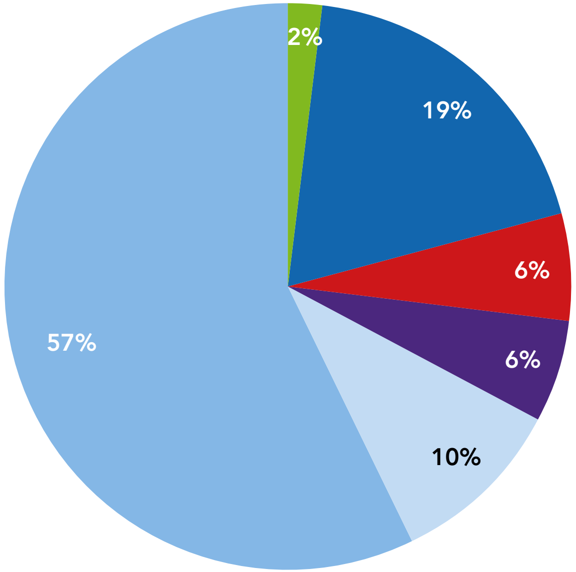
	2020/21 £m	2019/20 £m	Inc/(dec) £m	Inc/(dec) %
SW headline operating costs	**447.9**	**419.8**	**28.1**	**6.7%**
Transformation costs	(1.4)	–	(1.4)	
Covid-19 pandemic costs excluding bad debt charges	(5.2)	–	(5.2)	
Power price increases above inflation	(2.8)	–	(2.8)	
New legislative costs	(7.1)	(7.2)	0.1	
Incident and weather related costs	(6.8)	(1.4)	(5.4)	
Bad debt charges	(26.0)	(17.0)	(9.0)	
New operating costs	(0.9)	–	(0.9)	
Like-for-like controllable costs	**397.7**	**394.2**	**3.5**	**0.9%**
Average RPI inflation at 1.21%	–	4.8	(4.8)	
Like-for-like real costs reduction	**397.7**	**399.0**	**(1.3)**	**-0.3%**

Scottish Water is unable to influence approximately one third of its operating costs over the short-term. These include costs such as local authority rates, insurance and legislative costs. The pie-chart below illustrates the key operating cost components that Scottish Water is able to influence in the short-term. The diagram highlights that of those costs which Scottish Water is able to influence in the short-term, employment costs make up over 50%.

PFI operating costs increased £5.2 million or 4.1% in the year to £131.2 million (2020: £126.0 million) due primarily to annual contract indexation.

Infrastructure maintenance costs were £24.8 million higher than in 2020/21 at £151.1 million, reflecting the demand driven profile of maintenance expenditure.

Total depreciation and amortisation charges, net of the gain on sale from asset disposals, increased by £9.7 million to £299.8 million (2020: £290.1 million) due to the profile of capital investment and completed projects coming into beneficial use.



Analysis of costs to influence

- Power
- Chemicals
- Transport
- IT & Telecoms
- Employee & other
- Property

Finance Costs

As at 31 March 2021, the weighted average interest cost of the outstanding long-term debt within Scottish Water's regulated business reduced to 3.41% (2020: 3.70%). This was due to the repayment of £134.8 million loans with a weighted average interest rate of 4.93% offset by £354.3 million new and replacement loans drawn down during the year from the Scottish Government with a weighted average interest rate of 0.81%. Net interest payable in 2020/21 decreased by £3.5 million to £142.8 million.

Finance costs associated with finance lease liabilities on PFI assets were £1.2 million lower at £16.5 million reflecting the repayment pattern of the lease liabilities as they reduce year-on-year over the related contract periods.

During the year, net debt increased by £182.2 million to £3,719.7 million (being loans of £4,148.4 million less cash balances of £428.7 million). The increase was driven by net new borrowing of £219.5 million partly offset by an increase in cash balances of £37.3 million.

Capital Investment

Scottish Water's capital investment in the year, as reported in note 9 to the financial statements (Property, plant & equipment), was £433.2 million (2020: £502.7 million). When measured on a regulatory accounting basis, 2020/21 gross capital investment was £61.4 million lower at

£611.6 million (2020: £673.0 million) reflecting the impact of the national lockdowns in the early months of the year as a consequence of the pandemic. The table opposite reconciles investment as stated in the statutory accounts with investment on a gross regulatory accounting basis.

More information about Scottish Water's capital programme and projects is provided in Our Investment Programme on pages 72 to 79.

Capital Investment	2020/21 £m	2019/20 £m
Investment on a regulatory accounting basis	611.5	672.1
Add PFI capital additions	0.1	0.9
Total capital investment on a regulatory accounting basis	**611.6**	**673.0**
Less infrastructure maintenance included in operating costs (IAS 16)	(151.1)	(126.3)
Less investment financed by infrastructure charges & contributions	(27.3)	(44.0)
Company capital additions per note 9 to the financial statements	**433.2**	**502.7**

Performance Against the Regulatory Contract

Regulated Cash Performance

Scottish Water's cash balance at 31 March 2021 was £428 million, £388 million higher than the £40 million closing cash balance for the end of the 2015-2021 regulatory period set out in the Final Determination. Around £290 million of this cash balance will be utilised in the early part of the 2021-27 period to complete investment commitments made in 2015-21, leaving around a £138 million residual cash balance once these investment commitments have been fulfilled.

The cash increase over the regulatory period, relative to the Final Determination expectation, is summarised in the table opposite.

Regulated Cash Performance	£m
Overall regulatory cash out-performance	201
Household revenue from higher annual price increases than the annual average of the 2015-21 period price limit	110
Net wholesale revenue above the wholesale revenue cap	109
Lower capital investment	43
Change in costs outside Scottish Water control	14
Lower debt taken out by Scottish Water (regulated business)	(36)
Temporary relaxation of prepaid wholesale charges due to Covid-19 market measures	(27)
Impact of out-turn inflation relative to Final Determination assumptions	(26)
Total cash increase	**388**

Financial Out-performance

The 2014 Final Determination was set on the principal of incentive-based regulation; that Scottish Water should be incentivised to out-perform the determination's demanding targets and expectations. In turn, Scottish Ministers expected Scottish Water to out-perform the determination, delivering additional benefits for customers, and Scottish Water committed to achieving this in its Delivery Plan for the 2015-21 period.

Over the 2015-21 period, Scottish Water generated £201 million of cash out-performance against the 2014 Final Determination[25]. This represents out-performance of 2.5%. The Final Determination was accepted as a total package ('in the round') by Scottish Water in 2015 and therefore the precise allocation of out-performance by individual revenue or cost line is not appropriate. However, in overview, Scottish Water generated slightly over half the out-performance from higher revenue (£106 million) with the balance from lower costs (£95 million).

Additional Revenue

In addition to revenue generated through out-performance, additional revenue was generated from factors outside the parameters of the Final Determination.

Scottish Ministers' charging policy for the 2015-21 period required that charges should provide stability and certainty for customers. At the start of the period, CPI inflation was expected to be around 1.9% p.a. and real customer prices were set to fall by 1.8% across the six years. In light of this, during the first five years of the regulatory period, Scottish Water increased household prices by 1.6% p.a. in line with its agreement with the Customer Forum. However, this generated more revenue than assumed in the Final Determination as out-turn inflation was lower than assumed.

During 2015-21, as preparations were made for the 2021-27 period, it became increasingly clear that long-term charges would need to increase above the rate of inflation to ensure that Scottish Water could be financed sustainably to meet its long-term obligations. For 2020/21, it was therefore agreed with the Scottish Government and WICS that overall household charges across the 2015-21 period should increase by CPI-0.1%, rather than the originally intended CPI-1.8%. This was to avoid prices falling in 2020/21 only to face a compensating increase in subsequent years because of the need to transition to higher prices to support increased investment. The overall revenue benefit arising from the actual profile of household price increases across the 2015-21 period, relative to those assumed in the Final Determination, was £110 million.

In advance of the 2015-21 period, there was significant uncertainty about the level of wholesale income that would be available to Scottish Water, and it was agreed that this would be effectively 'ring-fenced' within the Final Determination. However, due primarily to the success of the project to maximise wholesale revenue collection from identifying properties that were previously not in-charge, £109 million of additional net wholesale revenue was generated.

Capital Investment

The Final Determination allowed for £3,451 million[26] of investment to meet the objectives set by Scottish Ministers for the 2015-21 period.

Shortly after conclusion of the Final Determination, Scottish Water identified significant risks that should be addressed as a matter of priority in respect of strengthening the resilience of water supplies to customers in Ayrshire and reducing the risks to public safety from particular strategic water mains. In addition, through the 2018 investment review, normal minor changes to regulatory investment requirements, and planning for the 2021-27 period, changes were made to the base regulatory investment programme. These changes increased the regulatory investment programme by up to £219 million.

[25] Including achieving the leakage incentive but removing out-performance generated prior to April 2015 increases this marginally to £202 million.

[26] Adjusted for out-turn inflation

These changes to the regulatory investment programme are a normal feature of Scottish Water's investment periods. Similarly, it is normal for some elements of the investment programme to be completed after the end of the regulatory period, typically where unforeseen delays occur on a small number of projects. For the end of the 2015-21 period this was compounded by the impact of Covid-19 which caused construction sites across Scotland to be closed in spring/summer 2020. Together these have led to up to £291 million[27] of investment requiring to be completed after 31 March 2021.

	2015-21 £m	Post 31 March 2021 £m	Total £m
Final Determination financed investment	3,451	–	3,451
Net additional investment committed in the period	219	–	219
Investment to be completed after 31 March 2021	(291)	291	–
Covid cost impacts	29	–	29
Adjusted regulatory investment	**3,408**	**291**	**3,699**
Change	**(43)**	**291**	**248**

In addition to the impact on the timing of investment, Covid-19 has added £29 million to the cost of delivering the regulatory investment programme; £10 million from the requirement to close down and then remobilise sites during the spring/summer 2020 lockdown, and £19 million from the productivity impact associated with adopting new safe working arrangements to minimise the risk of catching or spreading the virus.

The impact of these changes to the capital investment financed in the Final Determination is set out in the table opposite.

In summary, the £43 million reduction to investment delivered in 2015-21 resulted in a corresponding increase in the cash balance at 31 March 2021. Without the closure of construction sites to support the Covid-19 emergency, Scottish Water would have delivered over £100 million additional investment in 2020/21 and would have had a correspondingly lower cash balance at 31 March 2021.

Costs Outside Scottish Water Control

Scottish Water experienced a £14 million net cost benefit from changes to factors outside its control, particularly in respect of lower local authority rates charges.

Borrowing from the Scottish Government

Scottish Water took out loans from the Scottish Government of £724 million across the 2015-21 period, which was £36 million lower than envisaged at the start of the regulatory period. This was because £36 million of Scottish Water's borrowing allowance from the Scottish Government was allocated to absorb the debt within Aberdeen Environmental Services Limited, the company that operates four waste water treatment plants in north east Scotland under contract to Scottish Water, when it was acquired by Scottish Water Horizons Holdings in 2018.

Measures to Support Businesses During Covid-19

In April 2020, the requirement for licensed providers to prepay their wholesale charges was temporarily relaxed to enable them to support their business customers during the Covid-19 pandemic. While this provided £59 million of financial support into the business retail market, the cash cost to Scottish Water relative to the Final Determination expectation was £27 million.

[27] The cost of completing the regulatory investment programme is forecast in the range of £230 million to £291 million.

Inflation

Across the regulatory period, both CPI and RPI inflation were significantly lower than assumed in the Final Determination. The net impact of all the CPI and RPI differences between out-turn and those assumed in the Final Determination was £26 million (less than 0.4% of all revenue and cost items across the period).

Future Developments

As highlighted above, the performance for the 2015-21 period has been strong and the financial risks associated with the Covid-19 pandemic are being effectively managed however, the full impact of the pandemic remains uncertain in terms of duration and the residual financial consequences associated with ongoing macro-economic factors and the cost impact on the investment programme of new Covid-safe working arrangements.

Scottish Water is committed to taking all possible steps to drive for further efficiency and is targeting to achieve, at least, a 1% year-on-year real reduction (CPI-1%) in line with the challenging target set in the WICS Final Determination for the 2021-27 period.

As set out in Scottish Water's Delivery Plan to 2023, forecast investment will have to nearly double by 2040 with customer charges rising by an average of 2% above inflation each year to finance this. The WICS Final Determination provided flexibility as to how to phase these increases over the 2021-27 period. Having engaged directly with customers on their preferences in light of the pandemic and in light of the relevant CPI inflation rate of 0.7%, we decided on a 2.5% increase for 2021/22 for those that pay full charges. The decision of the Scottish Government to increase support to lower income households means this equates to an average price increase of 0.9% across all households. The Bank of England targets inflation to be 2% so in future years charge increases are likely to be around 4%.

Business Stream

Overview

Business Stream is Scottish Water's licensed retail subsidiary which supplies water and waste water services to business customers throughout Scotland and England. Business Stream is a wholly owned subsidiary of Scottish Water with its own Board and independent management team. Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings (SWBSH).

Revenue from this business segment totalled £574.4 million (2020: £477.7 million) (per note 3 to the financial statements). This represents 30.4% (2020: 26.8%) of the group revenue, before intercompany eliminations. The operating loss within this segment was £16.7 million (2020: £14.0 million loss) but this was after recognising a £16.6 million charge for the provision of doubtful debt in relation to the anticipated impact of the Covid-19 pandemic.

Strategic and Financial Framework

Business Stream is one of the Licensed Providers operating in the Scottish retail market and one of the retailers licensed to operate in the English market. The commercial strategy is to retain and grow market share by exploring options that will provide scale through a combination of acquisition and organic growth. With the aim of being the water and waste water services supplier of choice for businesses, Business Stream offers additional 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 SWBSH, subject to the appropriate board approvals.

Performance Review

Business Stream's priority over the last year has been providing on-going support to its customers and its people in response to Covid-19 and the restrictions that have been put in place. Despite challenges, Business Stream has continued to grow its market share, retaining its position as one of the largest retailers in the UK retail water market.

Business Stream felt an immediate impact from the lockdown restrictions as many customers ceased trading temporarily and customers either stopped paying or deferred payments to preserve cash. At an early stage, having assessed the potential financial impact under a range of scenarios, Business Stream concluded that additional funding would be required on a temporary basis to ensure that the business had the liquidity support in place to be able to continue to support its customers through the pandemic and its economic after effects and as such, Business Stream secured new funding arrangements as a precautionary measure.

Despite this complex and challenging environment, Business Stream's balance sheet remains strong and debt free, with net assets of £88.3 million at the end of March 2021, including cash balances of £70.2 million. This position is helped in part by sector-wide financial support arrangements put in place to allow retailers to provide temporary support for their customers, but notwithstanding this, the underlying financial performance of the business has held up well during the past year.

Financial Performance

Business Stream reported a loss before tax of £16.2 million (2020: £12.9 million loss) for the year. This was as a result of recognising a £16.6 million charge for doubtful debt provisions in relation to the Covid-19 pandemic (2020: £13.2 million).

The reported results include a full years trading activity (2020: 6 months) for the Yorkshire Water non-household customer book that was acquired on 1 October 2019. This was reflected in the increase both in revenue for the year (£574.4 million; 2020: £477.7 million) and the related operating costs.

Expenditure included £2.4 million of amortisation charges (2020: £2.0 million), in relation to the Southern Water and Yorkshire acquisitions where the intangible assets are following an eight-year amortisation approach.

Cash balances increased to £70.2 million at 31 March 2021.

Future Developments

As a water retailer, Business Stream's role is to deliver great service for its customers and to deliver a positive return for its shareholders. As a progressive business, Business Stream wants to look beyond profits and is committed to making a positive contribution to its customers, its people, the local communities that it operates within and the environment through its make a positive difference vision launched in 2019, as well as helping contribute towards the Scottish Government's ambitious net zero carbon targets.

Business Stream is undertaking a multi-million pound transformation programme designed to transform its systems, processes and the way it works so that it can continue to provide a market-leading experience for its customers. This will include replacing ageing technology with a scalable, resilient, modern technology platform that will directly benefit its customers, improve its operational efficiency and reduce its cost to serve, while ensuring that its systems and processes are fit for the future so that it can continue to provide excellent service for its customer base.

