

## **M Tables – Regulatory Accounts Commentary**

The sections in this document are:

1. General comments
  2. Results and reconciliations
  3. Assumptions
  - 4.1 Commentary – M tables 1-28
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### **1. General Comments**

The M Tables in their current format were not required to be completed in 2005/06. SW's business structure changed in 2006/07 to reflect the new regulatory regime effective from 1 April 2006. For these reasons it was agreed with the WICS that only figures for the financial year 2006/07 would be submitted, comparative figures not being required.

### **2. Results & Reconciliation**

On the 1<sup>st</sup> November 2006 Scottish Water Business Stream Limited (SWBS) commenced trading. SWBS is a fully owned subsidiary of Scottish Water (SW). SW produces statutory consolidated accounts incorporating the results of SWBS. The consolidated statements also include the balance sheet (and relevant notes) for SW itself ('company'). Detailed reconciliations between the statutory accounts and the regulatory tables have been attached in the appendix to this document.

M Table financial information is for SW only, i.e. excluding SWBS, and analysed between Core (= Regulatory business) and Non Core (= Non regulatory businesses) where required. Tables M27 and M28 provide reconciliations from the SW Core figures to the group consolidated income and expenditure statement and balance sheet respectively.

Because of some different descriptions and terminology between the regulatory M tables and the statutory accounts, Appendix 1.1 and 1.2 provide reconciliations from the Table M27 totals and M28 totals to the statutory consolidated income and expenditure account and consolidated balance sheet, respectively. Appendix 1.3 shows the reconciliation between Table M2 and the statutory "company" balance sheet.

Due to the change in business structure noted above, from 1 April 2006 Regulated / Non Regulated have been accounted for separately in SW's general ledger system enabling the production of regulated/non-regulated profit & loss accounts and balance sheets. These form the basis for the historical cost figures and analysis, in particular Tables M1, M2, M24, M27 & M28.

Cost analysis in Tables M18 W and M18 WW was prepared using reports from SW's Activity Based Management (ABM) systems. Detailed commentary on ABM methodology and cost allocation is provided in support of the E Tables and is not repeated in this document.

FRS17 entries in the statutory accounts have been included in the regulatory results, both HCA and CCA, but are excluded in Tables M18W and M18WW and the E Tables in the Annual Return. The impact of FRS 17 was an increase of operating costs (£5.6m) and a credit to financing (£2.8m), giving a net reduction to profit before tax in the income and expenditure account of £2.8m.

### **3. Assumptions**

#### **Non core tax charge**

It has been assumed that there are no brought forward profits/losses or capital allowances for the non core element. The tax charge is based on the actual capital spend, profit and grant amortisation attributable to the non regulatory businesses in 2006/07. (Tables M1, M2, M21)

#### **CCA adjustments**

RPI of 3.67% used in the relevant adjustments, being the rate as at October 2006.

#### **CCA working capital adjustment**

The working capital adjustment has been pro rated between water and waste water based on turnover values. (Table M7, line 7.14)

#### **CCA fixed asset values**

The opening CCA fixed asset values used in the Delivery Plan 2006-2010 were Table H1 values as at 31 March 2006. The same source has been used in Table M8 (CCA Analysis of Fixed Assets by Asset type (Core)). The assumption made here is that the closing values in this table equal the Table H1 values at 31 March 2007. Further details about the completion of table M8 are given in Section 4.

#### **2005/06**

As agreed with the WICS, the tables have not been completed for the prior year. However, some tables are a reconciliation of the opening to closing balances (e.g. Table M8) and in Table M11 the 2005/06 figures are entered for clarity. For this reason, Tables M2 and M5 – the balance sheets – have some figures in the prior year columns due to formulae referencing the other tables.

#### **Table M15 – Regulatory Capital Value**

Not required as per email 3 May 2007 from WICS.

#### **Tables M16 & M17 – 5 year rolling summaries**

Only 2006/07 figures entered (automatically). Figures for the previous years are not required (see 2005/06 paragraph above). Any figures shown in 2005/06 are due to formulae referencing other tables.

#### **4. Commentary – Tables M1 to M28**

This section has comments on individual tables, where it is felt that such narrative will aid understanding 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 – HCA Income & Expenditure Account**

The Core information is from the general ledger reports for the Regulated business. The non core operating costs and depreciation charge shown are based on the ABM costing allocations but in total are the same as the general ledgers. The tax charge calculation is based on the assumptions detailed above in the assumptions.

