

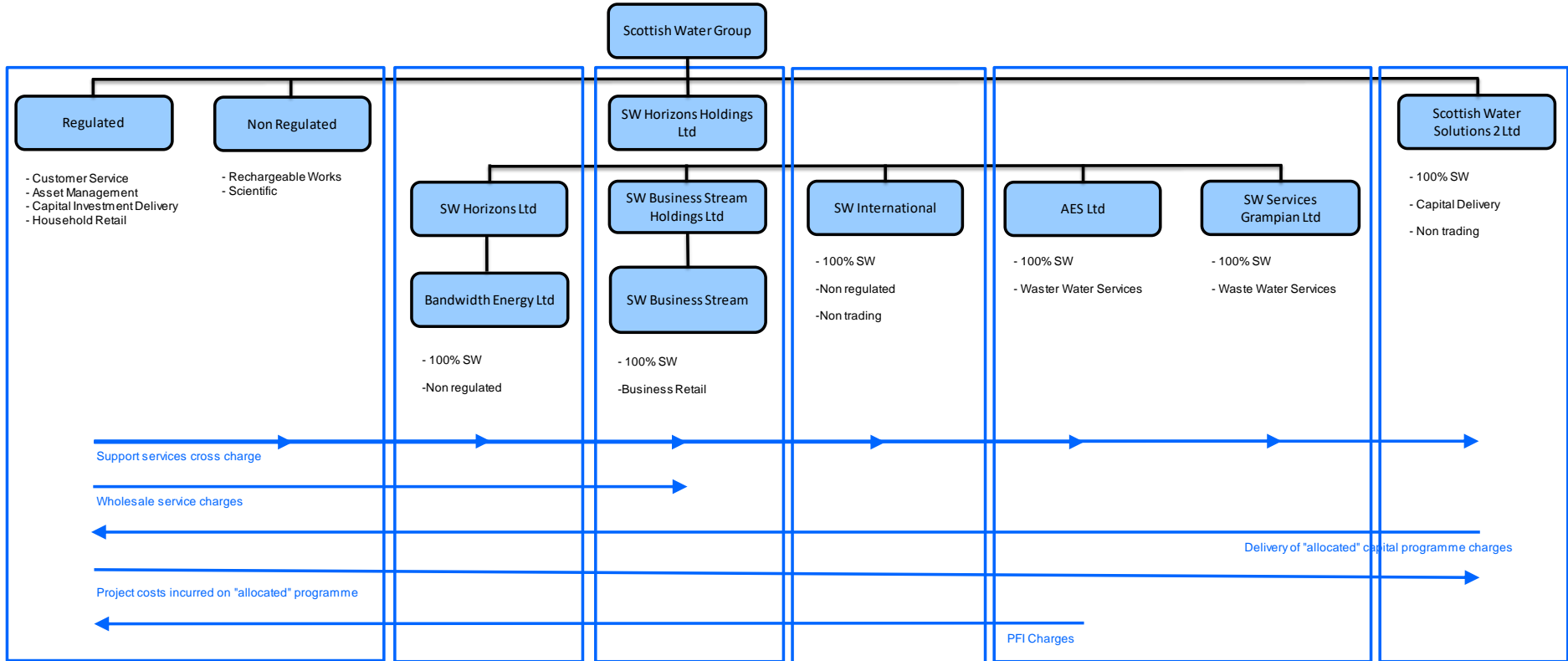
General Comments

The N tables for 2020/21 have been prepared in accordance with Regulatory Accounting Rule 5 and related definitions.

The N tables detail the financial and contractual transactions which have taken place between Scottish Water (Regulated) and the following associates:

1. Scottish Water Business Stream Ltd (SWBS): the subsidiary responsible for retail – non household activities.
2. Scottish Water Business Stream Holdings Ltd (SWBSH): the holding company for SWBS.
3. Scottish Water Horizons Ltd (SWH): the subsidiary responsible for the majority of Scottish Water’s non-regulated activities.
4. Aberdeen Environmental Services Ltd (AES): the PFI concession operator for 4 wastewater treatment works in North East Scotland.
5. Scottish Water Services (Grampian) Ltd (SWSG): the operating company of the 4 wastewater treatment works in North East Scotland.
6. Scottish Water Horizons Holdings Ltd (SWHH): the holding company for SWH, SWBSH, AES and SWSG.
7. Scottish Water Solutions 2 Ltd (SWS2): the subsidiary responsible for delivering part of the SR10 capital programme, now non-trading.
8. Scottish Water (Non-Regulated): activities undertaken by Scottish Water that are not necessary to fulfil the functions and duties of a water undertaker as defined in the Water (Scotland) Act 1980 as amended by subsequent legislation and as a sewerage undertaker as defined in the Sewerage (Scotland) Act 1968 or as amended by subsequent legislation. A small number of non-regulated activities did not transfer across to SWH. Activities which form an integral part of, or are incidental to, Scottish Water’s core operations, such as rechargeable works, and laboratory services, remain within Scottish Water as a separate accounting entity.