The next 12-24 months will be challenging, as Business Stream and other businesses respond to the economic after-effects of the Covid-19 pandemic. Business Stream's underlying business remains strong, with accumulated trading reserves of £88.3 million, a strong debt free balance sheet, cash reserves of £70.2 million, and with future profit streams forecast to grow as operating cost efficiencies are delivered through its transformation programme. This should position the business well as it continues to navigate the challenges brought by the Covid-19 pandemic.

Non-Regulated Businesses

Overview

Our non-regulated business activities are governed and monitored within Scottish Water Horizons Holdings (SWHH) and mainly operate through Scottish Water Horizons (SWH) and the North-East Scotland PFI waste water treatment operations.

Revenue from this business segment totalled £49.8 million (2020: £49.1 million) (per note 3 to the financial statements). This represents 2.6% (2020: 2.8%) of the group revenue, before intercompany eliminations. Operating profit within this segment was £2.1 million higher than last year at £7.1 million. This reflects £7.9 million operating profit (2020: £5.4 million) from North-East Scotland PFI waste water activities. Operating profit from SWH at £0.1 million, was £0.5 million lower than last year but the initial impact of the pandemic in the year is estimated at £1.4 million. Activities and the charging of costs associated with the Your Water, Your Life campaign and the Learn to Swim programme in partnership with Scottish Swimming were £0.1 million lower. The profits generated from the other licensed and commercial activities are all retained within the group and invested in the future development of the business.

Scottish Water Horizons

Strategic and Financial Framework

The activities of SWH are aligned to support Scottish Water's core objectives, with particular emphasis on supporting its innovation agenda, carbon reduction targets and renewable energy ambitions. The main objectives of the business activities within SWH are to harness the skills and expertise of our people and use innovative ideas, knowledge and Scottish Water assets to encourage economic growth across Scotland, develop the use of sustainable technologies and provide water and waste water consultancy services to utilities, governments and other international clients.

Performance Review

It has been a challenging year for SWH with profit before tax for the year of £0.1 million (2020: £0.6 million). This was achieved during an extremely challenging year where the impact of the Covid-19 pandemic reduced profit initially by an estimated £1.4 million. The impact of the pandemic was offset by strong performance across three main business activities; Third Party Waste; project Aquatrine; and renewable energy development, despite operational restrictions caused by the pandemic.

Highlights from the year include:

Out-performance in the Third-Party Waste business despite the pandemic and part-closure at one of our key disposal sites.

Developer Projects had a delayed start but recovered well once teams were able to return safely to developer sites, completing key projects in the year. The Fast Track Drainage service was also launched during the year.

Although initially delayed due to lockdown, a further £5.4 million was invested in renewable energy projects during the year bringing delivered output of renewable energy generation since April 2015 to 8.0GWh. This surpassed the overall target for the Scottish Water group of companies. These projects will also enable almost circa 1,800 tonnes of carbon reduction each year.

During the year two major capital investment projects commenced; our first solar PV and battery storage project at Perth Waste Water Treatment Works; and the Dalmarnock Waste Water Treatment Works district heated network project (in partnership with Clyde Gateway), which will also provide energy to the treatment works.

Future Developments

The Covid-19 pandemic continues to impact on the food stock available for the Deerdykes recycling plant, particularly from the hospitality sector and this will impact on the performance of the plant during the first half of 2021/22. But this should be offset by new service offerings in Developer Projects, External Vesting, Fast Tracked Drainage design, and standard design pumping stations which are attracting increasing interest from customers.

In 2021/22, SWH will scale up to deliver significantly more renewable energy projects to support the group's ambitious net zero targets.

North-East Scotland Waste Water PFI

Strategic and Financial Framework

On 19 December 2018, SWHH acquired the companies that operate waste water treatment works in the North East of Scotland which are being managed under a Private Finance Initiative (PFI). The PFI project consists of the concessionaire, Aberdeen Environmental Services (AES) and the operator, Scottish Water Services Grampian, who run the four waste water treatment works under contract to Scottish Water. The acquisition has enabled opportunities for Scottish Water to deliver value for customers through changes including shared purchasing with Scottish Water's waste water operations and optimisation of the works with waste water networks.

Performance Review

The North-East Scotland PFI companies returned an operating profit for the year of £7.9 million (2020: £5.4 million). The improved profit position in the year relates to process improvements which have reduced chemical and energy costs. Interest charges for the year were £2.8 million (2020: £3.1 million) in respect of the external loans held by AES.

Scottish Water
– Principal Risks and Uncertainties

Managing external influences

Risk (Threat)	Trend	Risk Description	Risk Appetite
Cyber Security	↑	Operational, financial and reputational risk from loss of key IT service arising from a deliberate external or internal attack (physical/ virtual).	Scottish Water seeks to ensure the integrity and security of the IT estate.

Key Mitigations

- Organisation wide education and awareness programme rolled out.
- External Expert Vulnerability and Threat Management service utilised.
- Security gap analysis undertaken, plans in place to further increase maturity level.
- Regular application of security patching.
- Detailed disaster recovery plans.
- Participation in UK & Scottish Government and industry cyber incident exercises.
- Compliance with Networks and Information Systems (NIS) Directive and compliance with Scottish Government Public Sector Action Plan on Cyber Resilience.
- Retainment of ISO27001 (Information Security Management) certification for Scottish Water Data Centres.

While the UK water industry has not been subject to a notable attack in 2020/21, we note that the number of attempted and successful cyber-attacks continues to increase globally and there have been recent attacks within the sector;

- in Oldsmar, Florida, USA a hacker attempted to alter chemical levels of sodium hydroxide to dangerous levels at an operational Water Treatment Works.
- the largest fuel pipeline in the US was hit by a ransomware cyber-attack resulting in fuel stranded at refineries.

As an operator of an essential service, Scottish Water is required under EU Network and Information Systems Directive (NIS) to take appropriate and proportionate security measures to manage risks to the network and information systems associated with drinking water supplies, and report serious incidents to the NIS Competent Authority, the DWQR.

As agile working continues, vigilance remains around the growing number of malicious phishing and fake websites purporting to offer Covid-19 support or vulnerabilities introduced as a result of new ways of working.

Developing the business

Risk (Threat)	Trend	Risk Description	Risk Appetite
Covid-19 Macroeconomic	↑	Risk of prolonged financial uncertainty due to the macroeconomic volatility arising from Covid-19 pandemic.	We should always have immediate access to a minimum of approximately eight weeks of operating cash to the regulated business from the group to enable us to protect the organisation from unplanned shocks and potential shortfalls in revenue.

Key Mitigations

- Monitor UK and Scottish Governments' financial budget announcements and analyse impacts.
- Ensure financial modelling remains up to date with current economic forecasts.
- Review of investment programme to identify areas which can be adjusted if required.
- Maintenance of communications with external stakeholders to highlight any changes in revenue collection trends.
- Ensure regular communications with external stakeholders on borrowing profile.

The UK economic environment continues to be uncertain as a result of the ongoing pandemic. It is hoped that, as measures to supress the pandemic progress, much of the economy will be reopened and lockdown restrictions lifted. Scotland moved back to the national tiered system of restrictions on 26 April 2021, with further reviews of restrictions on the economy to come. The overall impact of these restrictions over the past year may start to crystalise over the coming months, with increases to unemployment and volatile economic conditions expected.

The unwinding of the UK Government Furlough Scheme during the latter part of 2021 could see further impact on the wider wholesale market and subsequently on wholesale revenue.

Working with people

Risk (Threat)	Trend	Risk Description	Risk Appetite
People	↑	Risk arising from failure to develop and retain appropriately skilled, engaged and diverse people and acute impact on availability of people and /or key skills arising from Covid-19; and Risk that our people do not have sufficient resilience, capacity and / or are not effectively engaged due to the current internal and external environment, impacting our ability to deliver core services and drive transformational change.	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.

Key Mitigations

- Suite of people policies in place, routinely reviewed and refreshed as appropriate.
- Review of recruitment and retention activities including remuneration, reward and incentivisation tools.
- Regular engagement surveys undertaken, with improvement action plans developed as appropriate.
- Absence monitoring carried out.
- Essential skills, roles and business activities identified.
- Talent identified with implementation of supporting development plans.
- Developed clear succession plans for key roles.
- Established Business Continuity Plans to cater for low likelihood high impact events.

This risk continues to be closely managed and mitigated given our duties as a responsible employer and reliance on our people to deliver our core services.

Covid-19, the associated period of lockdowns and new ways of working has had a significant impact on our people across 2020/21. We continue to monitor, review and refine Covid-19 safe systems of work as we operate during the ongoing pandemic and follow Scottish Government protocols. We also continue to monitor employee morale and engagement, providing a range of supports to our people where required.

This risk could be further compounded as we progress into our next regulatory period 2021-27 involving important changes to our investment processes and as we begin a significant transformation programme. Our people and their ongoing engagement will be key in the successful delivery of these activities.

Managing external influences

Risk (Threat)	Trend	Risk Description	Risk Appetite
Climate Change	↑	Risk of failure to deal with the impact of extreme and unpredictable weather events on our assets and infrastructure. Risk of changes to future water resource supply and demand due to climate change. Reputational risk of not being seen to contribute to the mitigation of climate change.	As a water utility company, provision of safe drinking water remains our highest priority. 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.

Key Mitigations

- Undertaking a Scottish Water climate change risk assessment to inform routemap development.
- Undertaking climate change vulnerability assessments to inform priorities.
- Delivering investment in our water and waste water assets to minimise emissions impact.
- Participation in projects and studies, with outputs informing our strategic plans.
- Develop and maintaining a net zero routemap.
- Carbon costing will be included in future appraisals.

Climate change and more variable and extreme weather patterns are anticipated to present a challenge across the water industry. Scottish Water is committed to contributing to the mitigation of climate change and understanding the adaption needs of our business.

The UK is due to host the 26th UN Climate Change Conference of the Parties (COP26) in Glasgow. The summit will bring parties together to accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change.

Considerable work is underway to support the challenging objectives set, including our target to achieve net zero emissions. Scottish Water will review outcomes from the summit and adjust plans accordingly, should this be required.

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Managing our assets

Risk (Threat)	Trend	Risk Description	Risk Appetite
Water Quality	↔	Risk of delivery of water to customers which has the potential to impact health or cause significant customer concerns.	As a water utility company, provision of safe drinking water remains our highest priority.

Key Mitigations

- Skilled and trained employees operate our water assets.
- Routine monitoring of the water in our catchments, and in our treatment and distribution activities.
- Routine testing on water quality, beyond regulatory requirements, to manage drinking water quality and minimise associated risks.
- Water Supply Risk Management Group direct and oversee improvements related to Drinking Water Safety Plan audits and activity to achieve accreditation with BS EN15975 (Security of Drinking Water Supply).
- Water Quality Improvement Group actively manages emerging themes/concerns and implement appropriate actions to address these.
- Delivery of significant investment to maintain and further improve water quality.
- Management of detailed emergency and business continuity response plans.

The most recent DWQR Annual Report (2019 report year) reported compliance with water quality standards at 99.92%, demonstrating the continuing high quality of drinking water that consumers in Scotland receive.

Significant investment has continued across 2020/21 to further improve water quality, and the annual report covering 2020 is due to be published in mid-2021.

Managing our assets

Risk (Threat)	Trend	Risk Description	Risk Appetite
Critical Assets	⇔	Risk to service to customers arising from failure of a critical asset or assets.	Delivering a continuous service to our customers is paramount.

Key Mitigations

- Developing detailed knowledge and understanding of our critical assets.
- Undertaking operational inspections, maintenance and emergency planning activities to minimise the risk and consequences of failure.
- Identifying investment needs for promotion in our future investment programmes to reduce this risk
- Meeting the requirements of the Network and Information Systems Directive (NIS) and the Scottish Government Public Sector Action Plan.

Investigations have continued to identify critical assets and better inform our short and long-term strategies. As this work continues, our understanding of what assets are truly critical and our awareness of our risk exposure will increase.

Over the long term, and with sustained investment in inspections, maintenance, and network connectivity, our risk exposure will reduce. Until all key mitigations are in place however, we will remain exposed to service impacts.

Working with people

Risk (Threat)	Trend	Risk Description	Risk Appetite
Health & Safety	↔	Risk arising from our assets, activities and actions resulting in an impact on the health and safety of our people, contractors, supply chain, customers and the public.	We will ensure the health and 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.

Key Mitigations

- Detailed Health and Safety Management System and supporting processes.
- Strategic Health & Safety Improvement Plan in progress.
- Embedment of health and safety in our culture and processes via training and awareness raising.
- Completion of risk assessments and regular inspections.
- Investigation of all accidents and incidents and tracking of necessary remedial actions, including learnings for continuous improvement.
- Regular health and safety reporting to key governance groups.

Health and safety risk continues to be closely managed and mitigated given the inherent risks faced by our business. Health and Safety will be a continuing area of strong focus during 2021/22 and beyond.

We continue to monitor, review and refine Covid-19 safe systems of working as we operate during the ongoing pandemic and follow Scottish Government protocols.

Managing external influences

Risk (Threat)	Trend	Risk Description	Risk Appetite
Supply Chain	⟷	Supply chain risk arising from failure of key suppliers, partners, contractors or consultants, and/or acute operational impacts from Covid-19 and the UK withdrawal from the EU.	We should always endeavour to have a sustainable and resilient supply chain to meet our investment needs.

Key Mitigations

- Development and enhancement of productive relationships with key existing partners and suppliers.
- Undertake Supplier Risk Assessments to identify areas of emerging concern, enabling close monitoring and engagement.
- Routinely review Supplier Risk Profiles to monitor financial viability.
- Review and testing of Business Continuity Plans

Supply chain risk continues to be closely managed and mitigated given our alliance and partnership model which supports the delivery of our core services.

Close engagement and monitoring of our key suppliers' ability to provide critical goods and services continues following the UK's exit from the EU and during the ongoing pandemic. It is appreciated that some impacts to this risk may be realised once key government support schemes for the Covid-19 pandemic begin to wind down. Monitoring of the long-term sustainability of key suppliers also continues in light of these impacts and wider macro-economic pressures.

Developing the business

Risk (Threat)	Trend	Risk Description	Risk Appetite
PFI Operations	⟷	Financial and operational risk should a PFI plant or operations fail to deliver in accordance with the contract terms.	Scottish Water seeks to deliver services in an efficient and cost-effective manner including via a number of PFI waste water contracts.

Key Mitigations

- Maintaining ongoing strong relationships with the PFI companies.
- Monitoring and management of PFI company performance.
- Developing contingency plans for both the financing and operation of these contracts as they enter their final stages.

While there were no material changes to the level of PFI project risk faced in 2019/20, we continue to engage with operators and closely monitor their performance and obligations.

Scottish Water subsidiaries

Risk (Threat)	Trend	Risk Description	Risk Appetite
Business Stream	⟷	Risk of reducing value of Business Stream and increased demand on Scottish Water Group resources due to the impact of Covid-19 on Business Stream's revenue and cash collection, competitive market conditions, and the complex operating environment in the English market.	Business Stream will maintain a financially viable retail business.

Key Mitigations

- Continued transformation of customer service and cost base, and focus on cash management.
- Improvements to English market customer data sets and payment arrangements.
- Utilisation of available support including wholesale payment deferral and additional supports for Covid-19.
- Working with Regulators and stakeholders to implement further market changes to improve liquidity and solutions to expected increase in bad debt exposure due to Covid-19.
- Ensure appropriate funding facilities for financial sustainability.

The Scottish market remains very competitive. The retail market in England provides access to £2.5 billion of revenue opportunity. However, the English market environment is currently complex, with low margins available, data quality issues and complex wholesale tariff arrangements.

Like all Licensed Providers, Business Stream is facing cash collection challenges and reduced revenue due to a considerable reduction in business sector consumption due to Covid-19.

