M Tables – Regulatory Accounts
Commentary

The sections in this document are:

1. General Comments

Scottish Water prepares its statutory financial statements under International Financial Reporting Standards (IFRS). The M Tables have been prepared on a Regulatory basis, as agreed with the WICS in 2013, which includes IFRS based information in addition to the 'original' Regulatory based information.

Details and explanations of the IFRS adjustments are provided in the commentary for the relevant tables in Appendix 1 to this document.

The consolidation tables – M27 and M28 – include the results of Scottish Water and all its subsidiaries, including Business Stream. Business Stream's results are included in the Licensed column. Due to the layout of these tables and the fact that the SW Core information has been referenced to Tables M1 and M2, the consolidated figures exclude all IFRS adjustments.

2. Basis of preparation

SW produces statutory consolidated accounts incorporating the results of all subsidiary companies. The consolidated statements also include the balance sheet (and relevant notes) for SW only ('company'). Detailed reconciliations between the statutory accounts and the regulatory tables are detailed in Appendix 2 to this document.

M Table financial information is for SW only, i.e. excluding all subsidiaries, and is analysed between Core (= Regulatory business) and the remaining Non-Core (= Non-regulatory activities) where required. The exceptions to this are:

- tables M18W and M18WW which include the costs of SW Horizons (SWH) and SW International (SWI); and
- tables M27 and M28 which provide reconciliations from the SW Core figures to the group consolidated income statement and balance sheet respectively.

Due to some different descriptions and terminology between the regulatory M tables and the statutory accounts, Appendix 2.1 and 2.2 provide reconciliations from the Table M27 totals and M28 totals to the statutory consolidated income statement and consolidated balance sheet, respectively. Appendix 2.3 shows the reconciliation between Table M2 and the statutory "company" balance sheet.

Regulated and Non-Regulated activities have been accounted for separately in SW's general ledger system enabling the production of profit & loss accounts and balance sheets for them. These accounts form the basis for the historical cost figures and the analysis in Tables M1, M2, M27 & M28.

Cost analysis in Tables M18 W and M18 WW was prepared using reports from SW's Activity Based Management (ABM) system. Commentary on ABM methodology and cost allocation is provided in Appendix 3 of this document.

The 2015/16 forecast figures are from Scottish Water's Delivery Plan 2015-21 approved by Scottish Ministers in April 2015.

3. Assumptions

M Table completion

The M Tables are consistent with the basis agreed between Scottish Water and the WICS in 2013. Therefore, the M Tables have been completed using the historical cost information and IFRS based information. This approach aids transparency and the reconciliation processes between the historical cost based results in Tables M1 and M2, the IFRS based Regulatory Accounts themselves and the IFRS statutory accounts.

Non core tax charge

The tax charge for the non core element of Scottish Water is calculated on the actual profit attributable to the non regulatory businesses in 2014/15 at the standard Corporation Tax rate of 21% (2014: 23%) and added to the brought forward balance from the previous year (Tables M1, M2).

IFRS

Tables M4, M5, M6, M11 and M19 have been completed with IFRS based information to provide the Regulatory Accounts on the 'new' basis. There are no IFRS adjustments in respect of turnover, therefore Table M7 information remains unchanged, and the total appears in Table M1 and Table M4.

Additional tables have been provided, either within the commentary or as appendices, to aid the reconciliation between the historic costs tables (Tables M1 and M2), the IFRS Regulatory tables (Tables M4 and M5) and the statutory accounts.

Ratios

In agreement with the WICS in 2013, Table M6R – Regulatory Accounts, Ratio information – was added to the standard M Table file. This table provides all of the information for, and calculation of, the basic ratios in one place. The ratios calculated in Table M6R are the clean calculation using the actual financial information, with all figures referenced from the relevant M Tables. The information in Table M6R provides the platform from which any further regulatory funding type adjustments and calculations may be made by the WICS.

The 2010-15 Delivery Plan submission excluded IFRS adjustments. Therefore, for comparison purposes, the table below shows the ratios for 2014/15 consistent with the 2010-15 Delivery Plan and on an IFRS regulatory basis. The difference in the ratios is due to the treatment of the PFI costs on the IFRS basis – see narrative on page 5: Table M4, note 3.

Ratios - 2014/15	**Actual Historic basis**	**Actual IFRS/Reg basis**
Cash interest cover	3.6	3.4
Funds from operations to net debt	13.5%	11.9%

4.1 Commentary – Tables M1 to M28

This section has comments on individual tables, where it is felt that such narrative will aid understanding, explain significant year-on-year movements or provide additional guidance on how the information was gathered or calculated. There are no comments on the tables which appear self-explanatory.

Table M1 – Historic Cost Income & Expenditure Account

The Core information is from the general ledger reports for the Regulated business. The non core information relates to the sundry non regulated activities which remain within Scottish Water. The results in this table are consistent with the information presented in Table M1 in previous years and the basis for the internal management reporting to the Board. The main differences to the statutory income statement are due to the IFRS adjustments in respect of infrastructure assets, PFI costs and the pension charges. These are explained in more detail in the comments for Table M4.

Scottish Water's headline regulated operating costs (i.e. excluding depreciation, PFI charges and costs associated with non regulated activities) as shown in the table below, of £353.1m were 3.3% or £11.9m lower than in 2013/14. The decrease was primarily due to a £14.5m reduction in local authority rates charges, reflecting a one-off refund associated with a successful revaluation appeal. After adjusting for this, the movement in landfill taxes and the increase in energy and carbon prices, like-for-like costs, as planned, increased in real terms by 1.6% or £4.9m. The planned increase reflected the uplift in the household income collection charges from Scottish Councils, improvements to water quality processes and additional expenditure to improve data quality processes in the wholesale arena. The table below summarises this movement:

	2014/15 £m	2013/14 £m	Movement fav/(adv) £m
Core operating expenditure - line M1.2	**353.8**	**365.6**	**11.8**
Less: Internal PFI costs	-0.7	-0.6	0.1
SW Regulated operating costs	**353.1**	**365.0**	**11.9**
Local Authority rates charges	-46.5	-61.0	-14.5
Landfill tax	5.5	-5.5	-11.0
Carbon Reduction Charge & energy price	-5.1	-2.9	2.2
Dry weather related costs	-	-2.5	-2.5
New Opex	-3.3		3.3
Like-for-like costs	**303.7**	**293.1**	**-10.6**
Average inflation at 1.96%		5.7	5.7
Like-for-like real controllable costs	**303.7**	**298.8**	**-4.9**

Within the wholesale arena, we incurred additional operating costs of £2.3m in respect of the Gaps3 project.

The increase in PFI costs of £2.7m to £152.3m (line 1.3) was attributable to the annual indexation of service costs and the higher volume of waste being treated by the PFI schemes.

Depreciation, including infrastructure depreciation, increased by £6.8m to £338.0m (lines 1.4 to 1.7), due to the profile of the capital investment in the year.

Other operating income of £10.7m (line 1.8) was the gain on disposal of fixed assets, £0.4m higher than in 2013/14.