##### **Table M2 – HCA Balance Sheet**

Core / Non core information is from the general ledger reports. The main differences from the statutory HCA balance sheet are the Infrastructure Renewal Accrual (IRA) (line 2.12) and the fixed asset total (adjusted for the IRA).

##### **Table M3 – HCA Balance Sheet – Reconciliation to Statutory Accounts**

This provides a summary of the main reconciling items. However, more details have been given in the appendices – 1.1, 1.2 and 1.3.

##### **Table M4 – CCA Income & Expenditure Account**

The only differences between the HCA and CCA Income and Expenditure Accounts are due to the CCA adjustments.

- CCA depreciation is calculated based on the brought forward CCA net book values and assumes half of the relevant average useful life remains. The index applied is the RPI of 3.67%. For additions during the year, the actual cost and average useful lives are the basis, with no indexing.
- Amortisation of deferred income (grants and contributions) is adjusted for the indexing.
- The working capital adjustment is the indexed of the opening (operating) working capital (as in Table M11).
- The financing adjustment is the index applied to the opening net finance amount for SW.

##### **Table M5 – CCA Balance Sheet**

Third party contributions (line 5.2) include the index-adjusted value of both grants and contributions.

The income & expenditure reserve is the total of the HCA reserve at 31 March 2006, the CCA profit for 2006/07 and the FRS 17 actuarial gain 2006/07 in the STRGL (Table 19). The HCA reserve at 31 March 2006 is used as the brought forward balance because there is no equivalent CCA balance sheet at that date.

##### **Table M6 – CCA Cash Flow**

Interest received (line 6.2) includes the intercompany interest received from SWBS. The movement on loans to group companies (line 6.11) is the funding of SWBS. Interest paid, receipts from grants, purchase of fixed assets and disposal proceeds are the same amounts as disclosed in the statutory cash flow.

**Table M8 – CCA Analysis of Fixed Assets by Asset type (Core)**

The opening and closing values in Table M8 (lines 8.1, 8.6, 8.13 & 8.14) agree to the values in Table H1 as at 31 March 2006 and 31 March 2007 respectively. The additions in the year are at actual cost. The inflation adjustment figures (lines 8.3 & 8.9) are the indexing of the brought forward values, using RPI. The values shown for the investment plan adjustment (lines 8.2 & 8.8) are the revaluation adjustments bringing the closing values back into agreement with Table H1 values. H Table analysis generates a valuation of assets at a point in time and does not analyse year on year movements.

The H Tables categorise the assets into water / wastewater non infrastructure, water / wastewater infrastructure and support services. In Table M8 the support services have been allocated between water and wastewater based on their HCA values.

SW's additions to fixed assets are entered firstly to Assets in the course of construction (AUC) then, on beneficial use, reclassified to the appropriate asset category. AUC can be broken down into water/waste water and support services with a high level of confidence. The infrastructure/non infrastructure analysis is more difficult, since it is not until project completion that visibility of the expenditure into the categories is finally determined. As there is no AUC category in the H tables, the opening and closing amounts are zero. This results in no inflation adjustment and an amount in the investment plan adjustment line to bring the year end balance to zero.

CCA depreciation is calculated based on the brought forward CCA net book values, from the H Tables, and assumes half of the relevant average useful life remains. The index applied is the RPI of 3.67%. For additions during the year, half of the actual cost (i.e. assuming additions are in use for half of the year, on average) and the relevant average useful lives are the basis, with no indexing.

**Table M11 – CCA Working capital**

A separate reconciliation (Appendix 1.4) has been prepared showing reclassifications from statutory basis of debtors and creditors into regulatory CCA working capital (operating items) and non operating debtors and creditors. (Tables M11 & M5). The prior year figures entered are for SW total and exclude business separation that occurred during 2006/07. Consequently the decrease in receivable balances is due to the transfer of the non household business to SWBS on 1 November 2006.

**Table M12 – Movement on Current Cost Reserve**

The opening balance (line 12.1) is the difference between the CCA and HCA fixed asset balances at 31 March 2006. The fixed asset inflation adjustment (line 12.3) represents the cost and depreciation adjustments from Table M8 (lines 8.3 & 8.9) along with the infrastructure renewals expenditure for the year. The other items are the opposite entries of the CCA adjustments described under Table M4.