Managing our assets

Risk (Threat)	Trend	Risk Description	Risk Appetite
Strategic Water Mains	↔	Risk arising from repeat failure of key/strategic water mains resulting in significant water damage to surrounding properties and/or infrastructure.	Delivering a continuous service to our customers is paramount. Scottish Water seeks to minimise adverse impacts to our customers.

Key Mitigations

- Identify locations where previous bursts have caused flooding and develop options to mitigate risk exposures.
- Delivering mitigations at prioritised historic flooding locations.
- Developing policy on management of flooding risk from current infrastructure for new developments.
- Securing further investment to address via strategic planning process (2021-27).
- Proactively identify high consequence flood locations and consider mitigation options.

Historic high-profile flooding locations are being reviewed and addressed as appropriate, with further work to identify wider flooding risks. This work remains at an early stage in developing methodology, with assessments still to be carried out.

Working with people

Risk (Threat)	Trend	Risk Description	Risk Appetite
Data Protection	↔	Risk of failure to maintain a suitable and sufficient framework to manage data protection legislative obligations.	Scottish Water seeks to safeguard customer and employee data by complying with relevant standards.

Key Mitigations

- Developing and communicating data protection policies, processes and guidelines.
- Raising awareness of data protection and General Data Protection Regulation (GDPR) requirements.
- Producing and publishing corporate privacy notices.
- Developing and communicating a process to ensure data breaches are identified, reported and investigated in a timely manner.

As the data security landscape has continued to mature, significant work to improve data protection practices to ensure compliance with the new and changing standards has continued. For example, the introduction of the EU General Data Protection Regulation and Data Protection Act 2018, introduced additional obligations. We continue to adapt and embed our policies, processes and guidelines in support of these, learning from external breaches and the ramifications of these where appropriate.

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Risk (Threat/ Opportunity)	Trend	Risk Description	Risk Appetite
Constitutional Change	↔	Financial and operational risk and operational risk and opportunity arising from constitutional change.	We will seek to maximise any opportunities and minimise any risks arising from constitutional change.

Key Mitigations

- Ongoing review of potential threats and opportunities from constitutional change on Scottish Water.
- Engagement with Water UK to monitor areas of concern for water industry.
- Engagement with government and regulators, to shape priorities in both EU and domestic context.
- Utilisation of escalation route where appropriate (short-term risks) – Availability of critical spares and chemicals.
- Monitoring of exposures (medium to long-term risks) – Legislative change, Economic or Political volatility.
- Review of the EU-UK Trade and Cooperation Agreement.

The EU-UK Trade and Cooperation Agreement came into effect on 1 January 2021. Scottish Water continues to monitor political relationships as governments, and businesses adjust to the new/changing protocols. Drawdown of stockpiled chemicals and critical spares commenced in April 2021 with ongoing tracking in place.

Monitoring of longer-term opportunities and threats arising from legislative changes, and risks from potential economic volatility continues, alongside monitoring of potential domestic constitutional change through a second Scottish independence referendum.

Developing the business

Risk (Opportunity)	Trend	Risk Description	Risk Appetite
Transformation	⟺	Opportunities arising from the development and implementation of large scale transformational programme required to shape the business and enable achievement our ambitions set out within the Strategic Plan – A Sustainable Future Together.	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.

Key Mitigations

- Understand the scale of transformational change required to deliver our strategic plan and ambitions.
- Design the routemap setting out timescales and objectives.
- Review business priorities to ensure adequate resource levels.
- Continuously engage with internal and external stakeholders.
- Deliver change programme.
- Undertake regular monitoring of progress.

Work is underway to consider the scale of transformational change required and identify suitable opportunities which will aid in progressing toward our strategic objectives.

The routemap to support transformational change will be published Autumn 2021.

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. These risks are more likely to have a longer-term impact, however there is the potential for the velocity to significantly increase within a shorter time frame and affect the performance of Scottish Water. As such, these are continually monitored and routinely reported; a minimum of four times per annum, through our existing risk processes.

We undertake regular horizon scanning to monitor both the internal and external business environment, to help identify and review new and emerging risks. Recent events of concern relating to Critical National Infrastructure include attempted tampering of chemical dosing at a water treatment facility in Florida, a prolonged power outage in Texas requiring water boil notices, and fuel stranded at refineries across the United States.

The key emerging risks identified at this time can be viewed in the table on the following page. They are grouped by risk appetite perspectives, and risks with the potential for velocity to increase within a shorter timeframe are indicated at the higher end of the scale.

Velocity scale Low → High

Emerging Risks	Description	Velocity scale
Managing our assets		
Power interruptions	Total or partial shutdown of the national electricity transmission system requiring a black start recovery, which could impact the running of our core services e.g., prolonged power outage in Texas.	
Contaminants of emerging concern	Understanding and addressing the impact of contaminates e.g., micro plastics, oestrogen, coronaviruses and pesticides on natural resources, employees, customers and the public.	
Biosolids[28]	Loss of key disposal routes e.g., land reclamation arising from diminishing availability, public perception and/or regulatory changes.	
Rainfall return	Increase in the number and/or severity of extreme rainfall events leading to sewer flooding, with potential limitations of the public sewer network in the context of a changing climate.	
Working with people		
Future pandemics or variants	New and/or increased frequency of epidemics/pandemics impact the ability to operate our core services effectively.	
Remote talent management	Changes in approaches to talent management, e.g. ability to attract and retain key skills, coupled with risk if strategies and approaches are not adapted to keep our people connected and engaged.	
New working model	Changes to working environments, such as office vs home working presents opportunity, and may also lead to sustainability issues if the optimum balance and blend is not fully explored or understood.	
Developing the business		
Future technologies	Increased automation through transformational activities could impact roles, relations and morale, as we focus on delivering associated benefits, opportunities and efficiencies.	
Managing external influences		
Legislative changes	The need to adapt and respond to potentially multiple legislative changes arising from UK divergence from EU environmental standards and climate change adaptations.	

[28] Biosolids are solid organic matter recovered from the waste water treatment process and used as fertiliser.

Our Approach to Risk Management
Principal Risks and Uncertainties
Cyber Security
Covid 19 Macroeconomic
People
Climate Change
Water Quality
Critical Assets
Health & Safety
Supply Chain
PFI Operations
Business Stream
Strategic Water Mains
Data Protection
Constitutional Change
Transformation
Emerging Risks

GOVERNANCE

BOARD MEMBERS
2020/21 BOARD MEMBER BIOGRAPHIES

Executive Members

Douglas Millican, Chief Executive

Douglas was appointed as Chief Executive in 2013 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 Vice Chair of World Vision UK. 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 36 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, Finance Director

Alan joined Scottish Water in September 2013 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 Scottish Fiscal Commission, the Banking Standards Board, Senior Independent Director of J Sainsbury Plc and of the North American Income Trust. 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 20 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 took up her first Non-Executive Director position in 2000 joining the Board of Right Track in Glasgow.

She also joined the Scottish Power Advisory Board in 2007 and was appointed to the main Board of the parent company, Iberdrola, in 2008 where she is currently a member of the Sustainable Development Committee and the Executive Committee. Samantha is also Chair of the Scottish Ensemble and an Advisory Board member at Imperial College London.

James Coyle

James is a Non-Executive Director and Chairman of the Audit Committee and a member of the Risk Committee of HSBC UK Bank Plc, Chairman of HSBC Trust Co (UK) Ltd and Marks and Spencer Unit Trust Management Limited and a Non-Executive Director of M&S Bank Plc. He is also Senior Independent Director to the Board and Chairman of the Audit Committee of Honeycomb Investment Trust Plc, and an independent non-executive member of the Deloitte UK Oversight Board. His former appointments include: Deputy Finance Director for Lloyds Banking Group; Group Chief Accountant of Bank of Scotland; member of the Audit Committee of the British Bankers Association; a Director of Scottish Financial Enterprise; a member of the Board and Chairman of the Audit Committee of Vocalink Plc, a member of committees of the Financial Reporting Council, the ICAS Council, a Non-Executive Director of the Scottish Building Society and Chair of the Board of Worldfirst and Chair of its Audit and Risk Committee.

Iain Lanaghan

Iain Lanaghan is an experienced Non-Executive Director and former Main Board finance director. He is also a Non-Executive Director of UK MOD Defence Equipment and Support agency (DE&S) and of the UK Oil and Gas Authority. His previous Non-Executive Director roles have included UK National Nuclear Laboratory and Cabot Energy plc. 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 brings 29 years of energy industry experience 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 was appointed CEO of OGUK in May 2015. She has an LLB Hons in Scots Law and extensive experience as a senior business leader in the global energy sector; Deirdre is a Non-Executive Director of Scottish Water, a Board member of Opportunity North East, a member of the Scottish Government's Energy Advisory Board and a member of the Women's Business Council, a UK Government body focused on increasing women's contribution to economic growth. Previously Deirdre was a Board member of the North East of Scotland College (NESCOL) and Chair of the Aberdeen Science Centre. In 2018, Deirdre was awarded an OBE for her services to the Oil and Gas industry in the Queen's Birthday Honours. Deirdre was also awarded a Fellowship from NESCOL in 2018 and is a Burgess of Aberdeen.

Paul Smith

Paul currently has a portfolio of Non-Executive and Advisor roles across the Energy, Infrastructure and Utility sectors. He chairs the Boards of Capstone Infrastructure Corporation and Diversified Energy from Waste Management Ltd, is an Independent Non-Executive Director of Cadent Gas Ltd, plus a Non-Executive Director of Orbital Marine Power Ltd. He is also Senior Advisor to Icon Infrastructure LLP. Prior to this Paul was Managing Director of Generation at SSE plc. He is a Chartered Chemical Engineer from Edinburgh University with an MBA from Henley Management College. He is a Fellow of both the Institution of Chemical Engineers and the Energy Institute.

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 member of the National Executive Committee for the Prospect Union, having occupied various executive positions since 2013 and been a senior negotiator on the BT Pay and Reward Committee since 2006. He also served a three year term on the governance board of BT's pension scheme in 2018.

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 116 to 119.

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 Commissioner for Ethical Standards in Public Life in Scotland. 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 2020/21, the Board met on 11 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 with stakeholders is held in place of an Annual General Meeting. The arrangements for appointment and termination 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 Committee Report on pages 124 to 129 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	11	11	–	–	–	–
Samantha Barber	11	11	–	–	6	6
James Coyle	11	11	5	5	–	–
Peter Farrer	11	11	–	–	–	–
Iain Lanaghan	11	11	5	5	–	–
Ken Marnoch	11	11	–	–	6	5
Deirdre Michie	11	11	5	4	–	–
Douglas Millican	11	11	–	–	–	–
Alan Scott	11	11	–	–	–	–
Matt Smith	11	9	–	–	6	5
Paul Smith	11	11	5	5	6 (2*)	2

Notes:

*Mr Paul Smith resigned from the Remuneration Committee on 1 August 2020.

Audit Committee

The Audit 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 and business risk management. The Chair of the Audit Committee reports to the Board on internal control and risk management matters following each Audit Committee meeting. The Committee adheres to the requirements of the Audit 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 Committee's activities is provided on pages 124 to 126.

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 130.

Board and Committee Performance

An external review of Board and Committee effectiveness was undertaken during the financial year of 2020/21 and actions arising from it have been implemented. Formal annual evaluation processes are in place for all Members, including the Chair. Induction and ongoing training is provided for Members with specific emphasis on finance, regulation and risk analysis. An internal review of Board and Committee effectiveness will be undertaken during the financial year of 2021/22.

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 Finance 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 2009 (as amended). 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 26 to 32. 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.

As part of the risk management system, Scottish Water has established a comprehensive risk management policy which sets out a consistent approach to the management of risk, both threat and opportunity, within the organisation and clearly defines our risk appetite.

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

The business identifies risks at corporate, directorate and functional levels. Risks are evaluated and prioritised by considering their consequences and likelihood. They are then assessed against Scottish Water's risk appetite and managed effectively to ensure the achievement of service delivery and business objectives. Existing arrangements for managing the risks are considered and, where these are not assessed to be effective, action plans are established which aim to achieve the appropriate balance between risk and control.

Risks are managed in a reasonable and prudent manner, having regard to Scottish Water's risk appetite, the current regulatory framework in which we operate, and the resources available to us.

The Corporate Risk Register is reviewed bi-annually by the Executive Leadership Team, Audit Committee and Board, supplemented by a further two reports which review the status of the most significant business risks. The Corporate Risk Team periodically reviews supporting risk management processes, with approval by the Audit Committee.

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 undertaken 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 Members' reports. The controls assurance process is co-ordinated by Internal Audit and incorporates independent assessment by audit, and 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.

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 129).

AUDIT COMMITTEE REPORT

Annual statement by the Chair of the Audit Committee

I am pleased to present this report covering the role and function of the Group Audit Committee for the year ended 31 March 2021. I am the Chair of the Committee and during the year I was supported by 3 other Non-executive Members; Iain Lanaghan, Deirdre Michie and Paul Smith. 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. Emma Campbell, Scottish Water's Group Legal Counsel, is Secretary to the Committee.

Group Audit Committee Role and Responsibilities

The Group Audit Committee was established by the Board to support them in their responsibilities for issues of risk, control and governance and associated assurance and assessment through a process of constructive challenge. Although Scottish Water is not a quoted company it does adopt and follow, as far as is appropriate, the accounting and disclosure practices of a quoted 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 risk, control and governance and their effectiveness;
- The accounting policies, the financial statements, principal risks, the interim Accounts and Performance & Prospects reports;
- The planned activity and results of both internal and external audit, including approval of the annual Internal Audit plan and strategy and annual Cost Audit plan;
- The adequacy of management response to issues identified by audit activities;
- The assessment of the effectiveness of the internal control environment;
- The corporate governance requirements for the organisation;
- Anti-fraud policies, whistleblowing processes, arrangements for special investigations and activities and reports by the Business Ethics 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 LP, competing with other LPs 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 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 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 2020/21 the Committee met on 5 occasions, with an extra meeting in June 2020 to review the draft Annual Report and Accounts.

In addition to the Committee members, the Scottish Water Board Chair, Chief Executive, Finance Director, Head of Internal Audit, Group Financial Controller, General Manager Revenue & Risk, Director of Digital and the external audit partner also attend 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 Risk 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 external audit 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 risk management controls covering 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;
- Consideration of Scottish Water's Covid-19 short and medium-term risk assessment;

- Reviewing development of the 2021-27 Capital Investment Value Assurance Framework;
- Update on the refresh of risk appetite statements;
- Discussing specifically requested papers on 2021-27 residual risk, third party risk and wholesale market risk; and
- Reviewing findings and recommendations from an external assessment of Audit Committee effectiveness.

Covid-19 Pandemic

- The Committee at its meetings throughout the year considered the risks associated with the Covid-19 pandemic which may have a significant impact on the future finances of the Scottish Water Group beyond 2020/21. The current and residual impact of the pandemic is highly uncertain on the Group and in particular Business Stream.
- During 2020/21, the Scottish Water Group agreed funding arrangements for the subsidiary companies in order to support the short-term liquidity impacts of the Covid-19 pandemic. To date, there has been no requirement to provide any additional funding to Business Stream under these arrangements. However, in March 2021, SWBSH increased its equity investment in Business Stream by £10m; this was a conversion of an original agreed loan facility previously drawn down from SWBSH by Business Stream in April 2020. Other than this loan to equity conversion, there has been no further drawdown from the facility. The Board of SWBSH will continue to monitor Business Stream's performance against its recovery plan by receiving regular progress updates from Business Stream.
- The Committee will continue to keep the whole Group financial position under active review by monitoring the position in Scottish Water and relying on the SWBSH Board to monitor the position in Business Stream with cash updates to the SWBSH Board.

Financial Reporting

In order 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 and Accounts: Performance & 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 Scottish Water Group Financial Controller 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 Group Financial Controller and the external auditor covering the financial statements for full year 2020/21. 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 has 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 future challenges 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 their 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 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 main risk covered was the assessment of the specific risks identified as a consequence of the Covid-19 pandemic that would have an impact in 2020/21 and potentially beyond.