The net interest charge was £158.0m (2014: £155.9m) (line 1.11) an increase of £2.1m, reflecting the drawdown of new borrowing.

SW's total tax charge, on a statutory basis, was £10.1m (2014: £71.6m credit) (line 1.14). Changes to the UK corporation tax system were announced in the March 2013 budget statement and substantively enacted prior to 31 March 2014. The main rate of corporation tax reduced to 20% from 1 April 2015. Therefore, the re-measurement of deferred tax due to the reduction in the UK rate of corporation tax from 23% to 20% generated the majority of the tax credit in 2014. To date, there has been no cash impact on SW's tax position as a result of accounting on an IFRS basis.

Table M2 – Historic Cost Balance Sheet

Core / Non core information is from the general ledger reports. The non core information relates to the sundry non regulated activities which remain within Scottish Water following the transfer of the majority of the non regulated activities to SWH on 1 April 2008.

The results in this table are consistent with the information presented in Table M2 in previous years and the basis for the internal management reporting to the Board. The main differences to the statutory balance sheet are due to the IFRS adjustments in respect of infrastructure assets, PFI assets and the pension liability. These are explained in more detail in the comments for Table M5. In addition, the Infrastructure Renewals accrual is recognised separately in Table M2 (£31.4m, line 2.14).

Investment – other (line 2.3) of £37.6m is the investment in SWHH (£37.6m).

Total cash at bank (lines 2.7 & 2.8) increased by £75.1m to £345.4m, of which £194.0m was on short term deposit (2014: £144.0m).

The infrastructure renewals accrual (line 2.14) has decreased to £31.4m at 31 March 2015. However, this is offset by the infrastructure maintenance expenditure identified within assets under construction of £31.7m, awaiting project completion and reclassification. Consequently, total infrastructure maintenance investment over the SR10 period has matched the infrastructure renewals charge.

The corporation tax and deferred tax balances are shown on a statutory (IFRS) basis, excluding the deferred tax asset in respect of the IAS 19 pension liability. To date, there has been no cash impact on SW's tax position as a result of accounting on an IFRS basis.

Post employment liability (line 2.27) is blank because the IAS 19 pension liability is not included in Table M2, being an IFRS adjustment. This approach is consistent with the presentation of Table M2 in previous years.

Other provisions (line 2.28) have decreased by £9.0m to £28.2m due to a reduction in the reorganisation provision (£10.1m) partly offset by a net increase in the wholesale income uncertainty provisions (£0.7m).

Table M3 – HCA Balance Sheet – Reconciliation to Statutory Accounts

This provides a summary of the main reconciling items from Tables M1 and M2 to the main financial results in the statutory accounts.

The Profit and Loss section (lines 3.1-3.5) reconciles the statutory Group consolidated figures to Table M1 Core figures, because no profit and loss figures are provided for SW company in the statutory accounts. However, more details have been given in the appendices – 2.1, 2.2 and 2.3. The balance sheet section (lines 3.8-3.15) reconciles SW Company figures from the statutory accounts to Table M2 Core figures.

Table M4 – Regulatory Accounts Income & Expenditure

Table M4 provides the results of Scottish Water Core on the IFRS Regulatory Accounting basis i.e. aligning with the statutory IFRS basis. The additional lines provide greater visibility of the relevant cost elements.

The reconciliation of the results shown in Table M1 to the results in Table M4 is provided in Appendix 1.1. The reconciling items are purely the IFRS entries in respect of the pension and holiday pay adjustments, infrastructure assets and PFI costs. The net impact on the profit before tax is summarised below.

Decrease / (increase) in costs		£m	*Note ref.*
IAS 19	Pension & holiday pay adjustments - Opex	13.1	*1.*
IAS 19	Pension adjustments - Finance costs	(6.2)	*1.*
IAS 16	Infrastructure assets - depreciation & maintenance	(37.3)	*2.*
IFRIC 12	PFI costs - depreciation & lease liability	2.0	*3.*
Scottish Water - net increase in costs		**(28.4)**	

1. IAS 19 'Employee benefits'

Pension charges are calculated under IAS 19. In the statutory income statement, the adjustments impact on cost of sales, administration costs and finance costs. In Table M4, line 4.5 'Pension contributions (ongoing contribution)' captures the current service cost as determined by IAS 19; and line 4.18 'Net pension financing income/expense' captures the net financing elements as calculated under IAS 19.

In 2014/15, the total service cost under IAS 19 was £19.3m (line 4.5) which replaced the 'management' operating costs charge of £32.4m, giving the net adjustment to operating costs of £13.1m. The higher management operating costs charge was due mainly to increased costs associated with the 2014 pension fund triennial valuation. The net financing expense was £6.2m (line 4.18).

There was no material movement in the holiday pay accrual in 2014/15.

These charges replace the costs charged in Table M1, with a net decrease to costs of £6.9m (being £13.1m less £6.2m).

2. IAS 16 'Property, plant & equipment'

Under IAS 16 infrastructure renewals accounting is not permitted and infrastructure assets are depreciated over the estimated lives of the identified components of the network. Expenditure which is judged to enhance the asset base, or where it is probable that future economic benefits will flow to Scottish Water, is capitalised. All other expenditure is charged as an operating cost and is entered in line 4.10 'Infrastructure capital maintenance charge'. However, these costs, along with the calculated depreciation, replace the original 'Infrastructure renewals charge' (IRC).

In 2014/15, the infrastructure expenditure charged to the income statement was £136.2m (line 4.10) and the depreciation charge was £14.8m (line 4.8). These charges were partly offset by the reversal of the infrastructure renewals charge of £113.7m in Table M 1 (line 1.5). Therefore, the net increase to costs was £37.3m.

3. IAS 17 ‘Leases’ & IFRIC 12 ‘ Service concession arrangements’

Under IFRIC 12, the PFI service concession arrangements were reclassified as finance leases resulting in the PFI assets being brought on to Scottish Water’s balance sheet. The annual PFI costs incurred are broken down into three categories: operating costs, finance costs and a reduction of the finance lease obligation. In addition, there is a depreciation charge calculated in respect of the leased assets held on the balance sheet.

In Table M4, line 4.3 ‘PPP costs’ consists of the operating costs totalling £111.4m in 2014/15. The total depreciation charges of £18.1m are in line 4.9 and the finance costs of £23.6m are in line 4.17.

Therefore, the total of the PPP costs in Table M4, as detailed above, is £153.1m whereas the total in Table M1 is £155.1m (lines 1.3 & 1.6). The net reduction to costs of £2.0m is due to the offsetting effect of the costs transferred against the finance lease obligation in the balance sheet (Table M5, line 5.25).

Table M5 – Regulatory Accounts Balance Sheet

Tangible assets balance (line 5.1) equals the Property, plant & equipment balance per the IFRS statutory accounts, excluding the PFI assets which are shown separately in line 5.2.

The PFI assets total of £379.5m consists of the SW owned assets and the assets treated as leased under the IFRS basis. The related finance lease liability is shown in line 5.25. The following tables provide additional analysis and reconciliation to the presentation in the statutory accounts.

