

Annual Return 2013/14

Overview

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**Scottish
Water**
Always serving Scotland

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Appendix 1 – Chief Executive - Board Assurance Statement

1. Executive Summary

This overview document reports on Scottish Water's performance and activities in 2013/14, the fourth year of the 2010-15 regulatory period, 2013/14 proved to be another very successful year for us. We are on target to deliver improvements to our customers in line with our delivery plan and we are providing services that have reached new heights that mean that our service is now comparable with the best in the UK water sector.

2013/14 Dashboard

Table 1 shows the 2013/14 year-end position for the key regulatory outputs set out in the Regulatory Contract.

Table 1 – Annual Regulatory Dashboard – 2013/14

Annual Dashboard – 2013/14			
Measure to be reported	Actual 2013/14	Delivery Plan Target 2013/14 ¹	Current RAG Status
Output Delivery			
Investment – completion of Q&SII/IIIa (Number of remaining projects requiring regulatory sign-off)	1	0	R
Investment – Delivery of Q&SIIIb Outputs (OMD Measure)	230	227	On target
Levels of Service			
Customer Service – OPA (rolling four quarters)	[397]	380	G
Leakage (MI/d) (rolling four quarters)	566	600	G
Water into Supply (MI/d) (rolling four quarters)	1,824		
Expenditure			
Total Capital Expenditure (£m)	475	495	
Operating and PFI Costs (£m)	515	524	G
Financial Strength			
Cash Interest Cover	3.6	3.2	G
Funds from operations to net debt	13.2%	12.0%	G
Gearing	47%	47%	G
Net new borrowing (£m)	85 ²	85	G

Performance Status
Performance below target and not expected to achieve year end target
Performance below target, but expected to achieve year end target
Performance above target or expected to achieve year end target.

¹ As per our March 2013 Delivery Plan Update, with the exception of net new borrowing (see note 2).

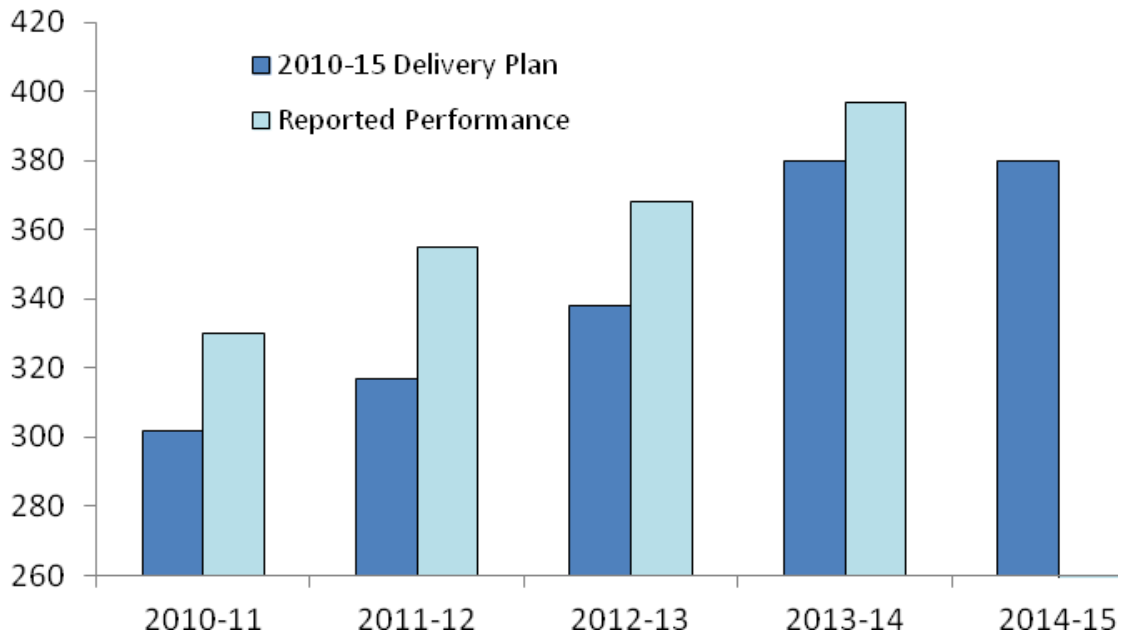
² Our March 2014 Delivery Plan assumes a total of £485m borrowing will be available from the Scottish Government for the 2010-15 regulatory period. Net new borrowing for Scottish Water in 2013/14 was £85m in line with our 2013 plan.