The primary areas of judgement considered by the Group Audit Committee in relation to the 2020/21 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;
- Covid-19 related impacts; 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 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 £13 million, representing 1% of total expenses, incurred in 2019/20 (excluding interest), in the consolidated income statement for 2020/21. However, the Committee agreed with the external auditor that the firm would report any misstatements identified during the audit above £270,000, as well as misstatements below that amount that, in their view, warranted reporting for qualitative reasons.

In addition, the General Manager Strategy and Economic Regulation, the Head of Internal Audit and the General Manager Revenue and Risk carried out a review to verify that the Annual Report & Accounts 2020/21: 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 2020/21: 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 2020/21: 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 Business Ethics 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 risks including third party risks, 2021-27 Capital Investment Value Assurance Framework, and wholesale revenue.

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 Internal Audit plan, 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 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 undertook a robust 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 six-year period from 2016/17 to 2021/22.

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 an internal control 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 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 6 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 that KPMG has remained independent.

James Coyle
Chair of the Audit Committee

REMUNERATION COMMITTEE REPORT

Annual Statement by the Chair of the Remuneration Committee

I am pleased to present the Members' remuneration report for the year ended 31 March 2021, in the preparation of which I am thankful for the support of fellow Remuneration Committee and Non-executive Member, Ken Marnoch and former Non-executive and Remuneration Committee member, Matt Smith, who stepped down from the Board on 30 April 2021. I was pleased to welcome new Non-executive Steven Dickson, who joined the Board and Remuneration Committee from 1 May 2021.

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 2020/21. 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 our key strategic priorities.

The key decisions made by the Committee over the 2020/21 period were as follows:

Decisions / remuneration for 2020/21

- Agreeing a base salary increase of £2,000 with effect from 1 April 2020 for Executive members and the Chief Executive, within the Scottish Government's Public Sector Pay Policy. The Chief Executive waived this increase.
- Confirming the 2020/21 AOIP payment calculated at 34.3% out of the 40% maximum opportunity for Executive Members and Chief Executive.
- Noting management's proposed salary increases for Scottish Water employees.
- Review of succession planning for posts on the Executive Leadership Team.

Decisions / remuneration for 2021/22

- Agreeing base salary increases for Executive Members, with effect from 1 April 2021, at £800 within the Scottish Government's Public Sector Pay Policy.
- Setting the structure and performance criteria for the 2021/22 AOIP.
- Setting the structure and performance criteria for the 2021-27 LTIP.

Our Remuneration Policy and our Annual Report on Remuneration is set out on pages 130 to 144.

Samantha Barber
Chair of the Remuneration Committee

MEMBERS' REMUNERATION REPORT

The presentation of this Remuneration Report complies with the HM Treasury Financial Reporting Manual 2020/21 (December 2020) 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 in the delivery plan, 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 (formerly Hay Group) 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.

In addition, bespoke benchmark analysis is carried out approximately every three years and when last undertaken by independent consultancy Mercer, in November 2018, showed that Executive Members' base salaries were below 70% of an industry median, a deterioration of the comparative position indicated three years previously.

Given that our aim is to set pay levels with reference to 95% of the median of an agreed industry benchmark group, reflecting remuneration levels in comparable organisations for similar work, the benchmark position demonstrates the scale of this challenge.

e. Annual Out-performance Incentive Plan

Scottish Water has an AOIP designed to incentivise and reward the out-performance of targets agreed with regulators. Targets are set out in the Delivery Plan for the regulated business that has been approved by Scottish Ministers and reflect those set by the Water Industry Commission in its Final Determination of charges.

The Remuneration Committee maintains 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. During 2020/21 there was no requirement to exercise these step-in rights.

The potential maximum annual incentive attainable for out-performance by Executive Members is 40% of base salary and is non-pensionable. Delivery Plan targets, out-performance targets, and actual performance in 2020/21 are set out on the following page.

Measure	Weight	Delivery Plan Target	Out-performance target	Actual performance
Regulated financial surplus before tax ex. depreciation	40%[1]	£429m	Financial surplus before tax and depreciation to exceed delivery plan by £0 to £50 million. Sliding scale with 0% at delivery plan figure and 100% at +£50 million.	+£44.7 million
Customer service OPA performance	25%	385 to 400 points	Overall Performance Assessment (OPA) based on sliding scale discussed with Customer Forum where, for 2020/21, the Leading score is 385 points and Best in Class is 400 points. Below leading score 0%; at leading score 30%; at best in class 90%; beat best in class 100%.	404 points
Customer Experience Measure	20%	Exceed 82.6 hCEM points	Improvement in the Household Customer Experience Measure (hCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 82.60 points; 30% payable at 82.60 points; 100% payable for greater than or equal to 88.42 points.	88.45 points
	5%	Exceed 75.50 nhCEM points	Improvement in the Non-household Customer Experience Measure (nhCEM) as developed and agreed with the Customer Forum. Beat the baseline on a sliding scale so that: 0% payable below 75.50 points; 30% payable at 75.50 points; 100% payable for greater than or equal to 86.50 points.	88.36 points
Customer Benefit – Overall Measure of Delivery	10%	Exceed 240 points	Exceed the target Overall Measure of Delivery (OMD) of 240 points and ensure forecast capital programme cost is within the regulatory allowance[2].	229 points; programme cost inside allowance

Notes

(1) Financial surplus is a gateway on the AOIP scheme i.e. payments must be funded from financial out-performance; the delivery plan figure will be as updated for inflation and regulatory out-turn assumptions.

(2) Plus customer contributions

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.

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

For the six years to March 2021

The 2015-21 LTIP agreed with the Scottish Government provides clear targets for out-performance of the Water Industry Commission's Final Determination for the 2015-21 period. The LTIP is funded by 10% (2010-15 LTIP: 12%) of base salary that will be in payment at the end of the performance period being accumulated each year during the 6 years to March 2021, ultimately vesting as determined by the performance targets opposite and being paid as a single sum at the end of the 2015-21 period. Any LTIP payment is funded from financial out-performance after payment of any incentive awards to employees and is non-pensionable. The LTIP is only payable if there is overall financial out-performance of the Final Determination.

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.

The LTIP structure and indicative performance for the 2015-21 period is as follows:

Measure	Weighting	Basis of calculation	Target	Draft Performance
Growth in cash, measured as debt less cash, relative to the Final Determination	50%	Straight line sliding scale	£0 to £200m above Final Determination (before any cash returned to customers)[1]	£202 million
OPA – the average performance 2015-21 linked to leading company and best in class thresholds agreed with the Customer Forum	50%	Sliding scale	• 0% below an avg. 382.5 points • 30% at an avg. 382.5 points • 90% at an avg. 400 points • 100% for an avg. >400 points	401 points

Note:

(1) Cash growth is before the impact of valid changes to external costs (e.g. rates) and any changes to customer prices from those set out in the WICS Final Determination.

The long-term out-performance that generates awards under the 2015-21 LTIP is subject to external verification. Consequently, the Remuneration committee will determine payments in late 2021 and these will be disclosed in next year's accounts and Members' Remuneration Report for 2021/22.

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 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 line with the earlier stated aims of our Executive Remuneration Policy.

Targets

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 • 100% at 40,000 tCO_2e reduction	Sliding scale between 20,000 and 40,000 tCO_2e targets

Notes

(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. The Remuneration Committee will make a holistic assessment of a systematic gathering of stakeholder sentiment. Over the long term it will be important for all stakeholders to verify that our progress is sufficient for the Remuneration Committee to determine that LTIP payments are warranted, 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 the period).

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 the 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.

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.

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 above.			45% of salary	45% of salary	45% of salary	45% of salary

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. Should recruitment of an Executive Member require compensation for forfeit of variable remuneration from a former employer, this would also be included in any recommendation made.

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 circumstances such as departure due to redundancy and efficiency, ill health or normal retirement, 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 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 the employees. The Board member who fulfilled that requirement until 30 April 2021 was replaced on both the Board and The Remuneration Committee from 1 May 2021, by a new Non-executive with similar special knowledge.

l. Service contracts

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

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

Executive Member	Name	Date of Contract
Chief Executive	Douglas Millican	1 February 2013
Chief Operating Officer	Peter Farrer	1 April 2013
Finance Director	Alan Scott	24 September 2013

Non-executive Members

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

Dame Susan Rice, Chair	31 May 2023
James Coyle	31 July 2024
Paul Smith[2]	31 July 2024
Samantha Barber	31 March 2025
Iain Lanaghan	31 March 2025
Steven Dickson[1]	30 April 2025
Deirdre Michie	30 November 2021
Kenneth Marnoch	31 March 2022

Note:

(1) Steven Dickson was appointed as a new Non-Executive Board Member from 1 May 2021.

(2) Paul Smith has resigned from the Board with effect from 29 June 2021, before the end of his current appointment term.

(3) Matt Smith stepped down from the Board at his appointment expiry date of 30 April 2021, having served 2 terms.

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

		Salary/Fees £000	Benefits[1] £000	AOIP[2] £000	Total £000	Pension[3] £000	Total £000
Executive Members							
Douglas Millican[4]	2021	267	12	92	371	7	378
	2020	267	12	0	279	31	310
Peter Farrer	2021	197	11	68	276	30	306
	2020	195	11	70	276	36	312
Alan Scott[5]	2021	195	11	67	273	16	289
	2020	191	11	34	236	14	250
Non-executive Members[6]							
Chair - Dame Susan Rice	2021	104			104		104
	2020	103			103		103
Samantha Barber	2021	27			27		27
	2020	27			27		27
James Coyle	2021	27			27		27
	2020	27			27		27
Iain Lanaghan	2021	22			22		22
	2020	21			21		21
Deirdre Michie	2021	22			22		22
	2020	21			21		21
Kenneth Marnoch	2021	22			22		22
	2020	21			21		21
Matt Smith	2021	22			22		22
	2020	21			21		21
Paul Smith	2021	22			22		22
	2020	21			21		21
Total Remuneration	**2021**	**927**	**34**	**227**	**1,188**	**53**	**1,241**
	2020	915	34	104	1,053	81	1,134

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 2020/21. This requires the real increase in accrued benefits, as detailed in section 2c below, to be multiplied by 20, plus the real increase in accrued lump sum and reduced by the contribution made by the individual member.

(4) Mr Millican waived his entire AOIP payment of £96,184 for 2019/20. Scottish Water donated an equivalent sum to the charity World Vision to support their global Coronavirus emergency response to limit the spread of Covid-19 and reduce its impact on vulnerable children and families.

(5) Comparative figures for Mr Scott reflect a temporary reduction in working hours and salary in line with normal policies between 24 and 29 February 2020 inclusive, as part of a phased return to work following a period of absence. Mr Scott's 2020 AOIP figure for 2019/20 also reflected absence during that year.

(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-executives are flexible in the hours they work and in their availability to provide experienced, high value advice and guidance to Scottish Water.

The Committee approved a £800 increase in base salaries for the three Executive Members with effect from 1 April 2021. Consequently, base salaries for 2021/22 are as follows: Douglas Millican £267,979; Peter Farrer £197,830; and Alan Scott £195,598. Fee levels for Non-executive Members, including the Chair, for 2021/22 will increase by £3 per day, also with effect from 1 April 2021 and in line with Public Sector Pay Policy for Senior Appointments.

b. Details of benefits received 2020/21

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	10	1	11

c. Total pension entitlements to end of financial year 2020/21

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 opposite 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 2021		Transfer Values		
	Years in Scheme	Pension £000	Lump sum £000	Pension £000	Lump sum £000	At 31 March 2021 £000	At 31 March 2020 like-for-like basis £000	Increase in 2020/21 net of Member's own contributions and inflation £000
Douglas Millican	26.1	2	(1)	80	141	1,537	1,471	29
Peter Farrer	36.7	3	1	95	182	2,001	1,906	64
Alan Scott	7.5	2	–	20	–	276	244	10

Notes:

(1) Members of the pension scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table opposite.

(2) 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.

(3) 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.

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

(5) The rate of tax payable on pension savings above the lifetime allowance of £1.073 million depends on how the money is paid to individuals. The current rate is 55% if the individual takes a lump sum, or 25% if the individual takes it as pension payments or cash withdrawals. This is in addition to income tax payable on the pension paid.

d. Pay multiples

The Companies (Miscellaneous Reporting) Regulations 2018 set out the method of pay multiple comparison to be used from 2019/20 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. Further, the regulations require this comparison to be built up over a 10-year period moving forwards. Scottish Water has been reporting a mean pay ratio calculation for several years, but in 2019/20 switched to using the prescribed percentile approach and recalculated 2018/19 in the same way.

	Remuneration excluding movement in pension (i) £000		
	2020/21 percentile calculation	2019/20 percentile calculation (ii)	2018/19 percentile calculation
Chief Executive	371.0	375.0	367.0
Employees 25th percentile	27.2	26.5	25.8
Employees 50th percentile	31.7	30.7	29.9
Employees[3] 75th percentile	40.6	39.5	38,7
Ratio at 25th percentile	13.6	14.2	14.2
Ratio at 50th percentile	11.7	12.2	12.3
Ratio at 75th percentile	9.1	9.5	9.5

Notes:

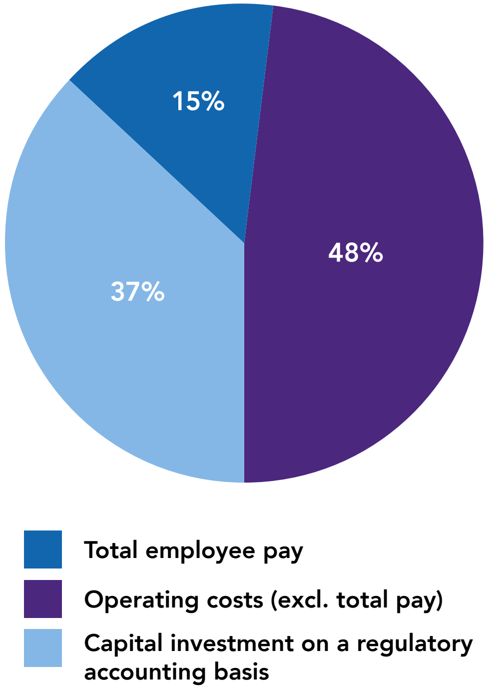
(1) The total excludes the calculation of change in pension as the value relies heavily on length of pensionable service and so has little meaning when comparing one person (the Chief Executive) against a group of employees with varying lengths of service, i.e. an individual with greater pensionable 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.

(2) For fair comparison, the figure for the Chief Executive in 2019/20 uses that from the single total figure table at 2(a), excluding pension as per the above note but including the value of waived AOIP in that year.

(3) Percentile earnings shown are for full time equivalent salary, AOIP and benefits of all employees with a full year of service, other than Executive Members.

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.



f. Implementation of Remuneration Policy in 2021/22

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 2021/22 the out-performance targets are as follows.

Strategic outcome	Measure	Description	Target	Weight
Great Value & Financial Sustainability	Tier 1 costs[1]	Tier 1 costs (operating, PFI and interest) relative to Delivery Plan[2] – i.e.: excluding responsive repair and refurbishment, developer contributions and tax	• Sliding scale • 50% on plan • 100% for £30m below plan	30%
	Capital programme momentum	PCL (progress of projects from the Development List to the Committed List)[3]	• Zero below target zone • 50% at bottom of target zone (100% of plan) • 100% at top of target zone (110% of plan)	10%
		Overall Progress of Investment Delivery (replacement for OMD)	• Zero > 3 months either side of plan • 50% +/- 3 months of plan • 75% +/- 2 months of plan • 100% +/- 1 month of plan	10%

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.

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

Samantha Barber
Chair of the Remuneration Committee

18 June 2021

Strategic outcome	Measure	Description	Target	Weight
Service Excellence	New Outcome Performance Assessment (OPA)	Broader metrics of our water and waste water services; target zone 395 – 410pts	• Zero below 395 points • 50% at 395 points • 100% at 410 points	15%
	Customer Experience Measures (CEM)	Household CEM (hCEM); target zone 85.0 – 87.78pts	• Zero below 85.0 points • 50% at 85.0 points • 100% at 87.78 points	7.5%
		Non-household CEM (nhCEM); target zone 85.4 – 88.66pts	• Zero below 85.4 points • 50% at 85.4 points • 100% at 88.66 points	7.5%
Net Zero	Operational emissions	Routemap delivered successfully and achieving emissions reductions	• Zero below 6,000 tCO_2e • 50% at 6,000 tCO_2e • 100% at 12,000 tCO_2e	20%

Notes:

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

(2) At year end we may need to present valid adjustments to plan costs once we have a clearer understanding of 2021-27 cost allocation between operating costs and responsive repair and refurbishment expenditure.