Balance sheet (see Appendix 2.3)				
Property, plant & equipment				
	Leased assets			329.7
	Owned assets	*(reclassification)*		49.8
			M5, line 5.2	**379.5**
Other loans & borrowings				
	Finance lease liability	< 1 year		(18.3)
		> 1 year		(363.6)
		total	**M5, line 5.25**	**(381.9)**

Third party contributions (line 5.3) consist of grants and contributions.

Other creditors due after one year (line 5.17) consists of payments received in advance (£48.1m).

Post employment asset / (liability) (line 5.20) shows the retirement benefit obligation under IAS 19, net of the related deferred tax balance, as detailed below.

Balance sheet (see Appendix 2.3)		
Retirement benefit obligations (/Post employment liabilities)		(201.4)
Deferred taxation on retirement benefit obligations		40.3
Retirement benefit obligations - net	**M5, line 5.20**	**(161.1)**

The other provisions total of £15.8m (line 5.21), a decrease of £0.6m compared to 2013/14, is made up of restructure (£0.6m), income uncertainty (£14.0m) and other (£1.2m).

> *Restructure:* This provision relates to the redundancy costs associated with employees who will leave SW under VR and early retirement. Pension related liabilities associated with employees who have left SW under the VR schemes are recognised in the post employment liability (line 5.20).

Income uncertainty: This provision relates to uncertainty around the wholesale/non-domestic income. The balance of £14.0m represents the balance associated with Business Stream and 3rd party licence providers.

For the purposes of the year end close and group consolidation, the forecast out-turns for 2013/14 and 2014/15 as calculated by SW's wholesale team were compared to the forecasts calculated by Business Stream. Overall, there were no material differences. The out-turn positions for 2010/11, 2011/12 and 2012/13 had already been agreed by SW and Business Stream prior to the year end. The total of the out-turn positions was therefore agreed with the relevant adjustments being posted by both companies in March 2015.

Retained earnings (line 5.26) consists of the total of the reserve brought forward from 31 March 2014 and the retained profit for 2014/15 (Table M4, line 4.26).

The movement in the pension surplus/(deficit) (line 5.27) of £60.7m is the actuarial loss on the post employment plans, net of deferred tax as per Table M19. The principal driver of the loss was the impact of the lower discount rate applied to the pension scheme net liabilities, which reduced from 4.3% (2014) to 3.25% in 2015.

Table M6 – Regulatory Income and Expenditure and Cash Flow

Table M6 includes the calculation of the '*Operating profit for regulatory purposes*' (line 6.10) and the reconciliation to the 'Net cash flow from operating activities' (line 6.17).

The capital maintenance charge (line 6.7), used in calculating the '*Operating profit for regulatory purposes'*, is the three year rolling average of capital maintenance expenditure, in real terms. This calculated average charge replaces the actual annual charges shown in Table M4 for depreciation (lines 4.7, 4.8 & 4.9) and infrastructure capital maintenance (line 4.10).

The average capital maintenance charge is added back, along with other 'non cash' adjustments and the working capital movement, to give the net cash flow from operating activities (line 6.17).

Interest paid (line 6.20) of £158.6m includes intercompany interest paid to Business Stream of £0.1m in relation to the settlement of wholesale billing and reconciliation process. Loan interest payments in respect of Government and other borrowings totalled £158.5m.

On the IFRS basis, £23.6m of PFI costs were reclassified as finance lease interest payments and appear in line 6.21.

The total capital expenditure is adjusted for the movement in short term capital creditors year on year. The tables below provide the detail and the reconciliation of the total capital investment to the capital enhancement expenditure (line 6.25) and capital maintenance expenditure (line 6.26).

		M Table / line ref		2014/15 £m
Opening short term capital creditor		M11.10	(13/14)	85.2
Add:	Capital investment (gross)			460.2
Less:	Closing short term capital creditor	M11.10	(14/15)	-114.1
=>	**Capital enhancement expenditure**			**431.3**
Analysed:				
	Capital enhancement expenditure	M6.25		166.0
	Capital maintenance expenditure	M6.26		265.3
				431.3

		2014/15 £m
	Capital investment (net cost) on a regulatory basis	442.8
Add:	PFI investment	11.1
	Capital investment including PFI (net cost)	453.9
Add:	Infrastructure income release	6.3
	Capital investment (gross)	**460.2**

In 2014/15 £11.1m was invested at Dalmuir PFI thereby increasing PFI assets. This expenditure has been included in the capital enhancement total within the cash flow (line 6.25) as shown in the table above.

Table M6R – Regulatory Accounts – Ratio information

Table M6R provides all of the information for, and calculation of, the 'basic' ratios in one place. The ratios provided are:

- funds from operations to net debt;
- cash interest cover [1]; and
- cash interest cover [2], i.e. after deduction of capital maintenance expenditure.

The ratios presented here are the clean calculations using the actual financial information, with all of the figures referenced from the relevant M Tables.

Table M7 – Analysis of Turnover and Operating Income

Turnover from services supplied to household customers increased by £21.9m to £800.8m (line 7.1) reflecting the increase in household charges of 1.6%, effective from 1 April 2014, a 0.75% growth in new connected properties and a £2.3m lower charge to the credit note provision to cover application of exemptions and discounts by Councils.

Turnover from wholesale services provided to Licensed Providers decreased by £4.4m, or 1.5%, to £289.2m (line 7.3) primarily due to the planned reduction in tariffs. Vacancy and gap site incentive payments reduced turnover in the year by £2.8m (2014: £2.5m).

Turnover from other sales increased by £1.2m to £6.9m (line 7.7).

Table M11 – Regulatory Accounts Working capital (Core)

All of the balances presented in Table M11 are on an IFRS basis. A separate reconciliation (Appendix 1.3) has been prepared showing the reclassifications of the balances in Table M2 at 31 March 2015 into the regulatory IFRS working capital (Table M11).

Trade debtors decreased by £12.6m to £20.8m (line 11.2). The table below provides a breakdown of the household gross balances and bad debt provisions by age:

	96/10 £m	10/11 £m	11/12 £m	12/13 £m	13/14 £m	14/15 £m	Total £m
Gross Debt	258.1	29.4	29.8	31.7	36.0	54.4	439.4
Bad Debt Provision	**(257.2)**	**(29.0)**	**(29.3)**	**(31.0)**	**(33.1)**	**(39.0)**	**(418.6)**
Net Debt	0.9	0.4	0.5	0.7	2.9	15.4	20.8

Other trade debtors (line 11.4) relate to sundry and non primary wholesale billing.

The increase in prepayments and other short term debtors (line 11.6) was due mainly to the rates appeal refund (received in April 2015).

The wholesale charge prepayment of £24.3m at March 2015 is the total of the provisional invoices for April 2015.

Capital creditors consist of the balances of capital creditors and accruals relating to third parties (£119.1m), net of the balance due from SW Solutions 2 (£5.0m debtor).