Overall Performance Assessment (OPA)

In 2013/14 our OPA performance increased to [397] and exceeded our Delivery Plan target of 380.

Our 2013/14 OPA score represents a [29] point improvement compared with the 368 OPA points scored in 2012/13.

Figure 1 – OPA performance



Leakage

Our MLE reported leakage for 2013/14 is 566 ML/d which is a 9 ML/d reduction on our reported MLE leakage of 575 ML/d for 2012/13, successfully out-performing our 2013/14 Delivery Plan target of 600 ML/d. Table 1.2 below details the leakage reduction we have achieved in recent years.

Table 1.2 – Leakage

Description (ML/d)	2009/10	2010/11	2011/12	2012/13	2013/14
Regulatory Reported leakage (OPA)	704	699	629	575	566
Leakage Target (OPA) (ELL)	730	720	670	670	600
MLE adjusted leakage	738	699	629	575	566

Customer Satisfaction

We have been monitoring customer satisfaction since 2010 through a postal survey. Over 52,000 customers have taken part to provide insight and understanding and direct access to the voice of our customers. This bank of customer information is being used to inform and shape a continuous service improvement programme.

Customer satisfaction has increased again this year and reached a score of 90.1%. This has been achieved through a determined focus on listening to customers, combined with the delivery of a number of considerable improvement projects in our main contact areas, such as those on Sewer Flooding, Repeat Customer Contact and Avoidable Complaints. We continue to focus on customer satisfaction and further improve the customer experience for all our customers.

Compliance

Overall Water Quality Compliance

For the calendar year 2013, overall compliance with water quality standards continued to be of a very high standard with 99.91% of all water quality tests conducted in our sampling programme complying with quality standards.

For OPA purposes, water quality is assessed using the mean zonal compliance of a basket of six parameters. For these parameters performance in 2013 was 99.79% an improvement from 99.17% in 2012.

Wastewater Compliance

Wastewater Treatment Works compliance under serviceability measures is reported as 1 failing works (Stewarton) at 31 March 2014 against a Delivery Plan target of 18. This performance, which is awaiting final agreement with SEPA, represents an improvement from the 2012/13 performance of 2 failing sites. The performance at two sites (Stewarton and Port Rodie – the latter was not a serviceability failure) impacts adversely on OPA.

We continue to see significant improvement regarding the number of Environmental Pollution Incidents (EPIs). In 2010/11 there were 824 incidents and year on year improvements have led to the current performance of 264 Category 1-3 wastewater EPIs. Use of improved data and intelligence from the field to better allocate resources to avoid EPIs has been key to these improvements, and we will continue to apply these approaches.

We continued to reduce the number of Unsatisfactory Intermittent Discharges (UIDs) on our sewerage network as a result of our investment programme during 2013/14, with the completion of the 6 remaining Q&S3a UIDs and delivery of a further 36 under Q&S3b.

Scotland had 83 bathing waters officially designated under the EU Bathing Water Directive for the 2013 Season, 71 of which may be impacted by Scottish Water assets. These assets are closely managed, with pre-season inspections used to identify and address any issues. No bathing waters failed for the season, and it is understood that the generally good weather contributed to exceptional performance through reduced rainfall runoff.

The annual (2013) register of sludge recycled to farmland under the Sludge (Use in Agriculture) Regulations was issued to SEPA in March 2014. This showed that all sludge was recycled in compliance with the regulations.

Capital Programme delivery

During 2013/14 investment totalled £475m, comprising £466m on Q&SIIIb projects and £9m on completion projects.

At the end of March 2014, the Overall Measure of Delivery (OMD) score, which provides a high-level measure of progress in implementing the Q&S3b enhancement investment programme stands at 230 points and is on target.

We have delivered a total of 312 completion projects since April 2010. The final Q&S2 project was completed in September 2013. Killylour is the last remaining Q&S3a project and will be delivered in 2014/15.