**Table M13 – Reconciliation of Current Cost operating surplus to net cash flow from operating activities**

The working capital movement (line 13.3) is an input figure (instead of a calculation). The actual movement of £72.6m is mainly due to the transfer of the non household business to SWBS during the year. This is offset by the loan made to SWBS of £64.5m, as shown in the cash flow (line 6.11).

Opening figures at 31/03/06 have been provided (Table M11) and are for SW in total at that date. However, the calculation of the working capital movement for cash flow purposes excludes the capital creditors and the balance receivable from SWBS relating to the intercompany transfer of assets to SWBS.

Line 13.10 includes the movement on non trade debtors and creditors, other creditors and provisions along with the FRS17 adjustment in operating costs.

**Table M16 – 5 year rolling summary: Current Cost Income & Expenditure Account for Core Business**

As agreed with the WICS, this table has not been populated for the earlier years. 2006/07 figures are entered automatically from the other tables.

**Table M17 – 5 year rolling summary: Current Cost Balance Sheet for Core Business**

As agreed with the WICS, this table has not been populated for the earlier years. 2006/07 figures are entered automatically from the other tables. The figures appearing in the 2005/06 column are due to formulae referencing other tables.

**Tables M18B W – Analysis of fixed assets – Water Service**

The information presented here is a more detailed analysis of the non infrastructure and infrastructure water assets provided in Table M8. The opening (lines 18b.1 & 18b.16) and closing (lines 18b.6 & 18b.15) balances agree to the values in Table H1 at 31 March 2006 and 31 March 2007 respectively. The Table H1 figures for water storage (H1.2) and water resources (H1.4) are combined under “Sourcing”; water treatment works (H1.1) is “Treatment”; water pumping (H1.3) and water mains (H1.5) are “Water distribution”. Support service assets are not included in Table M18b. Their inclusion, which could only be by means of allocation across the current category headings, would distort the clear tie between Tables H1 and M18B.

Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.673% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). The revaluation adjustments to bring the closing figures back to the H1 values are shown in the investment plan adjustment (lines 18b.2 & 18b.8). H Table analysis generates a valuation of assets at a point in time and does not analyse year-on-year movements.

**Tables M18B WW – Analysis of fixed assets – Waste water Service**

The information presented here is a more detailed analysis of the non infrastructure and infrastructure waste water assets provided in Table M8. The opening (lines 18b.1 & 18b.16) and closing (lines 18b.6 & 18b.15) balances agree to the values in Table H1 at 31 March 2006 and 31 March 2007 respectively. The Table H1 figures for wastewater infrastructure (H1.6, H1.7 & H1.8) and sewage pumping (H1.9) are combined under “Sewerage”; sewage treatment works (H1.10) is “Sewage treatment”; sludge treatment facilities (H1.11) is “Sludge treatment & disposal”. Support service assets are not included in Table M18b. Their inclusion, which could only be by means of allocation across the current category headings, would distort the clear tie between Tables H1 and M18B.

Additions/reclassifications from AUC are at actual cost. As in Table M8, the RPI of 3.67% was applied to the opening balances to calculate the RPI adjustment (lines 18b.3 & 18b.11). The revaluation adjustments to bring the closing figures back to the H1 values are shown in the investment plan adjustment (lines 18b.2 & 18b.8). H Table analysis generates a valuation of assets at a point in time and does not analyse year on year movements.

**Table M19 – Statement of total recognised gains and losses (core)**

Although the table title states ‘Core’, line 19.1 is actually referenced to the total column of Table M1, i.e. total of Core and Non Core.

**Table M22 – Fixed asset additions and expected depreciation (CCA)**

The non infrastructure additions (line 22.8) are the amounts reclassified from AUC, as described above.

The figures in the section “Infrastructure renewals charges, expenditure and provision”, (lines 22.20 – 22.22), are the movements during 2006/07. Therefore the resulting total is not the closing balance as given in the balance sheets at 31 March 2007. The table below shows the full reconciliation:

<b>Infrastructure renewals:</b>	<b>31 March 2006</b>	<b>2006/07 movements</b>	<b>M22 refs</b>	<b>31 March 2007</b>	<b>M2 / M5 refs</b>
- Expenditure	322.233	283.055	22.20	605.288	
- Charges	-538.000	-88.000	22.21	-626.000	
Prepayment/(accrual)	-215.767	195.055	22.22	-20.712	2.12 / 5.7

In the section “Expected depreciation on closing assets as of 31 March 2007”, (lines 22.23 – 22.28), the gross book values are taken from Table H1, with the net book value being the total NBV per Table H1, pro rated based on the gross values. The forecast depreciation charges are calculated using the relevant NBV at 31 March 2007 divided by half of the average useful life.