The increase in accruals and other creditors (line 11.12) of £19.9m to £147.0m was due mainly to a higher proportion of the payments received in advance being classified as due under 1 year, based on recent trends. This was offset by the decrease in other creditors over 1 year (line 2.23 / line 5.17) of £27.2m to £48.1m. When taken together, total accruals and other creditors decreased by £7.3m primarily due to the release of the landfill tax accrual (2014: £5.5m) no longer required.

Table M18W and M18WW commentary - see Section 4.2 below

Table M19 – Regulatory Accounts - Statement of total recognised gains and losses

This table has been completed on the IFRS basis. The profit for the year is the Core retained profit from Table M4 (line 4.26). The actuarial gains/losses on post employment plans are the actuarial gains/losses, net of related deferred taxation, as reported in the statutory results for Scottish Water. There were no other gains or losses.

Table M21 – Taxation analysis

The 2013/14 data has been updated to reflect the actual 2013/14 tax computation submitted. We have further updated the data in relation to the conclusion of an ongoing issue between the water industry and HMRC. This was in relation to the capital allowances on spend on Water Treatment Works and Wastewater Treatment Works and has resulted in a reduction to our capital allowance claims which has also resulted in a reduction to our tax losses carried forward.

Table M22 – Fixed asset additions

The non infrastructure additions (line 22.8) are the amounts reclassified from the fixed assets under construction (AUC) during the financial year. The total of £318.4m (line 22.8) agrees to the total of the reclassifications in the statutory accounts (Note 9, SW company) from AUC into Specialised operational properties and structures; Non-specialised operational properties and structures; and Plant, machinery and vehicles.

The figures in the section “Infrastructure renewals charges, expenditure and provision”, (lines 22.20 – 22.22), are the movements during each financial year. The closing balance at March is shown in Table M2, line 2.14.

As previously mentioned, the infrastructure renewals prepayment/(accrual) balance is only relevant in the historic cost accounts (Table M2). Due to the different treatment of the non-enhancement infrastructure expenditure under IFRS, there is no prepayment/(accrual) balance in the new Regulatory/IFRS balance sheet (Table M5).

Table M27 – Consolidated Historic Cost Income & Expenditure Account
The intercompany items being visibly eliminated (in col 3) on this table are the intercompany wholesale income in SW and the intercompany cost of sales in Business Stream. Due to an adjustment to Business Stream’s cost of sales relating to the reconciliation process, there is an intercompany profit elimination along with the related tax impact. The intercompany interest between SW and Business Stream already eliminates across line 27.11.

Non core / non licensed includes the remaining non regulatory business within SW (as per table M1), the results for the two holdings companies (SWBSH & SWHH - interest and taxation), SWH and SWI.

For 2014/15 Business Stream declared a dividend of £9.5m, payable to SWBSH. This eliminates across row 27.18.

Appendix 2.1 provides a reconciliation between Table M27 and the statutory consolidated income statement. The differences are due to the IFRS entries, along with different terminology and descriptions being used.

Table M28 – Consolidated Historic Cost Balance Sheet
The intercompany items being visibly eliminated are:

- intercompany debtor and creditor balances (lines 2.6 & 2.15);
- intercompany profit elimination and related tax impact; and
- investments in subsidiary companies and the relevant share capitals (lines 2.3 & 2.30).

The intercompany loans eliminate across line 2.2.

Non core / non licensed includes the remaining non regulatory business within SW (as per table M2), the balance sheets for the two holdings companies (SWBSH & SWHH – intercompany loans, investment in subsidiary, intercompany debtors and creditors, taxation, share capital and reserves), SWH and SWI.

Appendix 2.2 provides a reconciliation between Table M28 and the statutory consolidated balance sheet. The differences are due to the IFRS adjustments in addition to reclassifications and grouping of various items.

4.2 Commentary & Reconciliation – Tables M18W & M18WW

Trading Results Reconciliation

Scottish Water produces consolidated accounts incorporating the results of Business Stream. However, M18 table financials are produced for Scottish Water Regulated and Non Regulated activity, excluding Business Stream.

To aid comparison, the table below summarises Scottish Water consolidated results, Scottish Water company, Scottish Water Horizons and Scottish Water International results.

		2014/15	
SW Group Statutory Accounts:			
		£m	**£m**
	Cost of sales	754.6	
	Administration expenses	135.5	
SW Group Consolidated Expenditure			**890.1**
Less	Business Stream costs		(37.8)
Add	IFRS adjustments		1.4
Total expenditure (excluding Business Stream & IFRS adjustments)			**853.7**
Represented by			
	SW Regulated		833.4
	SW Non Regulated		2.1
	Horizons		16.3
	International		1.9

M18W & WW Tables include the costs of Scottish Water (Core / Regulated), Scottish Water (Non Regulated), Scottish Water Horizons (Non Regulated), and Scottish Water International (Non Regulated).

Scottish Water company, Scottish Water Horizons and Scottish Water International combined results are summarised and reconciled below, to the regulatory account tables M18 (W & WW).

(£m)	SW SWH & SWI*	Diff SW/SWH - M18	M18W/WW Tables Total	M18 W	M18 WW
Employment	174.0		368.0	207.0	160.9
Other	198.9				
Opex	**372.8**	**4.9**	**368.0**	**207.0**	**160.9**
PFI	**153.0**	**(5.1)**	**158.0**	0.0	158.0
Infrastructure depreciation	**113.7**	**0.3**	**113.4**	83.7	29.7
Depreciation charges	**223.2**		**215.6**	110.0	105.5
Grant amortisation	**(1.0)**	**(0.3)**	**(1.0)**	(0.7)	(0.3)
Amortisation of PFI assets	**2.8**		**0.0**		
Gain on sale of assets	**(10.7)**		**0.0**		
Expenditure **	**853.8**	**(0.2)**	**854.0**	**400.0**	**454.0**
Explained by					
Charges to SWBS for support		0.2			

* Excludes Business Stream & IFRS adjustments
** Table References - lines: [M18W.55] [M18WW.56]

The line differences are table presentation differences explained as follows:

- £5.1m difference between the SW Board report and M18 Tables re PFI costs, is due to transfer of costs from Customer Operations for Intersite Sludge Tankering from Scottish Water wastewater treatment works to PFI works (£3.5m), terminal pumping station costs pumping to PFI works and inlet headworks (£1.1m) and support costs for the PFI team (£0.5m).
- £0.2m of Scottish Water expenditure has been charged to Business Stream under Service Agreements. This cost has been netted off Scottish Water's expenditure in line with group inter-company transaction reporting. However, for the purposes of regulatory reporting this expenditure has been added back to report the full costs of providing these third party services.

For detailed commentary on M18 table methodology and cost allocation see Appendix 3.

Overview Commentary

Total operating costs decreased by £0.2m (>0.1%) to £854.0m.