Wholesale Service

Scottish Water provides water and sewerage services to Licensed Providers who in turn provide services to non-household premises. The number of Licensed Providers active in the market has increased significantly over the period, and with further applicants in the pipeline the number is expected to continue to grow in the coming year. At the end of 2013-14, there were thirteen companies awarded water and sewerage licences and with whom Scottish Water had signed a Wholesale Services Agreement. Subsequently one further Licensed Provider has been granted a licence by the Commission, although a Wholesale Services Agreement has not been agreed with Scottish Water.

All new Licensed Providers were offered a one-day training session on the practical and operational aspects of inter-working with Scottish Water after signing the Wholesale Services Agreement.

In April 2013, a number of changes to market processes were implemented to enable Licensed Providers to select accredited entities to undertake defined work in relation to metering activities. This was in addition to the changes made the previous year to allow accredited entities to undertake work in relation to connections and temporary disconnections activities.

Scottish Water has been continuing to work with the Commission and market participants in the context of the Commission's Data Alignment project. The project had a number of workstreams; a one-off alignment of Licensed Provider customer billing services data; a review of premises which were candidates for deregistration from the market; and a review of meter data. The bulk of the project is complete, with remaining issues generally being related to access issues at premises and resolution of certain complex data issues.

Under the Wholesale Scheme of Charges for 2014-15, a temporary measure has been adopted in relation to the application of changes to Rateable Valuations. Where premises have been modified and the valuation has been amended accordingly by the Scottish Assessors, Licensed Providers are normally expected to update the valuation at the CMA. Under the 2014-15 Scheme of Charges Licensed Providers have until 1 April 2015 to update the records at the CMA, where they have not already been updated, and bring all Supply Points correctly into charge.

Scottish Water has participated in the Open Water programme which aims to facilitate the implementation of market reform in the water sector in England. We are members of the Programme Development Board and have contributed to a number of the workshops as well as in more detailed experience-sharing meetings.

Research and Innovation

Innovation is key to sustaining high performance and delivering ever higher service standards. We continue to work with academia to develop new knowledge to improve services and with our supply chain to explore better ways to deliver increased value for customers. Our strategic research and innovation programme is progressing and will further improve our services to customers:

- Enhancing water quality compliance
- Value recovery from wastewater
- Sustainable rural communities

Alongside this, we are also pursuing single topic issues such as leakage, sewer flooding and carbon reduction through the UKWIR programme.

During 2013/14 we developed our Innovation Strategy to formalise our strategic approach to research & development, accelerating the adoption of new technologies and developing a corporate culture that supports innovation in all areas of the business.

Innovation Panel

The Commission established an Innovation Panel, independent of the Commission, with the role to:

- advise the Customer Forum on the adequacy of the innovation being built into Scottish Water's Business Plan for 2015-21, and
- set out to establish whether there are further regulatory or systemic barriers to innovation and, where these exist, propose solutions

The Panel produced an interim report which is positive about Scottish Water's approach to innovation and reports a leading position in comparison to England and Wales.

Financials

The surplus before tax in the year for Scottish Water was £86.3 million, £18.0 million higher than in 2012/13 (£68.3 million). The regulated surplus before tax of £86.1 million was £18.3 million higher than 2012/13 (£67.8 million), and £31 million greater than our Delivery Plan target (2013 update) of £55 million.

Revenue

Regulated revenue for the year totalled £1,078.2 million (2013 - £1,053.0 million).

Revenue from services supplied to household customers increased by £28.0 million or 3.7% to £778.9 million reflecting the 2.8% tariff increase effective from 1 April 2013 and the increase in connected properties.

Revenue from wholesale services supplied to Licensed Providers decreased by £3.1 million or 1.0% to £293.6 million primarily due to the planned reduction in tariffs. Revenue from other sales increased by £0.3 million to £5.7 million.

Total costs

Total costs of £836.2 million were £5.4 million higher than in 2012/13.

Operating costs of £515.3 million were £16.0 million higher than 2012/13. Within these costs, regulated operating costs of £365.0 million were 4.5% or £15.7 million higher than in 2012/13 and PFI costs were £0.3 million higher at £150.3 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £3.5 million or 1.3%. Compared with 2012/13, inflation of £7.8 million, increased costs associated with the exceptionally dry weather earlier in the year, increased energy prices, a charge of £5.5 million for landfill taxes and new operating costs associated with new capital investment were absorbed.