**Table 24 - Turnover**

Primary income (lines 24.1 – 24.13): The majority of the income types are directly identifiable with specific accounts in the SW general ledger. However, the analysis between Non household roads drainage (line 24.7) and Non household property drainage (line 24.8) is not held in this manner in the general ledger. The total of the three relevant ledger accounts (for surface water drainage) have therefore been pro rated between roads and property based on the billing coding held in the billings system.

Other sources (line 24.14 onwards): Each income source representing > 2% of the other sources total has been separately identified. The balance (under 1% of the total) has been shown as “Sundry” (line 24.20).

**Table M25 – Bad Debts (Trade debtors)**

This table shows the gross receivable less bad debt provision and credit note provision. For consistency within the tables, the net receivable amounts here are taken to Table M11 (lines 11.2 & 11.4). However, in the statutory accounts for SW the CNP is treated as part of accruals, resulting in a reclassification between regulatory and statutory reporting. The CNP is an adjustment to income for the issue of credit notes in the future.

A further point to note on Table M25 – “Bad debt provision in the year”: amounts shown are charges therefore negative values in the table (lines 25.9 & 25.10). The charge is net of a £6.0m atypical credit.

**Table M27 – Consolidated HCA Income & Expenditure Account**

The only intercompany item being visibly eliminated (in col 5) on this table is the intercompany cost of sales in SWBS which is the wholesale income for SW. The intercompany interest already eliminates across line 27.10.

Appendix 1.1 provides a reconciliation between Table M27 and the statutory consolidated income and expenditure account. The differences are due to the terminology and descriptions being used.

**Table M28 – Consolidated HCA Balance Sheet**

Appendix 1.2 provides a reconciliation between Table M28 and the statutory consolidated balance sheet. The differences are primarily due to reclassifications and grouping of various items.

Columns 1, 4, 7, 8 and 9 have balanced balance sheets. For the consolidation, the elimination of the intercompany balances can only balance in total, not in each company. Therefore the intercompany columns – 2 & 5 – do not balance individually, which in turn makes columns 3 & 6 out of balance.

For next year, we would propose that the Table be redesigned to facilitate deconsolidation. Our suggestion is noted at the end of this document.

## 4.2 M Table 18W & 18WW detailed commentary

### General

M Tables numbering has changed between 2005/06 and 2006/07. Table M1 is now M18W and table M2 is M18WW. References to previous tables are included in parentheses where appropriate.

### Methodology & Cost Allocation

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

Detailed commentary on ABM methodology and cost allocation is provided in support of table E and is not repeated in this document.

### Trading Results & Reconciliation

To aid E & M Table year-on-year comparison, the table below summarises Scottish Water group consolidated results and Scottish Water company results.

	SW Regulated Group			SW Company		
	SW Group Regulated	Less SWBS	TOTAL (SW Core)	SW Core	Non regulated	TOTAL (SW exc SWBS)
	£m	£m	£m	£m	£m	£m
Employment	117.2		117.2	117.2		145.7
Other	139.3		139.3	139.3	28.5	139.3
SWBS	7.0	-7.0	0.0			0.0
<b>Opex</b>	<b>263.5</b>	<b>-7.0</b>	<b>256.5</b>	<b>256.5</b>	<b>28.5</b>	<b>284.9</b>
PFI	125.6		125.6	125.6	0.0	125.6
IMC	88.0		88.0	88.0	0.0	88.0
Depreciation	136.3	-0.3	136.0	136.0	-0.2	135.8
Amort PFI	1.6		1.6	1.6	0.0	1.6
Gain on assets	-1.4		-1.4	-1.4	0.0	-1.4
Grant Amortisation			0.0			0.0
<b>Expenditure</b>	<b>613.6</b>	<b>-7.3</b>	<b>606.3</b>	<b>606.3</b>	<b>28.3</b>	<b>634.6</b>

E & M Tables include the costs of Scottish Water (core/regulated) and Scottish Water (Non Regulated). The costs of business retail activity from November 2006 to March 2007 undertaken by SWBS are not reported in Scottish Water's E or M tables.