The main transfers between associates are illustrated below.



Statement of Compliance

Alan P Scott, Finance Director, has signed the N Table return and accompanying commentary, and in so doing has confirmed Scottish Water's compliance with Regulatory Accounting Rule 5 – Transfer Pricing.

Declaration of Interest

Scottish Water Horizons Holdings Ltd, Scottish Water Horizons Ltd, Aberdeen Environmental Services Ltd and Scottish Water Services (Grampian) Ltd are fully owned subsidiary companies of Scottish Water with their own board of directors. The actions of the directors are governed by the Companies Act 2006.

Scottish Water Business Stream Holdings Ltd is a fully owned subsidiary of Scottish Water, via SWHH, with its own board of directors. The actions of SWBSH's Directors are governed by the Companies Act 2006 and the Governance Code agreed between the Water Industry Commission for Scotland, Scottish Water and Business Stream.

Scottish Water Solutions 2 Ltd is a fully owned non-trading subsidiary of Scottish Water with its own board of directors. The actions of SWS2's Directors are governed by the Companies Act 2006.

Scottish Water (Regulated) and Scottish Water (Non-Regulated) form part of the same legal entity and in most cases utilise common, shared resources. Therefore, in transactions between these associates, directors can act as both purchaser and supplier in any transaction with an associate entity. Compliance with transfer pricing rules is ensured, firstly through separate budgetary and accounting control at General Manager level and secondly through Finance and Regulatory enforcement of transfer pricing rules in cross-charges.

Table N1 Transfer Pricing Summary (Capex)

A. Market Testing

1. Scottish Water Solutions 2 Ltd

SWS2 Ltd did not trade during 2020/21, and therefore there were no refunds to, or costs incurred by Scottish Water in relation to any capital projects which had been contracted out to SWS2 to deliver.

Table N2 Transfer Pricing Summary (P&L)

A. Market Testing

There has been no additional market testing of Table N2 services in 2020/21.

B. Cost Allocation. Recharges to Associate / Non-Core from Core

1. Scottish Water charges to Scottish Water Business Stream

- (i) Service & Support Charges

Service agreements are in place between Scottish Water and Business Stream for the few services provided by SW.

Charges reduced to £86k for the year. The services charged under service agreements were in respect of the Internal Audit charge which is charged on a daily rate basis for the agreed audit plan.

(ii) Wholesale Charges.

Scottish Water is required to charge business retailers for Primary and Non Primary Water and Wastewater services. Cross-charges are based on the Wholesale Scheme of Charges.

2. Recharges from Scottish Water to Scottish Water Horizons

Table N2 reports the value of cross-charges between Scottish Water and Horizons, which includes the following transaction types:

- Labour, material and service costs transferred from Scottish Water as actually incurred on Horizons activities (projects); and
- Recharges from Scottish Water for support activities undertaken for Horizons. This includes the cost of functions such as IT, Fleet, Property, Finance, HR and Customer Services. Cross charges either reflect the actual cost of the service, e.g. actual fuel charge, actual mobile phone call charges; or the cost of the service as calculated via Activity Based Management System (ABM). ABM calculates the actual cost of the support activity, and allocates the cost of that support activity across internal customers based on the share of activity cost drivers. This is in accordance with RAR 5 requirements.

During the year Scottish Water charges to Horizons were £1,982k, a reduction of £144k compared to prior year.

- Management and support costs are captured within the regulated ledger and a recharge is made to Horizons for an element of these costs that relate to Non-Regulated work, based on work throughput. Management and support costs consist of Corporate Affairs, Contact Centre, Finance, Internal Audit, Legal, Payroll and Property recharges.
- Waste & Sludge Processing Charge for Waste Services is for waste being treated and disposed of using SW site assets and associated transport and labour costs. The value of this is based on the Mogden formula for 3rd party waste (liquids) treatment and sludge model costs for 3rd party waste (sludge) treatment.
- The cross-charge for Aquatrine work was for the SW call centre taking calls from Aquatrine clients and sampling services from SW Scientific.
- The cross-charge for Support Shipping Water Services was relate to costs recharged from the core business in relation to the provision of shipping water.
- The cross-charge for Asset Management costs are charged for SW staff working on Horizons capital projects, calculated using time sheets and hourly rates which include overhead recovery.
- The cross-charge for ABM Support costs represents corporate overhead recovery.
- The cross-charge for IT Service costs was in respect of providing service desk support, mobile devices, provision of desktop support, security and systems management, applications management/support and IT communications.