Table G01 : Total Operating Costs	**2014/15** £m	**2013/14** £m	**Variance** £m
Operating expenditure - Water M18w.43	207.017	222.621	+15.604
Capital maintenance - Water M18w.54	192.968	185.032	(7.936)
Operating expenditure - Waste M18ww.44	318.983	310.180	(8.803)
Capital maintenance - Waste M18ww.55	134.986	136.280	+1.294
	853.954	**854.113**	**+0.159**

Activity Analysis

	2014/15 £m	**2013/14** £m	**Variance** £m
Wholesale	776.898	778.601	+1.703
Retail	56.713	57.881	+1.168
Non Regulated	20.343	17.631	(2.712)
	853.954	**854.113**	**+0.159**

Wholesale activity costs, have decreased by £1.7m (0.2%) from 2013/14 to £776.9m reflecting the following key movements:

- the unwinding of an accrual made in 2013/14 associated with a potential retrospective landfill tax charge of £5.5m which is now no longer required; and
- a reduction in local authority rates charges of £14.2m mainly reflecting a one-off refund associated with a successful revaluation appeal;

  offset by:
- an increase in both energy prices and carbon reduction charges of £2.1m;
- new operating costs associated with capital investment of £3.3m;
- additional costs for improvements to water quality processes of £0.6m;
- increased charges for PFI schemes of £4m reflecting annual indexation of service costs and higher volumes of waste;
- additional infrastructure maintenance charges and net depreciation charges of £4m;
- the net impact of pay progression, the 2014 pension fund triennial valuation and increased regulatory and risk management costs.

Retail activity costs have decreased by £1.2m (2.0%) to £56.7m reflecting the following key movements:

- an uplift in household income collection charges from Scottish councils of £2.9m;
- an increase in the cost of managing retail bills of £1.2m mainly due to expansion in the retail market and continued market data cleansing;
  offset by:
- the net impact of decreases in advertising and marketing expenditure and bad debt charges.

Non Regulated activity costs have increased by £2.7m (15.4%) to £20.3m (£2.1m Scottish Water, £16.3m Horizons, and £1.9m International) reflecting the following key movements:

- growth in SW Horizons for design and build construction work; and
- growth in SW International business.

Non Regulated turnover increased by £3.9m from £18.6m in 2013/14 to £22.5m in 2014/15.

Scottish Water
Year ended 31 March 2015
Reconciliation of Historic Accounts Income Statement (Table M1) to IFRS Regulatory Income Statement (Table M4)

TABLE M1			IFRS adjustments					Table M4		
			IAS 19	IAS 19	IAS 16	IFRIC 12	Category			
Line	Description	Core	- Pension adj	Holiday pay	Infra costs	PFI	reallocation	Core	Line	Description
		£m	£m	£m	£m	£m	£m	£m		
1.1	Turnover	1,096.902						1,096.902	4.1	Turnover
1.2	Operating expenditure	(353.782)	32.400	0.012			0.641	(320.729)	4.2	Operating expenditure
1.3	PPP costs	(152.329)				40.900		(111.429)	4.3	PPP costs (excluding PPP interest costs)
							(0.641)	(0.641)	4.4	SW internal costs re PPP contracts
			(19.288)					(19.288)	4.5	Pension contributions (ongoing contribution)
1.4	Historical Cost Depreciation	(222.431)						(222.431)	4.7	Depreciation charges - non infra assets
					(14.800)			(14.800)	4.8	Depreciation charges - infra assets
1.5	Infrastructure Renewals charge	(113.700)			(22.500)			(136.200)	4.10	Capital maintenance charge (infra t/f from AUC)
1.6	Amortisation of PFI assets	(2.807)				(15.300)		(18.107)	4.9	Depreciation chargs - PPP assets
1.7	Amortisation of deferred income	0.934						0.934	4.11	Amortisation of deferred income
1.8	Operating income	10.697						10.697	4.14	Profit on disposal of fixed assets
1.11	Net interest receivable less payable	(157.961)						(157.961)	4.16	Net interest receivable less payable
						(23.620)		(23.620)	4.17	PPP interest payable
			(6.225)					(6.225)	4.18	Net pension financing income/expense
1.12	Profit on ordinary activities before taxation	105.523	6.887	0.012	(37.300)	1.980	-	77.102	4.19	Profit before taxation
1.14	Taxation - deferred	(10.028)	(2.762)					(12.790)	4.21	Taxation - deferred
1.19	Retained profit for year	95.495	4.125	0.012	(37.300)	1.980	-	64.312	4.26	Profit retained

Scottish Water
Year ended 31 March 2015
Reconciliation of Historic Accounts Balance Sheet (Table M2) to IFRS Regulatory Balance Sheet (Table M5)

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:					TABLE M5		
Line	Description	Core	IAS19 Pension / holiday pay	IAS16 Infrastructure assets/deprn	IFRIC12 PFI assets/ finance lease	Infra renewals accrual	Various - other		Operating working capital			Line	Description
		£m (3dp)									£m (1dp)		
	Fixed Assets												*Fixed Assets*
2.1	Tangible Assets	5,205.162		(83.7)		(31.4)					5,090.1	5.1	Tangible Assets
					379.5						379.5	5.2	PPP assets (IFRS)
							(14.7)	(i)			(14.7)	5.3	Third party contributions
2.3	Investment - Other	34.639					(34.6)	(ii)					
2.4	*Total fixed assets*	5,239.801											
2.5	Stocks	2.264							(2.3)	(iii)			
2.6	Debtors	97.798	(19.5)						(78.3)	(iii)			
									(254.3)	(iii)	(254.3)	5.4	Working capital
2.7	Cash at bank and in hand	151.441									151.4	5.5	Cash
2.8	Short term deposits	194.000									194.0	5.6	Short term deposits
2.10	Assets transferred to PPP contractors	49.840			(49.8)								
2.12	*Total current assets*	495.343									5,546.0	5.9	*Net operating assets*
2.14	Infrastructure Renewals accrual	(31.370)				31.4							
2.15	Creditors	(342.604)	7.7						334.9	(iii)			
							34.6	(ii)			34.6	5.12	Investment - other
2.17	Corporation tax payable	0.817									0.8	5.13	Corporation tax payable
2.19	*Total creditors*	(373.157)									35.4	5.15	*Non-operating assets & liabilities*
2.20	Net current assets	122.186											
2.21	*Total assets less current liabilities*	5,361.987											
2.22	Borrowings (excl. Govt. loans)	(1.000)									(1.0)	5.16	Borrowings
2.23	Other creditors	(48.100)									(48.1)	5.17	Other creditors
2.24	*Total creditors*	(49.100)									(49.1)	5.18	*Creditors > 1 year*
	Provision for liabilities & charges												
2.25	Deferred tax provision	(393.530)									(393.5)	5.19	Deferred tax provision
2.26	Deferred income - grants and contributions	(14.778)					14.7	(i)					
2.27	Post employment assets / (liabilities)	-	(161.1)								(161.1)	5.20	Post employment assets / (liabilities)
2.28	Other provisions	(28.209)	12.4								(15.8)	5.21	Other provisions
2.29	*Net Assets employed*	4,876.370	(160.5)	(83.7)	329.7	-	-		-		4,961.9	5.23	*Net assets*
	Capital and reserves												*Capital & reserves*
2.30	Govt. loans	3,423.275									3,423.3	5.24	Government loans
					381.9						381.9	5.25	PPP debt/lease (IFRS)
2.31	Income and Expenditure account	1,319.665	11.0	(83.7)	(52.2)						1,194.8	5.26	Income and Expenditure account
			(171.5)								(171.5)	5.27	Pension surplus/(deficit) (IFRS)
2.32	Other reserves	133.430									133.4	5.28	Other reserves
2.33	*Capital & reserves*	4,876.370	(160.5)	(83.7)	329.7	-	-		-		4,961.9	5.29	*Capital & reserves*