(3) As the PCL (Progress to the Committed List) capital programme measure is being used for the first time, the Board may need to adjust targets to drive the right outcomes and if so, would aim to do so within the first half of 2021/22.

MEMBERS' REPORT

The Members present the Members' report together with the audited consolidated financial statements for the year ended 31 March 2021.

The Government Financial Reporting Manual 2020/21 (FReM), published by HM Treasury, sets out the form and content for the Annual Report & Accounts 2020/21: 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 145 to 147 and the sections of this report incorporated by reference are as follows:

Corporate governance report	See pages 120 to 123
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 21 to 114
Going concern and viability statements	See pages 33 to 34
Greenhouse gas emissions	See pages 65 to 71
People	See pages 60 to 64
Accounting requirements and basis of account preparation	See Note 1.2, page 162
Financial risk management	See pages 191 to 194

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 138 of the Members' Remuneration Report.

Employee Relations and Involvement

The Scottish Water group of businesses employed an average of 4,393 (2020: 4,451) staff during the year. Details of the costs incurred in relation to these staff can be found in note 5 to the financial statements on page 171. 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 (2020: 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 (www.scottishwater.co.uk) following the approval of the Scottish Water Annual Report & Accounts 2020/21: Performance and Prospects. The report for this financial year will be available later in 2021.

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 149 to 157, 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 2020/21: 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 116 to 119, 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 EU and interpreted 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

29 June 2021

FINANCIALS

INDEPENDENT AUDITOR'S REPORT

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

Report 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 2021 under the Water Industry (Scotland) Act 2002. The financial statements comprise the Group and Company Balance Sheets, the Consolidated Income Statement, the Consolidated Statement 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 a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs), and as interpreted and adapted by the 2020/21 Government Financial Reporting Manual (the 2020/21 FReM).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers of the state of affairs of the body and its group as at 31 March 2021 and of the group surplus for the year then ended;
- have been properly prepared in accordance with IFRSs, as interpreted and adapted by the 2020/21 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 31 May 2016. The period of total uninterrupted appointment is five years. We are independent of the body and its group 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 body. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusion relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report and accounts, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report and accounts that describe the principal risks and explain how they are being managed or mitigated;
- the board members' confirmation in the annual report and accounts that they have carried out a robust assessment of the principal risks facing the body and its group, including those that would threaten its business model, future performance, solvency or liquidity;
- the board members' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements, and their identification of any material uncertainties to the ability of the body and its group to continue to do so over a period of at least twelve months from the date of the approval of the financial statements; and
- the board members' explanation in the annual report and accounts as to how they have assessed the prospects of the body and its group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the body and its group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We draw attention that we identified going concern as a key audit matter which is described in the next section of our report.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the audit team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

	The risk	Our Response
Capital additions (£433.2 million, 2020: £502.7 million) Refer to page 124 (Audit Committee Report), page 162 (accounting policy) and page 174 (note 9 to the financial statements) Risk of material misstatement v/s 2019-20 ⟷	*Accounting application* Capital additions related to the delivery plan for regulated activities for the period 2015-16 to 2020-21 are significant. Executive members are incentivised across a number of financial and other measures including profit and completion of capital investment programmes. There is judgement involved in the allocation of expenditure between capital and revenue which can affect profit and investment measures reported in the financial statements.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the allocation of costs between capital and revenue within the financial ledger at the project initiation stage and on an ongoing basis; and • Testing the design and operating effectiveness of controls over the appropriateness of reclassification from assets in the course of construction. • Testing the design and operating effectiveness of controls over the approval stages of a sample of projects. *Test of details* • Building on our work over control design we compared the reports of Scottish Water's capital project monitoring group at the year end to amounts recorded as capital additions; • In respect of a sample of capitalised additions, we evaluated the appropriateness of the classification as capital by considering the nature of the expenditure with reference to invoice, certificate or timesheets and considering the application of the relevant accounting policies; • We assessed a sample of items allocated to revenue expenditure and considered whether they were correctly classified by considering the application of the relevant accounting policies; and • We also reviewed material journals related to capital additions.

Overview
Strategic Report
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INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

	The risk	Our Response
Bad debt provision (£427.7 million, 2020: £408.8m million) Refer to page 124 (Audit Committee Report), page 162 (accounting policy) and page 191 (note 27 to the financial statements) Risk of material misstatement v/s 2019-20 ⟷	*Forecast-based valuation* There are a number of assumptions included in the calculation of the bad debt provision; the most sensitive of these is the overall forecast collection rate based on historical data. As at 31 March 2021, the Scottish Water regulated business reported a household revenue debtor of £483.0 million (2020: £450.2 million) and a corresponding bad debt provision of £427.7 million (2020: £408.8 million) on household billings from all years dating back to 1996-97. Household water debt is a statutory debt recoverable from the occupier. The household billing and cash collection is performed by local authorities and cannot be influenced by Scottish Water. As part of our risk assessment, we determined that the recoverability of household revenue debtors has a high degree of estimation uncertainty, in particular because of the potential effects of the COVID-19 pandemic.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the review and approval of the provision and associated assumptions by the Members during the year and at the year end; and • Testing the design and operating effectiveness of controls in respect of the reconciliation of information provided on a monthly basis by local authorities to Scottish Water in respect of amounts billed and collected. This historical information forms the basis of the forecast collection rate. Tests of detail • We compared the information on historical collection rates, recorded by Scottish Water as the basis for the current year provision calculation, to the records held in respect of prior years; and • We agreed the total amount billed and collected in respect of 2020/21 as recorded in Scottish Water's records, to confirmations received from individual local authorities. Historical comparison • We compared the change in forecast collection rate in the current year, to the historical trend of increasing collection rates since 1996-97. Sensitivity analysis • We performed sensitivity analysis and challenged management in respect of the forecast collection rate by increasing and decreasing it based on our judgement and assessing the impact on the provision. Assessing transparency • We assessed the disclosure of sensitivities by the Members, and description of the provision in note 27 of financial statements.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

	The risk	Our Response
Pension liability (£221.9 million (2020: £220.5 million) Refer to page 124 (Audit Committee Report), page 162 (accounting policy) and page 187 (note 23 to the financial statements) Risk of material misstatement v/s 2019-20 ⟷	*Subjective valuation* Small changes in the assumptions and estimates used to value the pension obligation (before deducting scheme assets) would have a significant effect on the net pension liability. Employees of Scottish Water participate in three local government defined benefit pension schemes; North East Scotland pension fund, the Lothian pension fund and the Strathclyde pension fund.	Our procedures included: *Control design* • Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation. Benchmarking assumptions • Challenging, with the support of our own actuarial specialists, the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy against externally derived data; and • Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as the regulatory delivery plan and our understanding of Scottish Government expectations. Assessing transparency • Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

Going concern Refer to page 124 (Audit Committee Report), page 162 (accounting policy). Risk of material misstatement v/s 2019-20 ↓	All entities are required to provide appropriate disclosures in the financial statements in regard to the going concern assumption. Under ISAs (UK), we are required to report to you if we have anything material to add or to draw attention to in relation to the Members' statement, set out in the Annual Report and Accounts about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. That judgement is based on an evaluation of the inherent risks to the group's and company's business model and how those risks might affect the group's and company's financial resources or ability to continue operations over a period of at least 12 months from the date of approval of these financial statements. The evaluation of going concern is based on forecast cash flows which have a greater level of estimation risk because of the impact of the COVID-19 pandemic.	We considered whether risks in relation to going concern could plausibly affect the liquidity in the going concern period by assessing the directors' sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of severe, but plausible, adverse effects that could arise from these risks individually and collectively. Our procedures included: *Funding assessment* • We have considered the availability of existing funding from the Scottish Government, including reviewing the repayment profile and the external financing limit set for the period 2020-21. Review of regulatory framework • Reviewing the forecasts prepared by Scottish Water and considering the associated economic assumptions against our commercial understanding. Retrospective review • We have considered the budget to actual results for the period from year end to the date of signing of these financial statements. Sensitivity analysis • We considered sensitivities of the key assumptions used in the cash flow forecasts and assessed their related impact on the financial resources and headroom available. Assessing transparency • We assessed the completeness and accuracy of the matters covered in the going concern disclosure through procedures performed above, along with our assessment of the viability statement.

INDEPENDENT AUDITOR'S REPORT CONTINUED

Key audit matters (Continued)

Change to key audit matters

Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £13.6 million, determined with reference to a benchmark of group total expenditure of which it represents 1%. We consider total expenditure to be the most appropriate benchmark as the most significant part of the Group is its regulated business which is a Scottish Government owned body where the level of expenditure is the most important measure.

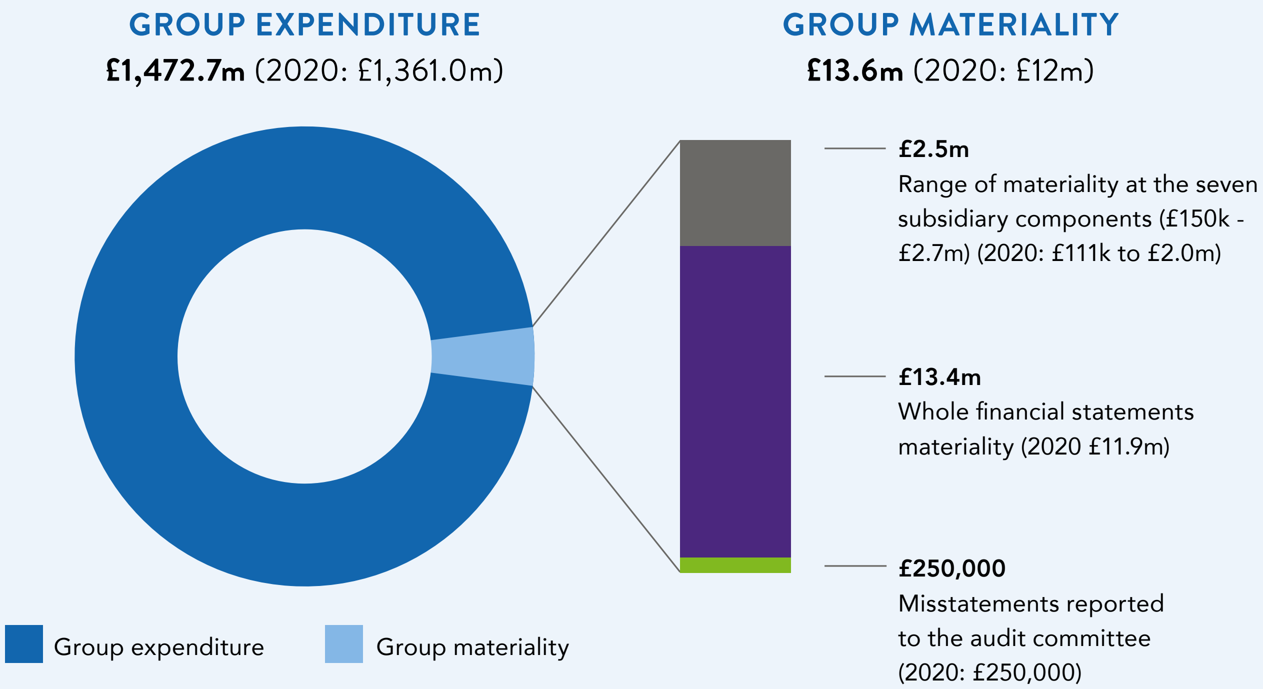
Materiality for the parent company financial statements as a whole was set at £13.4 million (2019: £11.9 million), determined with reference to total expenditure, of which it represents 1% (2020: 1%).

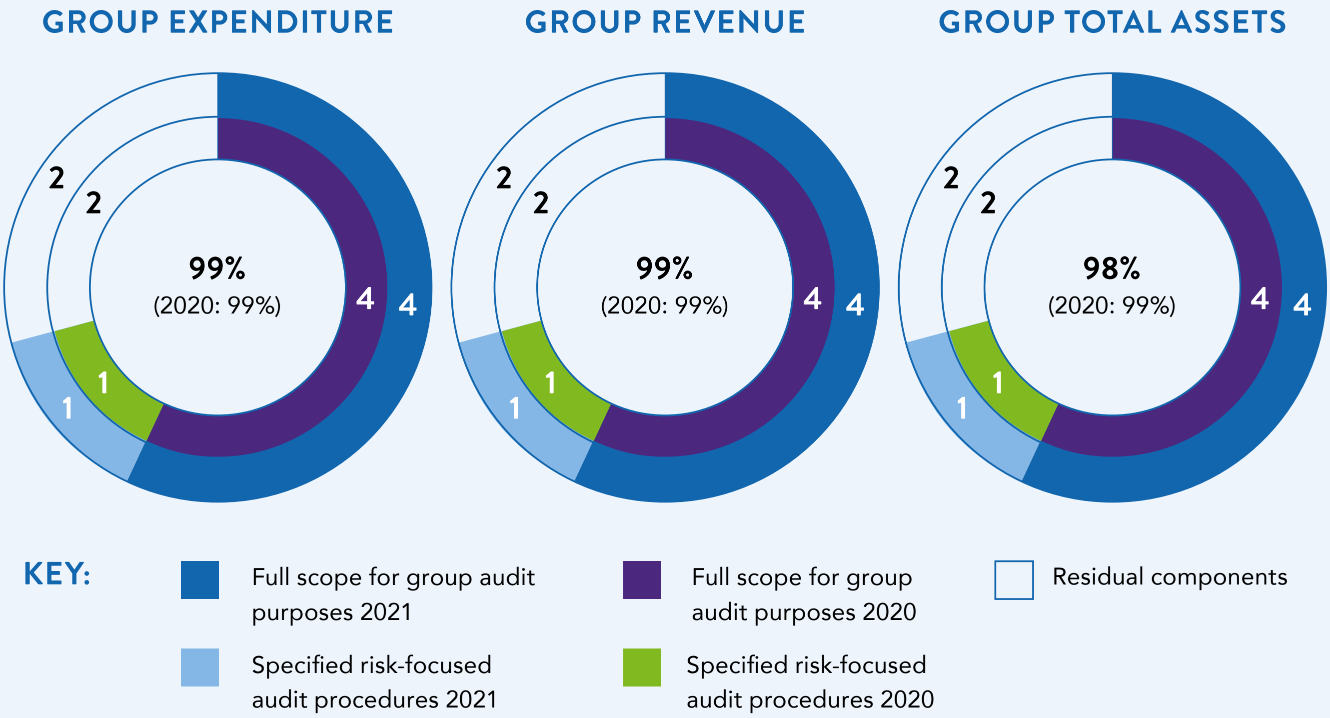
We reported to the Audit Committee all corrected or uncorrected identified misstatements exceeding £250,000. We did not identify any misstatements that warranted reporting on qualitative grounds.

Of the group's seven (2020: seven) reporting components, we subjected four (2020: four) to full scope audits for group purposes and one (2020: one) to specified risk-focused audit procedures over profit recognition. The latter was not individually financially significant enough to require a full scope audit for group purposes, but did present specific individual risks that needed to be addressed. Together these entities accounted for 99% of each of the Group's total revenue, total expenditure and total assets.

For the residual components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these. The work on all of the components, including the parent Company, was performed by the Group team. The component materialities ranged from £150k to £2.7 million, having regard to the mix of size and risk profile of the Group across the components.

INDEPENDENT AUDITOR'S REPORT CONTINUED





Responsibilities of the board members for the financial statements

As explained more fully in the Statement of Members' Responsibilities, the 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 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 is responsible for assessing the ability of the body and its group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

INDEPENDENT AUDITOR'S REPORT CONTINUED

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 economic 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:

- Obtaining an understanding of the applicable legal and regulatory framework and how the body is complying with that framework;
- Identifying which laws and regulations are significant in the context of the body
- Assessing the susceptibility of the financial statement 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 inherent difficulty in detecting irregularities, the effectiveness of the body'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 if 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.