Scottish Water company results are summarised and reconciled below, to E tables and M18 (W & WW) tables.



	SW Company	Difference		M Tables		Difference	E Tables
	TOTAL		TOTAL	M18 W	M18WW	M - E	TOTAL
	£m	£m	£m	Core	Core	£m	£m
Employment	145.7						
Other	139.3		282.8	160.3	122.6		282.8
SWBS	0.0						
<b>Opex</b>	<b>284.9</b>	<b>2.1</b>	<b>282.8</b>	<b>160.3</b>	<b>122.6</b>	<b>0.0</b>	<b>282.8</b>
PFI	125.6	-2.2	127.8	0.0	127.8	0.0	127.8
IMC	88.0	0.0	88.0	54.5	33.5	0.1	87.9
Depreciation	135.8		137.3	61.6	75.7		137.3
Amort PFI	1.6		0.0				0.0
Gain on assets	-1.4	-0.1	0.0			-0.1	0.0
Grant Amortisation	0.0		-1.2	-0.7	-0.5		-1.1
<b>Expenditure</b>	<b>634.6</b>	<b>-0.1</b>	<b>634.7</b>	<b>275.6</b>	<b>359.1</b>	<b>0.0</b>	<b>634.7</b>

The difference in the table above net to £0.1m and is due to rounding. The line differences are table presentation differences explained as follows:

- £2.2m difference on PFI costs is due to the transfer of costs from Customer Operations for Intersite Sludge Tankering from Scottish Water wastewater treatment works to PFI works (£1.7m), terminal pumping station costs pumping to PFI works (£0.4m) and support costs for the PFI team (£0.1m).
- £0.1m difference between E Tables and M Tables is due to Non Regulated IMC depreciation included in Third Party depreciation (depreciation line) in E Tables.

Scottish Water's statutory accounts reconcile to the M & E Table results.

		£m
Expenditure per E Tables		634.7
Expenditure per statutory accounts		
Cost of sales	549.7	
Administrative expenses	97.9	
		647.6
Less SWBS costs		-7.3
Less FRS 17 additional pension costs		-5.6
Total Expenditure		634.7

## Commentary

Total operating costs excluding PFI costs and exceptional items reduced by £46.4m to £506.9m.

	2006/07 £m	2005/06 £m	Variance £m
Functional costs - Water M18w.36 (M1.53)	115.792	140.487	24.695
Operating costs - Water M18w.45 (M1.74)	44.461	46.253	1.792
Capital maintenance - Water M18w.56 (M1.95)	115.360	145.149	29.789
Functional costs - Waste M18ww.35 (M2.53)	225.185	208.313	-16.872
Operating costs - Waste M18ww.44 (M2.74)	25.204	33.659	8.455
Capital maintenance - Waste M18ww.55 (M2.95)	108.738	106.262	-2.476
	<b>634.740</b>	<b>680.123</b>	<b>45.383</b>
<i>exclude PFI included in M18ww.35</i>	127.802	121.860	-5.942
	<b>506.938</b>	<b>558.263</b>	<b>51.325</b>
Remove Exceptional costs	0.000	-4.884	-4.884
	<b>506.938</b>	<b>553.379</b>	<b>46.441</b>

Detailed commentary on wholesale operating costs and efficiencies is provided in support of table E and is not repeated in this document.

More detailed commentary on Non Regulated and Retail activities is provided in this document.

## Activity Analysis

	2006/07 £m	2005/06 £m	Variance £m
Non Regulated	28.343	49.928	21.585
Wholesale (excluding PFI)	435.450	449.404	13.954
Retail	43.145	58.931	15.786
	<b>506.938</b>	<b>558.263</b>	<b>51.325</b>

The movement in Retail activity, explained below, includes two atypical cost movements:

- £1.5m increase in the cost of regulation. This was the contribution to Central Market Authority set up.
- £6m reduction in domestic bad debt. This was an additional release of bad debt provision in the year.

**Non Regulated** activity costs have reduced by £21.6m from 2005/6 to £28.3m. Direct costs have reduced by £18.3m, and General & Support and other operating expenditure by £3.3m.