3. Recharges from Scottish Water (Regulated) to Scottish Water (Non-Regulated)

Scottish Water (Non-Regulated) is not a separate legal entity. However, Scottish Water (Non-Regulated) is set up as a separate accounting entity. Certain costs are directly captured within Scottish Water (Non-Regulated). These are direct employment, materials and external service costs.

These costs are charged directly to Scottish Water (Non-Regulated), and therefore are not reported in table N2.

Table N2 does not report the total cost of Scottish Water (Non-Regulated), but reports the value cross-charged between the Scottish Water (Regulated) and Scottish Water (Non-Regulated) entities. The total cost of the Scottish Water Non-Regulated accounting entity, is included within Table M18, in line with Regulatory reporting requirements.

There are certain non-regulated activities which utilise Scottish Water (Regulated) assets and staff, and cross-charges are made to reflect this. Cross-charges are fully compliant with RAR 5 in that they reflect the full cost of services provided, and are based on resource consumed. The main non-regulated activities utilising regulated assets and staff are:

- Operate & Maintain 3rd Party Assets;
- Rechargeable Works;
- Septic Tank Emptying;
- Provision of non-Potable Water; and
- Lab Services.

These also include Support Activity costs as described in the schedule for SWH.

4. Recharges from Scottish Water to AES

Recharges to AES from SW were for Finance, Legal and IT services. These costs were based on the intra group recharge rates for SW group.

5. Recharges from Scottish Water to SWSG

Management and Support recharges to SWSG from SW were for Finance, Legal, IT, Scientific services and Group management. These costs were based on the intra group recharge rates for SW group.

6. Recharges from Scottish Water (Regulated) to SWBSH

Table N2 reports the value of cross-charges between Scottish Water and Business Stream Holdings. This related to recharges (based on timesheet data) associated with the development and agreement of a funding facility to support subsidiary companies through the short-term liquidity impacts of the Covid-19 pandemic. These charges consisted of £75k for Legal and £172k for Finance services.

7. Recharges from Scottish Water (Regulated) to Scottish Water Solutions 2

SWS2 is in the process of being wound down, therefore there were no recharges from Scottish Water to SWS2 during 2020/21.

Business Retail and Household Retail activities

Household retail activity and residual Business retail activity (management of Licensed Provider interfaces, Wholesale Billing and CMA activity), were not separate legal or accounting entities during the year. Scottish Water does, however, report the full cost of these services in the M18 tables.

C. Cost Allocation. Recharges to Core from Associate / Non-Core

1. Cross-charges from Scottish Water Business Stream (Regulated) to Scottish Water (Regulated)

Interest paid to SWBS

As per the wholesale agreement, Scottish Water Business Stream pays Scottish Water the wholesale charges (normally 2 months in advance). Interest is charged on this advance payment at 4%. There are also a series of subsequent reconciliations, as estimated charges are replaced with actuals, with interest paid on the resulting reconciliation payments between the parties. However, in April 2020, the prepayment of wholesale charges by Licensed Providers was temporarily relaxed to enable them to support their business customers during the Covid-19 pandemic. This resulted in lower interest charges being paid by Scottish Water during 2020/21.

Guaranteed Service Standard Payments

During the year Scottish Water made Guaranteed Service Standard Payments to SWBS in line with the Wholesale Scheme of Charges. The Schedule 4 of the Wholesale Services Agreement sets out a number of Service Standards with which Scottish Water must comply. Where failures occur, payments must be made from Scottish Water to the Licensed Provider in accordance with section 14 of the Wholesale Scheme of Charges. These amounts relate to such Service Standard payments.

Gap incentives

During the year Scottish Water made gap incentives payments to SWBS in line with the Wholesale Scheme of Charges.

2. Cross-charges from Scottish Water Horizons (Non-Regulated) to Scottish Water (Regulated)

During the year SWH charged Scottish Water £2,699k, an increase of £1,626k compared to prior year, primarily from new activity in the year relating to Scottish Water's vesting project and increased renewable energy. The full list of charges is provided below:

- Impact assessments relating to the effects of new developments on the existing infrastructure;
- The provision of plan and property searches;
- The services of Horizons staff working mainly on SW projects. This was for Horizons General Manager working on Commercial Estates projects;
- Renewable energy supplied to SW from the renewable energy assets delivered and operated by SWH;
- Trials and training carried out by SW at Test Centres operated by Horizons;
- The storage of Chemicals at Deerdykes as part of Brexit safeguarding;
- Supporting the delivery of SW's vesting project, bringing existing assets up to an adoptable standard to be vested by SW;
- The storage of Grit at Deerdykes for research and innovation trials; and
- Haulage costs incurred due to SW site inaccessibility.

3. Cross-charges from AES to Scottish Water (Regulated)

AES charged Scottish Water for the PFI services provided by the 4 wastewater treatment works in the North-East of Scotland during the year.