Other information in the annual report and accounts

The board members are responsible for the other information in the annual report and accounts. The other information comprises the information other than the financial statements, the audited part of the Members' Remuneration Report, and our auditor's report thereon. 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 matters prescribed by the Auditor General for Scotland to the extent explicitly stated later in this report.

In connection with our audit of the financial statements, our responsibility is to read all the other information in the annual report and accounts and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in 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 there is a material misstatement in the financial statements or a material misstatement of the other information. 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.

In this context, we also have a responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- The statement given by the board members that they consider that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for stakeholders to assess the position and performance, business model and strategy of the body and its group is materially inconsistent with our knowledge obtained in the audit; or

INDEPENDENT AUDITOR'S REPORT CONTINUED

- The Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of the above responsibilities.

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. 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

Opinions on matters prescribed by the Auditor General for Scotland

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

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

- the information given in the Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Governance Statement 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 directions made under the Water Industry (Scotland) Act 2002 by the Scottish Ministers.

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 120 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.

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

9 July 2021

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 MARCH 2021

	Note	2021 £m	2020 £m
Revenue	3	**1,667.2**	**1,615.9**
Cost of sales		(1,273.7)	(1,185.2)
Gross surplus		**393.5**	**430.7**
Administrative expenses		(194.5)	(175.8)
Operating surplus	3,4	**199.0**	**254.9**
Finance income	7	0.4	2.6
Finance costs	7	(165.4)	(171.8)
Surplus before taxation		**34.0**	**85.7**
Taxation	8	(7.9)	(65.1)
Surplus for the year	21	**26.1**	**20.6**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 2021

	Note	2021 £m	2020 £m
Surplus for the year	21	26.1	20.6
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	23	23.0	49.7
Effective portion of changes in fair value of cash flow hedge, net of deferred taxation		1.8	1.2
Total comprehensive income for the year		50.9	71.5

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Cash flow hedging reserves £m	Retained earnings £m	Other reserves £m	Total £m
Balance at 1 April 2019		(8.5)	1,543.7	133.4	1,668.6
Surplus for the year	21	–	20.6	–	20.6
Other comprehensive gain:					
Actuarial gain on post employment benefit obligations, net of tax	23	–	49.7	–	49.7
Effective portion of changes in fair value of cash flow hedge, net of tax	27	1.2	–	–	1.2
Total comprehensive income for the year		1.2	70.3	–	71.5
Balance at 31 March 2020		**(7.3)**	**1,614.0**	**133.4**	**1,740.1**
Surplus for the year	21	–	26.1	–	26.1
Other comprehensive gain:					
Actuarial gain on post employment benefit obligations, net of tax	23	–	23.0	–	23.0
Effective portion of changes in fair value of cash flow hedge, net of tax	27	1.8	–	–	1.8
Total comprehensive income for the year		1.8	49.1	–	50.9
Balance at 31 March 2021		**(5.5)**	**1,663.1**	**133.4**	**1,791.0**

COMPANY STATEMENT OF CHANGES IN EQUITY

	Note	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2019		1,371.7	133.4	1,505.1
Surplus for the year	21	31.1	–	31.1
Other comprehensive gain:				
Actuarial gain on post employment benefit obligations, net of tax	23	47.0	–	47.0
Total comprehensive income for the year		78.1	–	78.1
Balance at 31 March 2020		**1,449.8**	**133.4**	**1,583.2**
Surplus for the year	21	35.8	–	35.8
Other comprehensive gain:				
Actuarial gain on post employment benefit obligations, net of tax	23	30.0	–	30.0
Total comprehensive income for the year		65.8	–	65.8
Balance at 31 March 2021	21	**1,515.6**	**133.4**	**1,649.0**

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.

BALANCE SHEETS
AS AT 31 MARCH 2021

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Assets					
Non-current assets					
Property, plant and equipment	9	6,568.4	6,430.2	6,524.7	6,395.0
Intangible assets	10	11.6	14.0	–	–
Investments	11	–	–	37.6	37.6
Deferred tax asset	16	5.8	3.6	–	–
		6,585.8	6,447.8	6,562.3	6,432.6
Current assets					
Inventories	12	3.9	3.9	3.5	3.3
Trade and other receivables	13	239.6	246.8	107.6	98.9
Current tax asset		4.4	3.2	3.1	1.0
Cash and cash equivalents	14	570.4	531.6	428.7	391.4
		818.3	785.5	542.9	494.6
Total assets	3	**7,404.1**	**7,233.3**	**7,105.2**	**6,927.2**
Liabilities					
Current liabilities					
Trade and other payables	15	(445.4)	(532.6)	(322.8)	(399.9)
Other loans and borrowings	18	(24.9)	(24.6)	(23.3)	(23.1)
Provisions for liabilities	17	(9.0)	(12.9)	(11.6)	(16.4)
		(479.3)	(570.1)	(357.7)	(439.4)
Non-current liabilities					
Trade and other payables	15	(87.0)	(77.5)	(61.3)	(61.1)
Other loans and borrowings	18	(228.0)	(252.8)	(233.3)	(256.6)
Deferred tax liabilities	16	(441.3)	(432.7)	(436.2)	(426.2)
Retirement benefit obligations	23	(221.9)	(220.5)	(209.1)	(217.1)
Provisions for liabilities	17	(7.2)	(11.2)	(10.2)	(15.2)
		(985.4)	(994.7)	(950.1)	(976.2)
Total liabilities		**(1,464.7)**	**(1,564.8)**	**(1,307.8)**	**(1,415.6)**
Net assets		**5,939.4**	**5,668.5**	**5,797.4**	**5,511.6**
Equity					
Government loans	19	4,148.4	3,928.4	4,148.4	3,928.4
Retained earnings	21	1,663.1	1,614.0	1,515.6	1,449.8
Cash flow hedge reserve	27	(5.5)	(7.3)	–	–
Other reserves		133.4	133.4	133.4	133.4
		5,939.4	**5,668.5**	**5,797.4**	**5,511.6**

The financial statements on pages 158 to 194 were approved by the Board of Members on 29 June 2021 and signed on its behalf by:

Douglas Millican
Chief Executive

STATEMENTS OF CASH FLOW
FOR THE YEAR ENDED 31 MARCH 2021

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Surplus before taxation		34.0	85.7	47.1	97.2
Depreciation charges	9	308.8	297.0	303.3	292.2
Amortisation of intangible asset	10	2.4	2.0	–	–
Amortisation of grants		(1.4)	(1.2)	(1.2)	(1.0)
Surplus on disposal of property, plant and equipment		(2.2)	(0.9)	(2.3)	(1.2)
Non cash adjustment for retirement benefit obligations		24.7	26.1	24.0	24.7
Finance costs - net		165.0	169.2	165.1	170.5
Operating cash flow before changes in working capital and provisions		**531.3**	**577.9**	**536.0**	**582.4**
Changes in working capital and provisions:					
Decrease / (increase) in receivables		8.1	(42.6)	(7.9)	(20.9)
Increase in inventories		–	(0.2)	(0.2)	(0.4)
Decrease / (increase) in payables		(60.1)	56.0	(58.3)	(1.5)
Decrease in provisions		(9.5)	(2.8)	(11.5)	(3.9)
Cash flows from operating activities		**469.8**	**588.3**	**458.1**	**555.7**
Taxation paid		(8.4)	(11.4)	(9.6)	(10.8)
Net cash generated from operating activities		461.4	576.9	448.5	544.9
Cash flows from investing activities					
Purchase of property, plant and equipment		(484.0)	(525.4)	(470.7)	(515.2)
Sale of property, plant and equipment		2.4	1.4	2.5	1.4
Purchase of intangible asset	10	–	(6.0)	–	–
Government grant income received		7.1	0.6	3.7	–
Infrastructure income receipts		16.8	17.7	16.8	17.7
Net cash used in investing activities		(457.7)	(511.7)	(447.7)	(496.1)
Cash flows from financing activities					
Repayments of loans		(139.4)	(129.3)	(134.8)	(125.0)
Proceeds from borrowings		354.3	344.3	354.3	344.3
Interest received		0.4	2.7	0.2	2.0
Interest paid		(160.7)	(166.1)	(160.6)	(166.7)
Payment of finance lease liabilities		(19.5)	(20.0)	(22.6)	(22.9)
Net cash generated from financing activities		35.1	31.6	36.5	31.7
Net increase in cash and cash equivalents		**38.8**	**96.8**	**37.3**	**80.5**
Cash and cash equivalents at beginning of year	14	531.6	434.8	391.4	310.9
Cash and cash equivalents at end of year	14	**570.4**	**531.6**	**428.7**	**391.4**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2021

1. Accounting policies

1.1 General information

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

The 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 2021 have been prepared in accordance with EU adopted and endorsed International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations, as interpreted 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 profit and loss. 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 and, as permitted by Section 408 of the Companies Act 2006, no income statement or statement of comprehensive income is presented for the Company.

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 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 of the Covid-19 pandemic. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme. They also consider the risks associated with the Covid-19 pandemic including the impacts in relation to reduced cash collection levels (up to a maximum of 2%) and the reduction of water consumption by business customers (up to a of 20%) over the period of review. Under all of the scenarios, Scottish Water will be able to operate within its available facilities and is well placed to withstand the challenges presented by the Covid-19 pandemic.

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

1.3 Changes in accounting policy

There were no new standards, amendments or interpretations that were effective for the first time during the year that had a material impact on Scottish Water. The amendments to standards which were adopted by Scottish Water with effect from 1 April 2019 were:

– Annual improvements to IFRSs 2015 - 2017 Cycle; and

– Amendments to the Conceptual Framework, IAS 19 ‘Employee benefits’

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

1. Accounting policies (continued)

1.4 Accounting standards not yet adopted by Scottish Water

As at the date of authorisation of these financial statements, Annual improvements to IFRSs 2018-2020 Cycle had been issued but was not yet effective and consequently has not been applied by Scottish Water in the preparation of the financial statements.

IFRS 16 Leases came into effect for financial periods beginning on or after 1 January 2019 for the subsidiary companies. However, the implementation for public sector was deferred by the Financial Reporting Advisory Board (FRAB) on the 19 March 2020 to 1 April 2021. Early adoption was not an option for Scottish Water as the relevant criteria, based on the size of relevant subsidiary companies, were not met. IFRS 16 is not expected to have a material impact on the results and net assets of Scottish Water.

In December 2020 the Financial Reporting Council issued an amendment to FRS 102 in relation to interest rate benchmark reform. The proposed amendments impact on our subsidiary, Aberdeen Environmental Services Limited (note 11) and relate to the London Interbank Offered Rate (LIBOR) used in the valuation of the interest rate swap (note 27). The amendment is effective for periods beginning on or after the 1 January 2021.

1.5 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.

1.6 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.

1.7 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.

1.8 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

1. Accounting policies (continued)

1.9 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.

1.10 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.

1.11 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 part is 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

1. Accounting policies (continued)

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 date of 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	20 to 80 years
Plant, machinery and vehicles	1 to 20 years

1.12 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.

1.13 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.

1.14 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.

1.15 Intangible assets

Intangible assets represent the acquisition of a non-household customer base, 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 life is currently set at 8 years.

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

1.16 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.

1.17 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

1. Accounting policies (continued)

1.18 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 2009.

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.

1.19 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 in full 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

1. Accounting policies (continued)

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.

1.20 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.

1.21 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.

1.22 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 2009.

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. 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 27).

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 88). Therefore the estimates and assumptions made in determining the carrying values and related depreciation are critical to Scottish Water's financial performance and position.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

2. Accounting estimates and judgements (continued)

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.

The determination of whether expenditure is enhancement or maintenance also requires judgement. Expenditure that replaces or significantly refurbishes an existing asset, enhances or increases the capacity of the network is capitalised while those classed as repair or maintenance are expensed in the period they are incurred. There are controls in place to ensure that the classification is appropriate and in line with the applicable accounting standards.

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 23) 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

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.

	2021 £m	2020 £m
Revenue		
Scottish Water regulated water and waste water services	1,266.2	1,254.4
Business Stream	574.4	477.7
Scottish Water non-regulated activities	49.8	49.1
	1,890.4	1,781.2
Intercompany elimination	(223.2)	(165.3)
	1,667.2	**1,615.9**

	2021 £m	2020 £m
Operating surplus		
Scottish Water regulated water and waste water services	212.2	267.5
Business Stream	(16.7)	(14.0)
Scottish Water non-regulated activities	7.1	5.0
Reversal of IFRIC 12 adjustments on consolidation	(3.6)	(3.6)
	199.0	**254.9**

	2021 £m	2020 £m
Total assets		
Scottish Water regulated water and waste water services	7,064.2	6,880.1
Business Stream	246.3	262.9
Scottish Water non-regulated activities	123.2	122.1
Reversal of IFRIC 12 adjustments on consolidation	(29.6)	(31.8)
	7,404.1	**7,233.3**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

3. Segmental analysis (continued)

	Capital additions to property, plant & equipment		Depreciation on property, plant & equipment	
	2021 £m	2020 £m	2021 £m	2020 £m
Scottish Water regulated water and waste water services	433.2	502.7	303.3	292.2
Business Stream	6.2	2.8	1.9	1.7
Scottish Water non-regulated activities	7.8	7.5	3.6	3.1
	447.2	**513.0**	**308.8**	**297.0**

Revenue by geographical location of customers is as follows:

	Revenue	
	2021 £m	2020 £m
United Kingdom	1,666.9	1,615.3
Rest of the World	0.3	0.6
	1,667.2	**1,615.9**

£0.3 million of revenue has been generated outside the UK (2020: £0.6 million) and this resulted in a current tax charge of £nil (2020: £nil). The revenue was derived from Australia (£0.2 million) and Ireland (£0.1 million) where we have tax residencies and registered branches. There are no offices in Australia or Ireland and only one member of staff in Australia.

The Covid-19 pandemic has had a significant adverse impact across the Scottish Water group of companies during the 2020/21 financial year. A summary of this is provided below.