The key movements in Non Regulated Operating Costs from 2005/6 were:

- Reduction in infrastructure work carried out by Scottish Water Contracting for Scottish Water Solutions £26.4m (Water £24.8m, Wastewater £1.6m). This was offset by an increase in the SW Contracting work on Scottish Water's core capital programme;
- General & Support costs, included in the £26.4m movement above, generally reduced in line with direct costs, due to this shift in workload. Fleet costs reduced by £3.8m and Insurance Premiums by £0.5m;
- There has been an increase in Business Development activity (developers and consulting support) £7m generating additional profit of £0.5m. This has been driven by significant increases in design & build contracts (£3.6m), drainage impact assessments (£1.2m) and other developer support (£1.0m);
- The remainder of the decrease (£2.1m) is due to improved capture of non regulated costs, predominantly in water connections activity.

**Wholesale** activity cost movements are explained in support of E Tables and are not repeated in this document.

**Retail** activity total operating costs have reduced by £15.8m from 2005/6 to £43.1m, as follows:

- Functional expenditure has reduced by £3.2m;
- Doubtful debts have reduced by £11.6m, of which £6.0m bad debt provision release is considered atypical in nature;
- Exceptional costs have reduced by £0.7m;
- Capital Maintenance costs have reduced by £2.1m; and
- Other operating expenditure has increased by £1.8m, primarily due to atypical movement in cost of regulation for CMA set up costs (£1.5m);

The key movements in Retail Operating Costs from 2005/6 were due to:

- Transfer of business retail activity to Scottish Water Business Stream £(5.6)m. (£3.7m functional expenditure, £1.9m doubtful debt);
- Atypical release of domestic bad debt provision (£6.0m);
- Doubtful debt reductions due to improved cash collection and reduction in aged debt profile £(3.7)m (£(3.0)m domestic, £(0.7)m non domestic).
- Reduced IT depreciation charges due to transfer of IT assets and cross-charge of IT services to SWBS £(2.1)m.
- Reduced exceptional items and other cost savings £(1.3)m.
- Increase in activity in preparation for market opening and wholesale revenue management £1.0m (£0.3m regulatory liaison, £0.7m direct costs).
- Inflationary increases £0.4m.
- Increase in cost of regulation due to CMA set up fees £1.5m.

Costs have reduced across most direct activities due to the transfer of business retail activity to SWBS, with the exception of increased activity in preparation for market opening - £0.7m included under Other Direct Costs.

General and support costs appear to have increased between 2005/6 and 2006/7 by £1.1m. However, this is due to a change in the split of costs between direct and general

and support year-on-year. Classification of costs between general and support and direct has been re-aligned in M Tables to be consistent with E table classification.

The revised variance with 2005/6 split re-stated on the same basis as 2006/7 shows a revised variance as follows:

	2007			2006 restated			2007 - 2006		
	Water	Waste	Total	Water	Waste	Total	Water	Waste	Total
Direct	9.82	10.02	19.84	10.93	10.55	21.48	-1.11	-0.53	-1.64
General and Support	1.27	1.43	2.70	2.01	2.20	4.21	-0.74	-0.77	-1.51
	11.09	11.45	22.54	12.94	12.75	25.69	-1.85	-1.30	-3.15

## Customer Analysis

	2006/07 £m	2005/06 £m	Variance £m
Domestic	31.609	41.535	9.926
Non Domestic - Measured	7.564	11.331	3.768
Non Domestic - Non Measured	2.676	2.701	0.025
	<b>41.849</b>	<b>55.568</b>	<b>13.719</b>

**Domestic** customer retail total functional and operating expenditure has reduced by £9.9m. The main movements from 2005/6 were:

- Atypical release of bad debt provision £6.0m;
- Reduction in doubtful debts to reflect improved collection rates £2.9m;
- Reduction to other direct costs / general and support £0.6m, primarily due to better allocation of some corporate costs to activities;
- Reduction in advertising and marketing £0.3m due to a shift in purpose of campaigns;
- Reduction in exceptional items £0.4m;
- Increase in cost of regulation £0.2m; and
- Increase in Household Billing & Collection charge £0.2m;

**Non domestic** customer retail total functional and operating expenditure has reduced by £3.8m to £10.2m (£7.6m measured and £2.6m unmeasured).