Scottish Water
Year ended 31 March 2015
Reconciliation of Working Capital between M Tables

TABLE M2 Line	Description	Total	Non Core	Core	IFRS Adjs	Expand categories	Table M11	Table M5	Line	Description
		£m	£m	£m	£m	£m	£m	£m		
2.5	Stocks	2.3	-	2.3			2.3		11.1	Stocks
2.6	Debtors	98.0	0.2	97.8	(19.5)	(78.3)				
						20.9	20.9		11.2	Trade debtors - household
						7.3	7.3		11.4	Other trade debtors
						50.1	50.1		11.6	Prepayments & other short term debtors
2.15	Creditors	(339.6)	3.0	(342.6)	7.7	334.9				
						(18.5)	(18.5)		11.7	Trade creditors
						(24.3)	(24.3)		11.8	Wholesale income prepayment
						(114.1)	(114.1)		11.10	Short-term capital creditors
						(31.0)	(31.0)		11.11	Credit note provisions
						(147.0)	(147.0)		11.12	Accruals & other creditors
2.23	Other creditors	(48.1)	-	(48.1)				(48.1)	5.17	Other creditors
		(287.4)	3.2	(290.6)	(11.8)	-	(254.3)	(48.1)		

Scottish Water
Year ended 31 March 2015
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M27			IFRS	Statutory Accounts (IFRS)	
Line	Description	Consolidated	adjustments	Consolidated	
		£m (3dp)	£m (1dp)	£m (1dp)	
27.1	Turnover	1,187.429	-	1,187.4	Revenue
27.2	Operating costs	(409.387)			
27.3	PPP costs	(152.329)			
27.4	Historical Cost Depreciation	(225.138)		(754.6)	Cost of sales
27.5	Infrastructure Renewals charge	(113.700)			
27.6	Amortisation of PFI assets	(2.807)		(135.5)	Administrative expenses
27.7	Amortisation of deferred income	1.020			
27.8	Operating income	10.689			
		(891.652)	1.5	(890.1)	
27.9	Operating profit	295.777	1.5	297.3	Operating surplus
				2.0	Finance income
				(188.6)	Finance costs
27.11	Net interest receivable less payable	(156.874)	(29.7)	(186.6)	
27.12	Profit on ordinary activities before taxation	138.903	(28.2)	110.7	Surplus before taxation
27.13	Taxation - current	(6.860)			
27.14	Taxation - deferred	(10.099)			
		(16.959)	(2.7)	(19.7)	Taxation
27.19	Retained profit for year	121.944	(30.9)	91.0	Surplus for the year

Scottish Water
Year ended 31 March 2015
Reconciliation of Consolidated Historic Accounts / M Tables to Consolidated Statutory Accounts

TABLE M28			IFRS adjustments:			Reallocations / Reclassifications:				Statutory Accounts (IFRS)	
			IAS19	IAS16	IFRIC12	Infra	Deferred /	Rec-pay realloc /			
			Pension /	Infrastructure	PFI assets/	Renewals	Current tax	&			
Line	Description	Consolidated	holiday pay	assets/deprn	finance lease	Prepayment	presentation	Split <> 1yr		Consolidated	
		£m (3dp)								£m (1dp)	
	Fixed Assets										*Non-current assets*
2.1	Tangible Assets	5,219.312		(83.7)	379.5	(31.4)				5,483.8	Property, plant & equipment
2.3	Investment - Other	0.039									
							0.5			0.5	Deferred tax asset
2.4	Total fixed assets	5,219.351								5,484.3	
	Current Assets										*Current assets*
2.5	Stocks	2.547								2.5	Inventories
2.6	Debtors	168.538	(19.5)					5.0		154.1	Trade & other receivables
							3.7			3.7	Current tax asset
2.7	Cash at bank and in hand	247.402								491.4	Cash & cash equivalents
2.8	Short term deposits	244.000									
2.10	Assets transferred to PPP contractors	49.840			(49.8)						
2.12	Total current assets	712.327								651.7	
	Creditors: amounts falling due within one year										*Current liabilities*
2.14	Infrastructure Renewals accrual	(31.370)				31.4					
2.15	Creditors	(383.735)	7.7					(9.4)	(i)	(385.5)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	-			(18.3)					(18.3)	Other loans & borrowings
2.17	Corporation tax payable	3.711					(3.7)			-	Current tax liabilities
								(1.8)	(ii)	(1.8)	Provisions for liabilities
2.19	Total creditors	(411.394)								(405.6)	
2.20	Net current assets	300.933								246.1	
2.21	Total assets less current liabilities	5,520.284								5,730.4	
	Creditors: amounts falling due after one year										*Non-current liabilities*
2.22	Borrowings (excl. Govt. loans)	(1.000)			(363.6)					(364.6)	Other loans & borrowings
2.23	Other creditors	(48.100)						(20.2)	(i)	(68.3)	Trade & other payables
2.24	Total creditors	(49.100)								(432.9)	
	Provision for liabilities & charges										
2.25	Deferred tax provision	(394.248)	40.3				(0.5)			(354.5)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(24.610)						24.6	(i)		
2.27	Post employment assets / (liabilities)	-	(201.4)							(201.4)	Retirement benefit obligations
2.28	Other provisions	(15.798)	12.4					1.8	(ii)	(1.6)	Provisions for liabilities
2.29	Net Assets employed	5,036.528	(160.5)	(83.7)	(52.2)	-	-	0.0		4,740.0	*Net assets*
	Capital and reserves										*Equity*
2.30	Govt. loans	3,423.275								3,423.3	Government loans
2.31	Income and Expenditure account	1,479.823	(160.5)	(83.7)	(52.2)		-			1,183.3	Retained earnings
2.32	Other reserves	133.430								133.4	Other reserves
2.33	Capital & reserves	5,036.528	(160.5)	(83.7)	(52.2)	-	-	-		4,740.0	

Scottish Water
Year ended 31 March 2015
Reconciliation of Historic Accounts / M Tables to Consolidated Statutory Accounts (Company only)