Operating surplus is arrived at after charging/(crediting):

	Scottish Water £m	Business Stream £m	Other £m	Elimination £m	Total £m
Group	30.0	72.7	4.4	(13.0)	94.1
Net increase/(reduction) in cost of sales and administration expenses	5.2	(67.8)	(2.7)	13.0	(52.3)
Increase in the provision for bad and doubtful debts	8.0	16.6	–	–	24.6
Net impact on operating costs	13.2	(51.2)	(2.7)	13.0	(27.7)
Impact on operating surplus	**43.2**	**21.5**	**1.7**	**–**	**66.4**

The estimated impact of the pandemic on the operating surplus to 31 March 2021 is £66.4 million, being an estimated £94.1 million reduction in revenue partially offset by a net reduction of £27.7 million in operating costs. The estimated reduction in revenue reflects lower actual and anticipated consumption by business customers because of them stopping or reducing trading. The £27.7 million reduction in operating costs reflects lower cost of sales of £67.8 million, cost increases of £15.5 million, mainly for additional personal protective equipment and cleaning costs, and additional charges of £24.6 million for the provision of bad and doubtful debt.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

4. Operating surplus

Operating surplus is arrived at after charging/(crediting):

	Note	2021 £m	2020 £m
Scottish Water PFI operating costs		131.3	126.0
Depreciation of property, plant and equipment	9	308.8	297.0
Amortisation of intangible asset	10	2.4	2.0
Surplus on sale of property, plant and equipment		(2.2)	(0.9)
Release of deferred income in relation to capital grants		(1.4)	(1.2)
Operating lease rentals		3.2	3.8
Auditor's remuneration			
audit fee for audit of the company and consolidated financial statements (including £136,000 (2020: £116,000) in respect of the audit of subsidiary companies)		0.3	0.3
other services		–	–
Research and development expenditure		0.6	0.6

5. Staff costs

	Note	2021 £m	2020 £m
Wages and salaries		168.7	162.8
Social security costs		18.2	17.5
IAS 19 total service costs	23	62.7	63.0
Other pension costs		0.4	0.4
Employee benefit expense		250.0	243.7
Less: charged as capital expenditure		(88.8)	(92.6)
		161.2	**151.1**

The average monthly number of people (including Executive and Non-executive Members) employed by Scottish Water, split by activity, during the year was:

	2021	2020
Regulated water and waste water services	3,928	3,954
Business Stream	351	378
Scottish Water non-regulated activities	114	119
	4,393	**4,451**

6. Members' remuneration

Information concerning Members' remuneration, incentive schemes and pensions is detailed in the Remuneration Report on pages 131 to 144.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

7. Finance income and costs

	Note	2021 £m	2020 £m
Interest income:			
Short-term deposits		0.4	2.6
Finance income		**0.4**	**2.6**
Interest expense:			
Government loans		(142.1)	(145.6)
Other loans		(3.6)	(4.8)
Finance lease liabilities		(13.8)	(15.0)
Interest on pension scheme net liabilities	23	(5.9)	(6.4)
Finance costs		**(165.4)**	**(171.8)**
Net finance costs		**(165.0)**	**(169.2)**

8. Taxation

	Note	2021 £m	2020 £m
Analysis of tax charge recognised in the income statement			
Current tax: UK corporation tax		6.5	8.8
Current tax: Adjustment in respect of prior years		0.8	2.1
		7.3	10.9
Deferred Tax: origination and reversal of timing differences - current year		1.2	10.2
Deferred Tax: origination and reversal of timing differences - prior years		(0.6)	(1.1)
Remeasurement of deferred tax - change in UK corporation tax rate		–	45.1
	16	0.6	54.2
Total tax charge		**7.9**	**65.1**
The charge for the year can be reconciled to the surplus per the income statement as follows:			
Group surplus before tax		34.0	85.7
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2020: 19%)		6.5	16.3
Adjustment in respect of prior years		0.2	1.0
Re-measurement of deferred tax due to change in UK corporation tax rate		–	45.1
Accounting gain with no capital gain		(0.5)	(0.2)
Depreciation on non qualifying additions		2.5	2.2
Other permanent differences		0.8	0.7
Deferred tax not provided		(1.7)	–
Other timing differences		0.1	–
Total tax charge for the year		**7.9**	**65.1**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

8. Taxation (continued)

The UK Budget 2021 announcements on 3 March 2021 included measures to support economic recovery as a result of the ongoing Covid-19 pandemic. These included an increase to the UK's main corporation tax rate to 25%, which is due to be effective from 1 April 2023. These changes were not substantively enacted at the balance sheet date and hence have not been reflected in the measurement of deferred tax balances at the period end. If the group's deferred tax balances at the period end were remeasured at 25% this would result in an increase to the net UK deferred tax liability of £137.5m.

	2021 £m	2020 £m
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	34.0	85.7
Tax on surplus on ordinary activities at standard UK corporation tax rate of 19% (2019: 19%)	6.5	16.3
Relief for capital allowances in excess of depreciation	(4.4)	(7.8)
Financial transactions timing differences	6.6	7.0
Utilisation of tax losses	(5.5)	(9.6)
Expenses not deductible for tax purposes	0.8	0.7
Depreciation on non qualifying additions	2.5	2.2
Adjustment in respect of prior years	0.8	2.1
Current tax charge for the year	**7.3**	**10.9**

The Group's current tax charge is higher than the UK headline rate of 19% primarily due to the adjustment in respect of the prior year. Tax relief is available in relation to qualifying items of capital expenditure instead of accounting depreciation to encourage such investment. On a regulatory basis, in 2019/20, Scottish Water invested £612 million 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 total capital investment on a regulatory basis in this regulatory period to the end of 2020/21 is £3.7 billion.

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 adjustments where there is a simple timing difference between recognition of the income or expense 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.

For all of the timing differences, the corresponding deferred tax movements are at 19% as this is the rate of corporation tax that has been enacted as at the balance sheet date.

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Tax charge/(credit) recognised directly in reserves					
Deferred tax relating to:					
Pension scheme actuarial movements	23	5.4	8.5	7.0	8.1
Movements in cash flow hedge	27	0.4	0.1	-	-
Total	16	**5.8**	**8.6**	**7.0**	**8.1**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

9. Property, plant and equipment

	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
Group						
Cost						
At 1 April 2019	3,176.6	84.1	2,557.7	2,818.4	975.4	9,612.2
Additions	0.9	–	–	5.3	506.8	513.0
Disposals*	(0.8)	–	–	(137.4)	–	(138.2)
Reclassifications	114.6	1.1	177.2	224.4	(517.3)	–
At 31 March 2020	3,291.3	85.2	2,734.9	2,910.7	964.9	9,987.0
Additions	0.1	–	–	2.9	444.2	447.2
Disposals*	(5.9)	–	–	(62.3)	–	(68.2)
Reclassifications	98.2	11.6	89.0	265.9	(464.7)	–
At 31 March 2021	3,383.7	96.8	2,823.9	3,117.2	944.4	10,366.0
Accumulated depreciation						
At 1 April 2019	1,164.7	27.8	540.5	1,664.5	–	3,397.5
Charge for the year	68.4	2.6	19.4	206.1	–	297.0
Disposals*	(0.4)	–	–	(137.3)	–	(137.7)
At 31 March 2020	1,233.3	30.3	559.9	1,733.3	–	3,556.8
Charge for the year	69.4	2.8	20.8	215.8	–	308.8
Disposals*	(5.8)	–	–	(62.2)	–	(68.0)
At 31 March 2021	1,296.9	33.1	580.7	1,886.9	–	3,797.6
Net book value						
At 31 March 2021	**2,086.8**	**63.7**	**2,243.2**	**1,230.3**	**944.4**	**6,568.4**
At 31 March 2020	2,058.0	54.9	2,175.0	1,177.4	964.9	6,430.2

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 £7.1 million (2020: £0.6 million). Capital grants of £5.0 million were received during the year in respect of infrastructure assets.

*Disposals include the write down of redundant assets no longer in beneficial use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

9. Property, plant and equipment (continued)

	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 2019	3,172.1	84.1	2,557.7	2,754.0	972.3	9,540.2
Additions	0.9	–	–	–	501.8	502.7
Disposals*	(0.5)	–	–	(136.5)	–	(137.0)
Reclassifications	109.6	1.1	177.2	224.3	(512.2)	–
At 31 March 2020	3,282.1	85.2	2,734.9	2,841.8	961.9	9,905.9
Additions	0.1	–	–	–	433.1	433.2
Disposals*	(5.7)	–	–	(61.4)	–	(67.1)
Reclassifications	95.7	11.6	89.0	265.9	(462.2)	–
At 31 March 2021	3,372.2	96.8	2,823.9	3,046.3	932.8	10,272.0
Accumulated depreciation						
At 1 April 2019	1,163.3	27.8	540.5	1,623.9	–	3,355.5
Charge for the year	68.1	2.5	19.4	202.2	–	292.2
Disposals*	(0.3)	–	–	(136.5)	–	(136.8)
At 31 March 2020	1,231.1	30.3	559.9	1,689.6	–	3,510.9
Charge for the year	68.2	2.8	20.8	211.5	–	303.3
Disposals*	(5.6)	–	–	(61.3)	–	(66.9)
At 31 March 2021	1,293.7	33.1	580.7	1,839.8	–	3,747.3
Net book value						
At 31 March 2021	2,078.5	63.7	2,243.2	1,206.5	932.8	6,524.7
At 31 March 2020	2,051.0	54.9	2,175.0	1,152.2	961.9	6,395.0

*Disposals include the write down of redundant assets no longer in beneficial use.

Estimated Covid-19 impact on the investment programme

The Covid-19 pandemic has had a significant adverse impact across the Scottish Water group of companies during the 2020/21 financial year.

During the year to 31 March 2021, additions to property, plant and equipment for the Scottish Water group of companies totalled £447.2 million (2020: £513.0 million). The reduction was mainly because of the suspension of significant activities as a result of the Covid-19 restrictions. The investment figure includes estimated Covid-19 related costs of £11.2 million which are associated with closing and making safe capital works.

Additional productivity related costs, because of the new ways of working, will also be borne within the investment programme. In the year to 31 March 2021, these costs totalled £35.4 million. These productivity related costs are projected to be an ongoing additional cost element within the investment programme for the foreseeable future.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(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 Total £m	Company Total £m
Cost		
At 31 March 2019, 2020 and 2021	492.7	568.8
Accumulated depreciation		
At 1 April 2019	258.2	300.3
Charge for the year	13.1	15.3
At 31 March 2020	271.3	315.6
Charge for the year	13.1	15.3
At 31 March 2021	284.4	330.9
Net book value		
At 31 March 2021	**208.3**	**237.9**
At 31 March 2020	221.4	253.2

10. Intangible asset

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

	As at 1 April 2020 £m	Additions £m	Amortisation charge £m	As at 31 March 2021 £m
Acquisition cost	22.7	–	–	22.7
Amortisation total	(8.7)	–	(2.4)	(11.1)
Net book value	**14.0**	**–**	**(2.4)**	**11.6**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

11. Investments

	Company	
	2021 £m	2020 £m
Cost and net book value		
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	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
Scottish Water Solutions 2 Limited	Scotland	100.0	Non trading
Aberdeen Environmental Services Limited[3]	Scotland	100.0	PFI concession operator
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	Holding Company
Aberdeen Holdco Limited[1]	England & Wales	100.0	Holding Company

[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 2021. 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 2021 **(CONTINUED)**

11. Investments (continued)

Group

In March 2021, Scottish Water Business Stream Holdings Limited (SWBSH) increased its investment in Scottish Water Business Stream Limited by £10 million.

12. Inventories

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Raw materials and consumables	4.0	4.1	3.6	3.5
Less provision held	(0.1)	(0.2)	(0.1)	(0.2)
	3.9	**3.9**	**3.5**	**3.3**

All inventories will be recovered within 12 months.

During the year to March 2021, inventories recognised within cost of sales were £1.8 million (2020: £1.8 million)

13. Trade and other receivables

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Trade receivables	27	644.8	594.4	494.9	463.4
Less provision for impairment of trade receivables	27	(491.1)	(452.3)	(430.7)	(411.8)
Net trade receivables		153.7	142.1	64.2	51.6
Other receivables		31.0	29.7	28.2	26.1
Prepayments and accrued income		54.9	75.0	12.9	12.2
Amounts due from subsidiaries		–	–	2.3	9.0
		239.6	**246.8**	**107.6**	**98.9**
The following table shows the development of the provision for impairment of trade receivables:					
Balance at 1 April		452.3	425.9	411.8	402.0
Charge for the year		48.3	36.3	26.0	17.0
Amounts written down during the year		(9.5)	(9.9)	(7.1)	(7.2)
Balance at 31 March		**491.1**	**452.3**	**430.7**	**411.8**

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

Estimated Covid-19 impact on trade receivables / provision for impairment of trade receivables

The group and company provisions for impairment of trade receivables reflect the increased levels of uncertainty as a consequence of the Covid-19 pandemic. The additional provision in the year has been estimated at £24.6 million, £8.0 million of which is the estimated impact of the Covid-19 pandemic on household cash collections in the company. The balance of £16.6 million is the estimated impact of the Covid-19 pandemic on Business Stream's trade receivables.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

14. Cash and cash equivalents

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Cash at bank and in hand	170.6	256.8	28.9	116.6
Short-term bank deposits	399.8	274.8	399.8	274.8
Cash and cash equivalents per the statement of cash flows	**570.4**	**531.6**	**428.7**	**391.4**

The fair values of cash and cash equivalents are not different from those disclosed above.

In Business Stream, during January 2021, letters of credit to the value of £12.7 million (2020: £11.9 million) were renewed in relation to ongoing wholesale prepayments made to English wholesalers.

Estimated Covid-19 impact on cash balances

The consolidated cash balance as at 31 March 2021 was £570.4 million (2020: £531.6 million) and reflects the Covid-19 related issues as highlighted in notes 3 and 9 above, and in particular the lower level of capital investment. The reduced demand for cash was partly offset by the Covid-19 measures introduced by the Water Industry Commission for Scotland to support business customers. This included deferral of prepaid charges by Licensed Providers to Scottish Water which resulted in an estimated net £24 million reduction in group cash. Further demands on cash were caused by the slower rate of cash collections from household customers and the fast-track payment of supplier invoices to support Scottish Water's supply chain during the pandemic.

15. Trade and other payables

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Current					
Trade payables		60.7	73.6	19.1	24.1
Non trade payables and accruals		106.5	124.6	105.3	124.1
Accruals		192.8	207.5	155.6	153.1
Payments received in advance		48.9	91.5	34.1	57.7
Other payables		26.6	25.5	0.9	0.8
Deferred income		5.4	5.6	1.1	1.5
Other taxes and social security		4.5	4.3	4.1	3.9
Amounts due to subsidiaries		–	–	2.6	34.7
		445.4	**532.6**	**322.8**	**399.9**
Non-current					
Payments received in advance		58.8	51.6	50.1	51.6
Deferred income		21.4	16.9	11.2	9.5
Other financial liabilities - interest rate swap	27	6.8	9.0	–	–
		87.0	**77.5**	**61.3**	**61.1**

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 2021 **(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 2019		439.4	(42.2)	(19.4)	(11.5)	366.3
Charge/(credit) to income statement	8	56.1	(8.2)	7.0	(0.7)	54.2
(Credit)/charge to reserves	8	–	8.5	–	0.1	8.6
At 31 March 2020		495.5	(41.9)	(12.4)	(12.1)	429.1
Charge/(credit) to income statement	8	2.7	(5.6)	6.4	(2.9)	0.6
Charge to reserves	8	–	5.4	–	0.4	5.8
At 31 March 2021		**498.2**	**(42.1)**	**(6.0)**	**(14.6)**	**435.5**
Company						
At 1 April 2019		435.8	(41.3)	(19.2)	(11.1)	364.2
Charge/(credit) to income statement		56.1	(7.9)	8.9	(3.2)	53.9
Credit to reserves	8	–	8.1	–	–	8.1
At 31 March 2020		491.9	(41.1)	(10.3)	(14.3)	426.2
Charge/(credit) to income statement		3.1	(5.6)	6.8	(1.3)	3.0
Charge to reserves	8	–	7.0	–	–	7.0
At 31 March 2021		**495.0**	**(39.7)**	**(3.5)**	**(15.6)**	**436.2**

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Deferred tax assets	(5.8)	(3.6)	–	–
Deferred tax liabilities	441.3	432.7	436.2	426.2
At 31 March	**435.5**	**429.1**	**436.2**	**426.2**

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 the Group 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 £107 million (2020: £117 million) for both the Company and the Group. No tax is expected to be payable in this regard.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

17. Provisions for liabilities

	Income uncertainty provision £m	Restructure and other provision £m	Total £m
Group			
At 1 April 2019	23.4	1.7	25.1
Charged to the income statement	2.3	0.2	2.5
Utilised during the year	(3.1)	(0.4)	(3.5)
At 31 March 2020	22.6	1.5	24.1
Charged to the income statement	(4.8)	(0.7)	(5.5)
Utilised during the year	(2.4)	–	(2.4)
At 31 March 2021	**15.4**	**0.8**	**16.2**
Company			
At 1 April 2019	32.0	1.7	33.7
Charged to the income statement	5.0	–	5.0
Utilised during the year	(6.7)	(0.4)	(7.1)
At 31 March 2020	30.3	1.3	31.6
Charged to the income statement	(4.7)	(1.0)	(5.7)
Utilised during the year	(4.1)	–	(4.1)
At 31 March 2020	**21.5**	**0.3**	**21.8**

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Analysis of total provisions				
Current	9.0	12.9	11.6	16.4
Non-current	7.2	11.2	10.2	15.2
	16.2	**24.1**	**21.8**	**31.6**

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 2021 and 2022.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

18. Other loans and borrowings

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Current				
Non-government loans	5.0	5.1	–	0.5
Obligations under finance leases	19.9	19.5	23.3	22.6
	24.9	**24.6**	**23.3**	**23.1**
Non current				
Non-government loans	30.9	35.8	–	–
Obligations under finance leases	197.1	217.0	233.3	256.6
	228.0	**252.8**	**233.3**	**256.6**
Total				
Non-government loans	35.9	40.9	–	0.5
Obligations under finance leases	217.0	236.5	256.6	279.2
	252.9	**277.4**	**256.6**	**279.7**

(i) Non-government loans

Other loans are repayable as follows:

	Note	Up to 1 year £m	1-2 years £m	3-5 years £m	6-10 years £m	Total £m
Other loans - SW subsidiaries	20	5.0	5.2	18.6	7.1	35.9
At 31 March 2021		**5.0**	**5.2**	**18.6**	**7.1**	**35.9**
At 31 March 2020		5.1	5.0	17.1	13.7	40.9

Non-government loans of £35.9 million represent amounts borrowed by a subsidiary under a facility agreement with a consortium of banks which bear interest at a margin over LIBOR and are repayable in instalments over the period ending 31 March 2027. These are secured by fixed and floating charges over the undertaking, property, assets and rights of that and over the parent company's shares in that subsidiary. These loans have certain covenants attached.