Depreciation, including infrastructure depreciation, decreased by £2.4 million to £331.2 million, due to the profile of the capital investment and lower levels of accelerated depreciation in the year. The gain on sale from asset disposals was £8.2 million higher than in 2012/13 at £10.3 million primarily due to the disposal of land at the Fairmilehead site in Edinburgh.

Finance costs

As at 31 March 2014, the weighted average interest cost of the outstanding long-term debt was 4.93%, (2013 – 5.03%). Net interest payable during the year was £155.9 million, £1.5 million higher than in 2012/13.

During the year, net debt increased by £60.2 million to £3,084.0 million (being loans of £3,354.3 million less cash balances of £270.3 million). The increase was driven by a £85.0 million increase in borrowing from the Scottish Government, partly offset by a £24.8 million increase in cash balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £26.5 million for 2013/14. Actual net new borrowings in 2013/14 were £26.5 million, reflecting a £85.0 million increase in Scottish Water partly offset by a £58.5 million reduction in Scottish Water Business Stream Holdings Limited.

Health & Safety

The RoSPA awards recognise the organisations that have demonstrated the best health and safety management performance within specific industry sectors. In April 2014 we were informed that we are the overall winner for the Water Industry Sector for the third year in a row having demonstrated a consistently excellent and continuously improving performance across a wide range of key performance measures. Our continued focus on improving all aspects of health and safety has resulted in a 54% reduction in Lost Time Accidents during 2013/14.

Board Changes

In September 2013 Mr Alan P Scott was appointed Finance Director.

Mr Chris Banks left Scottish Water in March 2014.

During 2013/14 Mr Douglas Reid and Mr Matt Smith were appointed as non-executive board members.

SR15

As part of the Strategic Review of Charges 2015, we published our long term Strategic Projections and Draft Business Plan for 2015-2021. Our strategic projections and plan were informed by extensive research with our customers, discussions with the Customer Forum and our stakeholders, and the responses to our 'Your Views Count' consultation.

We agreed the detail of our Business Plan with the Customer Forum, along with some modifications. The agreed plan provides price certainty for our customers as we make further improvements to the services we provide. We received the Water Industry Commission's draft Determination of Charges on 20 March 2014.

To be successful over the 2015-21 period we will need to be at the leading edge of the UK water industry in terms of performance and efficiency.

Governance of the Annual Return

We have retained the methodologies and processes used for producing the detailed information in Scottish Water's Annual Return to the Water Industry Commission developed over previous years. Black and Veatch have again audited the information reported in the Annual Return as part of the normal assurance to the Scottish Water Board and consequently the Commission.

This approach has ensured that this submission continues to be based on sound processes and assumptions.