The split of costs between customers is based on activity and driver splits, for example:

- Metering activities directly to measured customers with minor allocation to household based on query and meter read volumes.
- Billing activities split based on drivers, e.g. number of bills issued, billing enquiries and complaints.
- Debt Management activities split based on aged debt, number of reminders issued, number of external recoveries actioned.
- Advertising / Marketing split based on the share of campaign expenditure and target customers.

The cost of handling customer calls has been split by service based on the number of calls. For example, the cost of "Handle Billing Enquiries" includes the cost of all customer

contact on this type of activity. This is consistent across all services, for example, the cost of wholesale water distribution includes the cost of all customer contact on this type of activity, e.g. low pressure calls, water rising calls. Therefore, no cost is shown in line M18WW.29 and M18W.30 under retail.

In the period April 2006 to October 2006, while Scottish Water was responsible for business retail activity, there was a shift in cost proportions from measured to non measured customers compared to 2005/6. This has been driven by a shift in billing and billing complaint volumes by c.9% from measured to unmeasured, and a shift in debt management drivers and aged debt profile by c. 6% from measured to unmeasured.

The main movements on business customer retail activity from 2005/6 were:

- Transfer of business retail activity to Scottish Water Business Stream £(5.6)m.
- Doubtful debt reductions due to improved cash collection and reduction in aged debt profile £(0.7)m.
- Reduced exceptional items £(0.3)m.
- Increase in activity in preparation for market opening and wholesale revenue management £1.0m.
- Increased cost of regulation due to atypical CMA set up fees £1.5m
- Inflationary increases £0.2m.
- Cost savings offset by absorption of restructuring costs

**Non Domestic Capital Maintenance** costs reduced by £1.9m. This is caused by a reduction in IT depreciation charges following transfer of IT assets to SWBS, and cross-charge shared IT services to SWBS post-separation.

## Water / Wastewater Analysis

Non regulated costs, excluding capital maintenance costs, are summarised below:

<b>Non Regulated</b>	<b>2006/07</b>	<b>2005/06</b>	<b>Variance</b>
	£m	£m	£m
Water	18.325	45.664	27.339
Waste	9.265	4.264	-5.001
	<b>27.590</b>	<b>49.928</b>	<b>22.338</b>

The movement in Non Regulated functional and operating expenditure for water and wastewater, is due to:

- A reduction in infrastructure work carried out by Scottish Water Contracting for Scottish Water Solutions £26.4m (Water £24.8m, Wastewater £1.6m).
- An increase in Business Development activity (developers and consulting support) £7m (£5.1m wastewater, £1.9m water)
- The £2.9m remainder of the decrease (£1.5m wastewater, -£4.4m water) is due to improved capture of non regulated and secondary third party costs – primarily water connections activity; and increases in levels of other non regulated activity.

Retail costs are summarised below:

Retail	2006/07	2006/07	2005/06	2005/06
	£m	%	£m	%
Water - Domestic	15.742	36%	20.814	35%
Water - Non Domestic	5.207	12%	7.806	13%
Wastewater - Domestic	16.021	37%	20.996	36%
Wastewater - Non Domestic	6.175	14%	9.315	16%
	<u>43.145</u>		<u>58.931</u>	

The split of Retail operating costs between water and wastewater level has remained consistent with 2005/6 (48% water, 2005/6 versus 49% 2006/7).

## 5. Sundry points

Tables M18B W, M8B WW

At present the asset category headings agree with the categories analysed in the H Tables. No allocations into the present categories have been made for the support service assets. If it is intended that support service assets should be included in these 2 tables, we would suggest that an additional column be inserted in each.

(The breakdown of support service assets between water and wastewater in Table M8 was based on the HCA values applied to the total in Table H1.)

Table M28

Columns 1, 4, 7, 8 and 9 have balanced balance sheets. For the consolidation, the elimination of the intercompany balances can only balance in total, not in each company. Therefore the intercompany columns – 2 & 5 – do not balance individually, which in turn makes columns 3 & 6 out of balance.

For next year, we would propose that the Table be redesigned. Our suggestion would be:

Column 1 – SW core

Column 2 – SWBS licensed

Column 3 – Intercompany eliminations

Column 4 – Consolidated total core/licensed

Column 5 – Non core / non licensed

Column 6 – Eliminations

Column 7 – Consolidated