The carrying amounts and fair value of the non-government borrowings are as follows:

	Book value 2021 £m	Book value 2020 £m	Fair value 2021 £m	Fair value 2020 £m
Non-government loans	35.9	40.9	39.4	45.5

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

18. Other loans and borrowings (continued)

(ii) Finance lease liabilities - PFI liabilities

Group

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts payable:				
Within one year	32.7	33.4	19.9	19.5
Between one and 5 years	127.0	130.7	108.4	108.2
After 5 years	135.0	163.9	88.7	108.8
Present value of minimum lease payments including finance charges	294.7	328.0		
Less future finance charges	(77.7)	(91.5)		
Present value of minimum lease payments	217.0	236.5	217.0	236.5

Company

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts payable:				
Within one year	38.5	39.2	23.3	22.6
Between one and 5 years	150.0	153.8	128.7	127.3
After 5 years	157.8	192.4	104.6	129.3
Present value of minimum lease payments including finance charges	346.3	385.4		
Less future finance charges	(89.7)	(106.2)		
Present value of minimum lease payments	256.6	279.2	256.6	279.2

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 19th 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

18. Other loans and borrowings (continued)

Characteristics of the arrangements

Description

The length of these contracts varies between 25 and 40 years with expiry dates ranging from December 2021 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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

19. Government loans

	Group and Company	
	2021 £m	2020 £m
Government loans	4,148.4	3,928.4

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 2009. 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	71.2	85.0	225.6	297.5	2,917.8	3,597.1
National Loans Fund	50.0	32.0	201.4	174.0	73.5	530.9
Public Works Loan Board	3.5	5.5	6.1	3.4	1.9	20.4
At 31 March 2021	**124.7**	**122.5**	**433.1**	**474.9**	**2,993.2**	**4,148.4**
At 31 March 2020	134.3	124.7	428.2	506.7	2,734.5	3,928.4

b. Fair values

The carrying amounts and fair value of the Government borrowings are as follows:

	Book value		Fair value	
	2021 £m	2020 £m	2021 £m	2020 £m
Scottish Consolidated Fund	3,597.1	3,340.4	4,810.7	5,259.8
National Loans Fund	530.9	563.9	694.8	772.8
Public Works Loan Board	20.4	24.1	26.9	32.7
	4,148.4	3,928.4	5,532.4	6,065.3

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

20. Analysis of net debt

	Note	As at 1 April 2020 £m	Increase in cash £m	Movement in debt £m	As at 31 March 2021 £m
Group					
Cash and cash equivalents	14	531.6	38.8	–	570.4
Government loans	19	(3,928.4)	–	(220.0)	(4,148.4)
Other loans	18	(40.9)	–	5.0	(35.9)
Net debt		**(3,437.7)**	**38.8**	**(215.0)**	**(3,613.9)**
Company					
Cash and cash equivalents	14	391.4	37.3	–	428.7
Government loans	19	(3,928.4)	–	(220.0)	(4,148.4)
Other loans	18	(0.5)	–	0.5	–
Net debt		**(3,537.5)**	**37.3**	**(219.5)**	**(3,719.7)**

21. Retained earnings reserve

	Note	Retained earnings excluding actuarial gains £m	Actuarial gains/ (losses) on pension obligations £m	Retained earnings including actuarial gains/(losses) £m
Group				
At 1 April 2019		1,702.5	(158.8)	1,543.7
Retained surplus for the year		20.6	–	20.6
Actuarial gain net of deferred taxation	23	–	49.7	49.7
At 31 March 2020		**1,723.1**	**(109.1)**	**1,614.0**
Retained surplus for the year		26.1	–	26.1
Actuarial gain net of deferred taxation	23	–	23.0	23.0
At 31 March 2021		**1,749.2**	**(86.1)**	**1,663.1**
Company				
At 1 April 2019		1,527.5	(155.8)	1,371.7
Retained surplus for the year		31.1	–	31.1
Actuarial gain net of deferred taxation	23	–	47.0	47.0
At 31 March 2020		**1,558.6**	**(108.8)**	**1,449.8**
Retained surplus for the year		35.8	–	35.8
Actuarial gain net of deferred taxation	23	–	30.0	30.0
At 31 March 2021		**1,594.4**	**(78.8)**	**1,515.6**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

22. Results of Scottish Water (the Company)

Of the results for the financial year, a retained surplus of £35.8 million (2020: £31.1 million) is dealt with in the consolidated financial statements of Scottish Water. The Members have taken advantage of the exemption available under section 408 of the Companies Act 2006 and do not present an income statement or a statement of comprehensive income for Scottish Water alone.

23. 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 18.5% (2020: 18.5%), 31.8% (2020: 31.8%) and 19.3% (2020: 19.3%) respectively.

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 2021 by a qualified independent actuary, to take account of the requirements of IAS 19.

The major assumptions used by the actuaries were:

	2021 %	2020 %
Rate of increase in pensionable salaries	2.85	1.90
Rate of increase in pensions payment	2.85	1.90
Discount rate	1.95	2.30
CPI inflation rate	2.85	1.90

Longevity assumptions on retiring at age 65 adopted for each fund:

	North East Scotland Years	Lothian Years	Strathclyde Years
Retiring at 31 March 2021			
Male	21.4	20.5	19.9
Female	24.1	23.3	22.6
Retiring at 31 March 2041			
Male	23.0	22.0	21.3
Female	26.2	25.2	24.7

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

23. Pensions (continued)

Guaranteed Minimum Pension (GMP) equalisation

In considering the potential impact of gender indexation of guaranteed minimum pensions (GMP), actuarial advice has been sought. In the case of the North East Scotland Pension Fund (NESPF), the Lothian Pension Fund (LPF) and the Strathclyde Pension Fund (SPF) the GMP adjustment has been calculated at approximately 0.25%, 0.3% and 0.4% of liabilities at 31 March 2021 respectively. This equates to a past service cost of £1.4 million for NESPF, £2.1 million for LPF and £3.8 million for SPF. The total £7.3 million has been recognised in the gross pension liability at 31 March 2021.

Retail Price Index (RPI) reforms

In considering the potential impact of the Retail Price Index (RPI) reforms announced in November 2020, the CPI assumption has increased by 0.25%. The impact of the change on the pension liability is approximately £87 million.

The McCloud Case

The impact of the McCloud Case (age discrimination) of approximately £0.9 million has been recognised in the gross pension liability at 31 March 2020.

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

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Total fair value of assets		2,051.9	1,676.5	2,008.0	1,640.9
Present value of scheme liabilities		(2,273.8)	(1,897.0)	(2,217.1)	(1,858.0)
Gross pension liability		**(221.9)**	**(220.5)**	**(209.1)**	**(217.1)**
Related deferred tax asset	16	42.1	41.9	39.7	41.1
Net pension liability		(179.8)	(178.6)	(169.4)	(176.0)

Scheme assets are stated at their bid values.

Reconciliation of opening and closing retirement benefit liabilities and assets

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Movements in liabilities during the year:					
Opening value of total liabilities		(1,897.0)	(1,991.1)	(1,858.0)	(1,950.2)
Total service cost	5	(62.7)	(63.0)	(60.9)	(60.5)
Interest on pension scheme liabilities	7	(43.7)	(48.0)	(42.8)	(47.0)
Contributions by members		(9.6)	(9.3)	(9.2)	(8.9)
Actuarial (loss)/gain		(317.0)	163.9	(302.2)	158.3
Benefits paid		56.2	50.5	56.0	50.3
Closing value of total liabilities		**(2,273.8)**	**(1,897.0)**	**(2,217.1)**	**(1,858.0)**
Movement in assets during the year:					
Opening fair value of total assets		1,676.5	1,742.8	1,640.9	1,706.9
Interest on pension scheme assets	7	37.8	41.6	37.0	40.7
Contributions by members		9.6	9.3	9.2	8.9
Contributions by the employer		38.8	39.0	37.7	37.9
Actuarial gain/(loss)		345.4	(105.7)	339.2	(103.2)
Benefits paid		(56.2)	(50.5)	(56.0)	(50.3)
Closing fair value of assets		**2,051.9**	**1,676.5**	**2,008.0**	**1,640.9**
Gross deficit in the schemes at 31 March		**(221.9)**	**(220.5)**	**(209.1)**	**(217.1)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

23. Pensions (continued)

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.

		Group		Company	
	Note	2021 £m	2020 £m	2021 £m	2020 £m
Actual return on pension scheme assets		383.2	(64.1)	376.2	(62.5)
Actuarial gain in other comprehensive income in the consolidated statement of comprehensive income					
Gross actuarial gain recognised in the pension fund		28.4	58.2	37.0	55.1
Deferred tax movement	16	(5.4)	(8.5)	(7.0)	(8.1)
Net actuarial gain recognised in other comprehensive income in the consolidated statement of comprehensive income	21	**23.0**	**49.7**	**30.0**	**47.0**

Amounts recognised in the consolidated income statement

	Note	2021 £m	2020 £m
Total service cost	5	62.7	63.0
Interest cost on pension scheme net liabilities (see above)	7	5.9	6.4
		68.6	69.4

The unpaid contributions outstanding at the year end included in other payables (note 15) was £0.4 million (2020: £0.5 million). It is estimated that Scottish Water will make contributions of £32.1 million to the pension funds in financial year 2021/22.

History of experienced gains and losses

	2021 £m	2020 £m
Group		
Difference between the expected and actual return on scheme assets:		
Amount	345.4	(105.7)
Fair value of assets	2,051.9	1,676.5
Experienced gains on scheme liabilities:		
Amount	23.6	7.6
Present value of liabilities	2,273.8	1,897.0
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	(340.6)	156.3
Total variance between pension fund actuarial assumptions and actual experience	**28.4**	**58.2**
Gross deficit in the schemes at 31 March	(221.9)	(220.5)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

23. Pensions (continued)

	2021 £m	2020 £m
Company		
Difference between the expected and actual return on scheme assets:		
Amount	339.2	(103.2)
Fair value of assets	2,008.0	1,640.9
Experienced gains on scheme liabilities:		
Amount	23.9	7.4
Present value of liabilities	2,217.1	1,858.0
Changes in assumptions underlying the present value of scheme liabilities:		
Amount	(326.1)	150.9
Total variance between pension fund actuarial assumptions and actual experience	**37.0**	**55.1**
Gross deficit in the schemes at 31 March	(209.1)	(217.1)

24. Commitments

a. Capital commitments

Scottish Water has contracted capital commitments of £541.4 million (2020: £483.8 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:

	2021 £m	2020 £m
Within one year	1.9	2.9
Between one and five years	3.8	7.5
After five years	10.1	15.8
	15.8	26.2

25. 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

25. Contingent assets and liabilities (continued)

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.

26. 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):

	2021 £m	2020 £m
Wholesale water and waste water services to Business Stream	191.2	133.8
Sale of waste water services to other subsidiaries	0.5	0.5
Purchase of waste water services from other subsidiaries	24.4	23.7
Seconded staff costs charged to subsidiaries	4.1	4.1
Other operating costs charged to subsidiaries	1.3	0.6
Purchase of renewable development and vesting services	2.5	–

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 131 to 144. Scottish Water's non-executive members hold additional roles within other organisations (see Members on pages 116 to 119).

27. 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 21 to 114 and Corporate Governance report on pages 120 to 123.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

27. Financial instruments and risks (continued)

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.

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.

Other borrowings, following the acquisition of Aberdeen Environmental Services Limited (note 11), are linked to LIBOR and are therefore exposed to changes in LIBOR which could have a material effect on interest costs from year to year and over time. In order to manage the exposure to movements in LIBOR a floating interest rate to fixed rate swap exists. The fair values of these derivatives at the balance sheet date are determined by reference to their market values, which are provided by a third party (note 15).

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 (CONTINUED)

27. Financial instruments and risks (continued)

The trade receivables total includes an allowance for impairment. Trade receivables comprise receivables from business customers and receivables from domestic household customers.

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Trade receivables per note 13:				
Trade receivables	644.8	594.4	494.9	463.4
Less provision for impairment of trade receivables	(491.1)	(452.3)	(430.7)	(411.8)
Net trade receivables	153.7	142.1	64.2	51.6
Analysed between:				
Household receivables	483.0	450.2	483.0	450.2
Less provision for impairment	(427.7)	(408.8)	(427.7)	(408.8)
Net household receivables	55.3	41.4	55.3	41.4
Business customer receivables	161.8	144.2	11.9	13.2
Less provision for impairment	(63.4)	(43.5)	(3.0)	(3.0)
Net business customer receivables	98.4	100.7	8.9	10.2

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 2021 trade receivables in respect of household customers totalled £483.0 million with a provision of £427.7 million (2020: £450.2 million and £408.8 million respectively).

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. £1.6m
In-year household bad debt provision charge	+/- 0.10%	Increase / decrease by c. £0.9m

As at 31 March 2021 trade receivables from business customers totalled £163.4 million (2020: £144.2 million). The ageing analysis of trade receivables from business customers and the related provisioning is as follows and includes an in year charge of £16.6 million (2020: £13.2 million) in relation to the potential consequences of the Covid-19 emergency:

Group	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Gross receivable	163.4	64.7	34.7	25.0	39.0
Provision	(63.4)	–	(10.3)	(19.2)	(33.9)
Net trade receivable as at 31 March 2021	100.0	64.7	24.4	5.8	5.1
Gross receivable	144.2	84.8	40.8	13.6	5.0
Provision	(43.5)	–	(27.7)	(10.8)	(5.0)
Net trade receivable as at 31 March 2020	100.7	84.8	13.1	2.8	–

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2021 **(CONTINUED)**

27. Financial instruments and risks (continued)

	Total £m	Current £m	< 3 months overdue £m	3-12 months overdue £m	> 12 months overdue £m
Company					
Gross receivable	11.9	7.4	1.2	1.9	1.4
Provision	(3.0)	–	(0.2)	(1.4)	(1.4)
Net trade receivable as at 31 March 2021	8.9	7.4	1.0	0.5	–
Gross receivable	13.2	9.3	2.3	0.5	1.1
Provision	(3.0)	–	(1.4)	(0.5)	(1.1)
Net trade receivable as at 31 March 2020	10.2	9.3	0.9	–	–

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).

Interest rate swap - financial liability	Note	2021 £m
Balance at 31 March 2020		(9.0)
Effective portion of changes in fair value of cash flow hedge		2.2
Balance at 31 March 2021	15	**(6.8)**

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 2020	9.0	(1.7)	7.3
Effective portion of changes in fair value of cash flow hedge	(2.2)	0.4	(1.8)
Balance at 31 March 2021	**6.8**	**(1.3)**	**5.5**

28. 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.

29. 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.

DIRECTION BY THE SCOTTISH MINISTERS
IN ACCORDANCE WITH SECTION 45(2) OF THE WATER INDUSTRY (SCOTLAND) ACT 2002

Under the Scottish Water Governance Directions 2009, 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	Ayrshire strategic resilience	£11,700,000
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*	£50,000
Gifts	£100	None	–

*Funded by Scottish Water Horizons Holdings Limited from the profits of non-regulated activities.

THE WATER INDUSTRY IN SCOTLAND

Scottish Water

Trusted to serve Scotland