TABLE M2			IFRS adjustments:			Reallocations / Reclassifications:				Statutory Accounts (IFRS)	
			IAS19	IAS16	IFRIC12	Infra	Deferred /	Rec-pay realloc /			
			Pension /	Infrastructure	PFI assets/	Renewals	Current tax	&			
Line	Description	Total	holiday pay	assets/deprn	finance lease	Prepayment	presentation	Split <> 1yr		Company	
		£m (3dp)								£m (1dp)	
	Fixed Assets										*Non-current assets*
2.1	Tangible Assets	5,205.162		(83.7)	379.5	(31.4)				5,469.6	Property, plant & equipment
2.3	Investment - Other	37.639								37.6	Investments
2.4	Total fixed assets	5,242.801								5,507.2	
	Current Assets										*Current assets*
2.5	Stocks	2.264								2.3	Inventories
2.6	Debtors	97.982	(19.5)					5.0	(iii)	83.5	Trade & other receivables
							0.8			0.8	Current tax asset
2.7	Cash at bank and in hand	151.442								345.4	Cash & cash equivalents
2.8	Short term deposits	194.000									
2.10	Assets transferred to PPP contractors	49.840			(49.8)						
2.12	Total current assets	495.528								432.0	
	Creditors: amounts falling due within one year										*Current liabilities*
2.14	Infrastructure Renewals accrual	(31.370)				31.4			{(i)/		
2.15	Creditors	(339.613)	7.7					(6.2)	{(iii)	(338.1)	Trade & other payables
2.16	Borrowings (excl. Govt. loans)	-			(18.3)					(18.3)	Other loans & borrowings
2.17	Corporation tax payable	0.817					(0.8)				
								(12.7)	(ii)	(12.7)	Provisions for liabilities
2.19	Total creditors	(370.166)								(369.1)	
2.20	Net current assets	125.362								62.9	
2.21	Total assets less current liabilities	5,368.163								5,570.1	
	Creditors: amounts falling due after one year										*Non-current liabilities*
2.22	Borrowings (excl. Govt. loans)	(1.000)			(363.6)					(364.6)	Other loans & borrowings
2.23	Other creditors	(48.100)						(13.5)	(i)	(61.6)	Trade & other payables
2.24	Total creditors	(49.100)								(426.2)	
	Provision for liabilities & charges										
2.25	Deferred tax provision	(394.384)	40.3							(354.1)	Deferred tax liabilities
2.26	Deferred income - grants and contributions	(14.778)						14.7	(i)		
2.27	Post employment assets / (liabilities)	-	(201.4)							(201.4)	Retirement benefit obligations
2.28	Other provisions	(28.209)	12.4					12.7	(ii)	(3.1)	Provisions for liabilities
2.29	Net Assets employed	4,881.692	(160.5)	(83.7)	(52.2)	-	-	-		4,585.3	*Net assets*
	Capital and reserves										*Equity*
2.30	Govt. loans	3,423.275								3,423.3	Government loans
2.31	Income and Expenditure account	1,324.987	(160.5)	(83.7)	(52.2)					1,028.6	Retained earnings
2.32	Other reserves	133.430								133.4	Other reserves
2.33	Capital & reserves	4,881.692	(160.5)	(83.7)	(52.2)	-	-	-		4,585.3	

Appendix 3

M18 Methodology and Cost Allocation

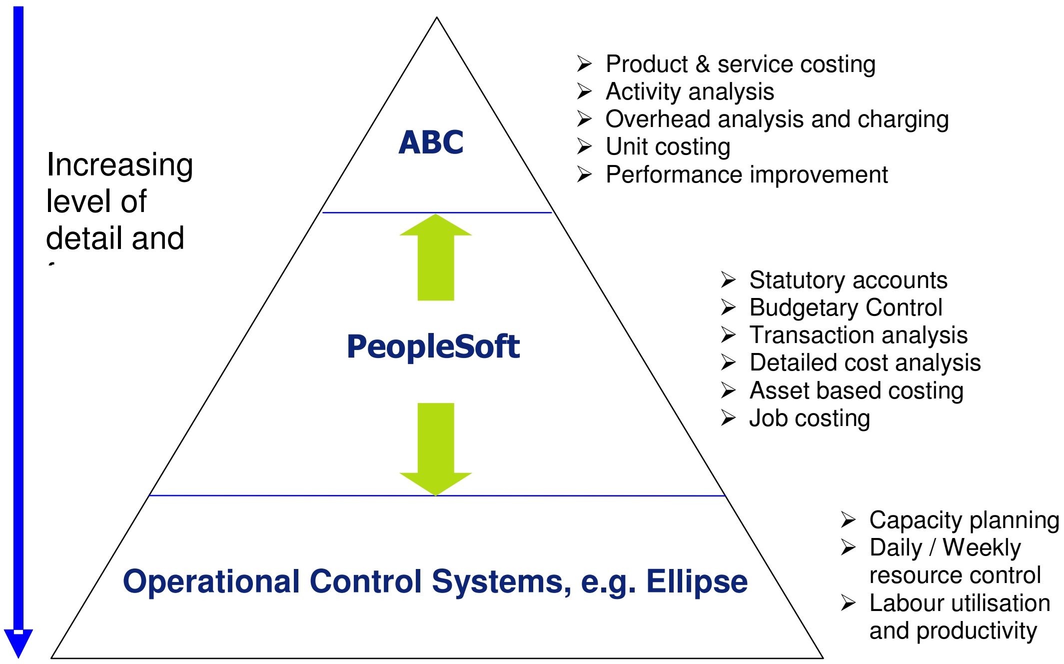
Methodology

Cost analysis in M18 Tables (M18W and M18WW) was prepared using reports from Scottish Water's Activity Based Management (ABM) systems.

ABM provides analysis of the costs of key activities and processes, and links these to the factors that cause or drive our level of cost. This allows us to develop an understanding of the full cost of providing services, either internally within Scottish Water, or to our external customers.

Scottish Water has built an ABM toolkit founded upon consistent principles which apply across some key core systems and processes.

Activity Based Management data (financial and non financial) is captured in various corporate systems. The key systems which provide ABM analysis for M18 Tables are:

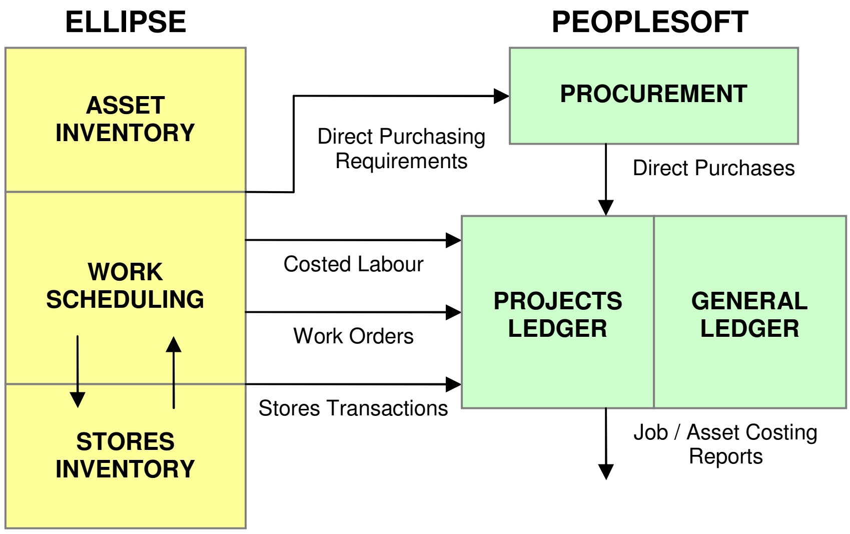


System	ABM Process Overview
Ellipse Works & Asset Management System	Ellipse is used to hold Scottish Water's Asset Inventory and to manage operational activity by individual job (work order), activity and asset. Time spent working on work orders is captured in Ellipse via timesheets, integrated mobile devices or laptops. Material issued to jobs from Stock is also captured by work order. Time and materials are then costed and interfaced to the PeopleSoft Financial System on a daily basis. See Overview diagram below.

PeopleSoft Financial & Procurement System	PeopleSoft is Scottish Water's primary financial and procurement system. The key modules utilised by Scottish Water are Procurement, Accounts payable, Projects, Timesheets, Billing, Accounts Receivable, General Ledger & Fixed Assets. Accounting separation within the Scottish Water group of companies has been enabled within PeopleSoft. Business Units are the highest level entity in PeopleSoft and are used to securely separate data and access to data and processes. Separate Business Units have been used to separate Scottish Water Horizons from Scottish Water, and in turn from Scottish Water Solutions. Cross-business unit transactions can only be made via inter-company invoicing. Within Scottish Water capture of activity based information within PeopleSoft has been maximised through the set up of our coding structure, systems and processes. Cost codes have been set up within PeopleSoft to capture and sub-analyse costs by: • Individual work order; • Individual asset; • Each capital or non regulated project; • Each support department; and • Expense subjective (account). All costs are held in PeopleSoft, and costed either directly through PeopleSoft Procurement or operational costing through the Ellipse-PeopleSoft interface. PeopleSoft, therefore, provides comprehensive costing analysis, on a monthly basis, of the costs directly attributable (including some key support activity recharges) to each team, asset, zone, project, service and job.
Hyperion Activity Based Costing (ABC) System	Hyperion Profitability and Cost Management (HPCM) is an ABC system structured around Scottish Water's key (c.250) activities. ABC is run periodically (typically annually) to cover all profit and loss expenditure. PeopleSoft feeds total expenditure directly into Hyperion. Where activity splits have already been captured, e.g. Ellipse effort by activity / asset, these are also fed directly into Hyperion. Costs are analysed by activity and for each activity a non financial driver is captured. The non financial driver is the measurable factor which drives activity cost, or the level of resource consumption. In Hyperion these drivers are used to allocate costs to services.

	Output from Hyperion provides analysis of the full cost of services. These services have been structured to match E & M Table activity classifications, and therefore Hyperion output directly feeds these tables. Non financial driver data is collected from a variety of corporate systems and input to Hyperion.
Driver Data Systems	Examples of systems and drivers are: • LIMS – Lab tests processed and samples taken; • Oracle CRM – Customer calls and written contacts; • Gemini – Waste movements; • Ellipse – Number of jobs, man hours, stores issues, etc; and • PeopleSoft – Number of invoices, purchase orders, customer bills, man hours.

Ellipse / PeopleSoft Integration



Cost Allocation

Consistent with prior years, costs are captured or allocated in line with Regulatory Accounting Rules including modifications, agreed with the Commission, to reflect the Scottish retail market.

<u>Transfers between Separate Entity Associates</u>

Transfers between our separate legal entities are invoiced in accordance with specified Service Agreement prices or Contracts. The prices in these agreements are in accordance with Regulatory Accounting Rules on Transfer Pricing, and prices reflect the full cost of providing the service to the entity. Activity Based Management output has been used extensively in determining the costs which should be included in transfer prices.

Transfers to Non Regulated Activities

Scottish Water Horizons Limited (SWH) along with Scottish Water International (SWI) are responsible for the majority of the Scottish Water Group's Non Regulated activities. Transfers to Non Regulated activities are undertaken as described in the section above "Transfers between Separate Entity Associates".

A residual number of Non Regulated activities remain within Scottish Water. These are activities which are incidental or integral to the regulated business activities. For example, rechargeable works on core assets, and use of laboratory services for third party sampling and analysis.

Within Scottish Water, Non Regulated activity is separately reported in a Non Regulated ledger tree within PeopleSoft. Non regulated costs are either directly captured and reported in the Non Regulated ledger tree, or are charged to Non Regulated through cost recharges.

Operational Staff working on Non Regulated activities, e.g. rechargeable works, charge costs to Non Regulated through Ellipse work orders as described in the methodology section.

Support cost recharges for Fleet, IT and Property are transferred on a regular basis, to reflect actual consumption of support costs. A further cost recharge is made on top of this, to cover areas, which are not regularly recharged. These recharges are made on the basis of ABC analysis.

Capitalisation Policy

Scottish Water has applied a consistent policy to capitalisation and ensures compliance with UK Generally Accepted Accounting Practices (UK GAAP) for Regulatory accounting and International Financial Reporting Standards (IFRS) for statutory reporting purposes. The main points of the policy are:

> 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. 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 items of property, plant and equipment, with the exception of land and assets under construction, are subject to depreciation.

The capitalisation policy provides guidance notes and examples on distinguishing between operational and capital expenditure.

Reactive Capital Expenditure

In general terms, infrastructure reactive activities can be capitalised where there is replacement of discrete lengths of mains or sewers, usually no less than 3 metres. The work must represent a permanent solution to a fault or deficiency in the network. Costs associated with clearing blockages or the use of a collar on a burst main are not capitalised but are charged to opex.

Reactive non infrastructure capital expenditure includes the replacement of an asset at the end of its useful life such as pumps, filters, screen. In addition, costs associated with a complete asset overhaul, the results of which extend the asset life for a number of years can be capitalised under either reactive or planned capital expenditure. Expenditure relating to the repair or replacement of a component of an asset, e.g. the replacement of a bearing, are not capitalised but charged to opex.

Expenditure on Leakage

Expenditure on leakage is predominantly allocated to operational expenditure since much of the activity relates to either operational intervention or investigative work. However, the replacement of discrete lengths of mains, usually no less than 3 metres, installation of valves and meters are capitalised.

Wholesale Cost Allocation by WICS Activity

Scottish Water's coding structure follows Regulatory Activity classifications, i.e. Water Treatment, Water Distribution, etc. by individual asset.

The majority of operational costs are directly captured against the individual assets, either by direct charging, e.g. Power, Chemicals, or through Ellipse work orders as described in the Methodology section, e.g. labour costs. In 2014/15 85% of costs, directly attributable to wholesale assets, were charged to assets. The shortfall against 100% was due to some gaps in labour costing. These gaps are addressed, for the purposes of regulatory reporting, via activity analysis undertaken with team leaders.

Fleet inventory costs are recharged to teams on a regular basis, and ABC then calculates the fully allocated costs of wholesale activities, including all support activity costs based on actual activity costs and driver volumes.