2. Key Outputs and Service Delivery

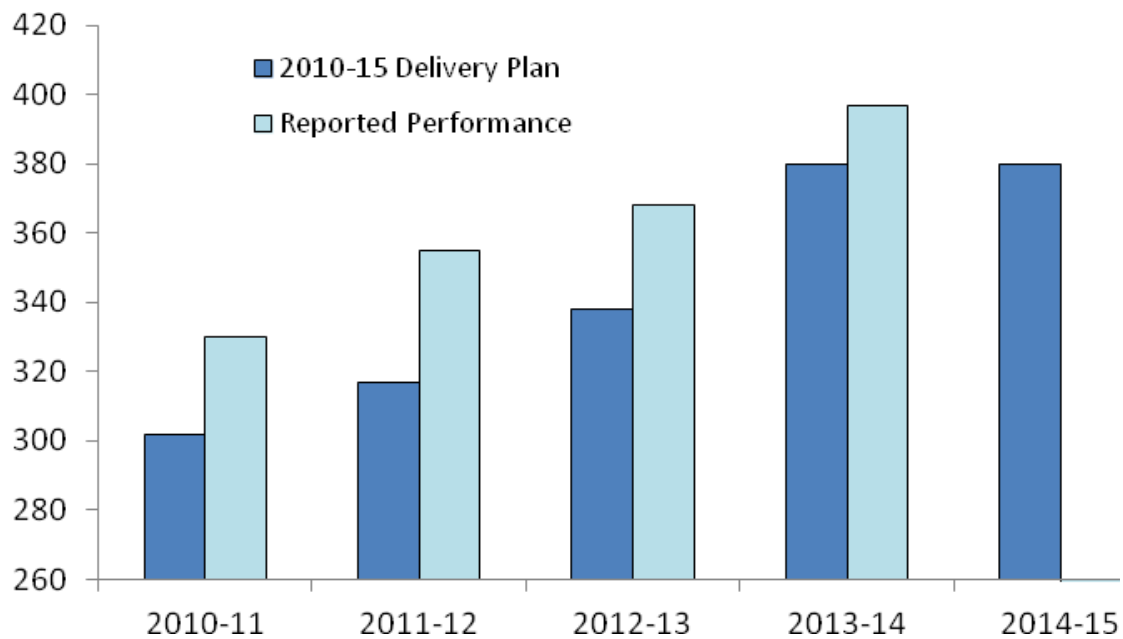
2.1 Service Outputs and Performance

Overall Performance Assessment (OPA)

In 2013/14 our OPA performance increased to [397] and exceeded our Delivery Plan target of 380.

Our 2013/14 OPA score represents a [29] point improvement compared with the 368 OPA points scored in 2012/13.

Figure 2.1 – OPA performance



Significant Improvements

The areas, in which we made the most significant improvement in 2013/14, are:

- Drinking water quality improved from 26.58 to 44.12 points (+17.54 points);
- Wastewater treatment works compliance improved from 40.08 to [47.39] points (+[7.31] points);
- Interruptions to Supply improved from 32.38 to 34.26 points (+1.89 points);
- Category 1&2 sewage related environmental pollution incidents (EPI) improved from 23.72 to 25 points (+1.28 points);
- Internal Flooding due to overloaded sewers (IFOS) improved from 23.64 to 24.90 points (+1.26 points), and
- Category 3 sewage related environmental pollution incidents (EPI) improved from 9.27 to 10.11 points (+0.84 points).

Table 2.2 below compares our 2012/13 and 2013/14 performance for each of the 17 indicators: In summary:

- 5 items continued to score full points;
- 2 item increased to maximum OPA points;
- 10 items showed increased performance, securing [31.01] additional OPA points;
- 1 item slipped back – which reduced OPA by 1.29 points.

Indicator	AR13 OPA	AR14 OPA	AR13 OPA score	AR14 OPA score	Change
% of properties subject to inadequate water pressure	0.01%	0.00%	36.99	37.36	0.37
Connected properties experiencing unplanned interruptions	0.57%	0.41%	32.38	34.26	1.89
Hosepipe restrictions	0	0	12.5	12.50	0.00
Security of Supply absolute performance	74	89	7.5	7.50	0.00
Security of Supply performance against target	-57.45%	-3.49%	12.5	12.50	0.00
% of water samples that comply with parameters	99.17%	99.79%	26.6	44.12	17.54
Leakage	-10.40%	-6.04%	12.5	12.50	0.00
Water Service (sub-total)			140.95	160.74	19.80
% properties suffering sewer flooding incidents caused by overloading	0.0036%	0.0017%	23.64	24.90	1.26
% properties suffering sewer flooding incidents caused by other causes	0.0049%	0.0037%	37.2	37.50	0.31
Sewer flooding (at risk)	0.01257%	0.01244%	12.4	12.44	0.02
Sewerage Service (sub-total)			73.3	74.84	1.59
Customer Contact (Total of complaints and telephone performance)	18.36	18.54	18.4	18.54	0.19
Assessed customer service	9	8	37.5	37.50	0.00
Customer Service (sub-total)			55.9	56.04	0.19
Category 1 & 2 sewage EPIs	9	5	23.7	25.00	1.28
Category 3 sewage EPIs	322	259	9.3	10.11	0.84
Category 1 & 2 water EPIs	0	1	12.5	11.21	-1.29
Sewage sludge disposal	0%	0%	12.5	12.50	0.00
% pe served by non-compliant sewerage treatment works	1.09%	0.29%	40.1	47.39	7.31
Environmental Performance Service (sub-total)			98.1	106.20	8.13
Total			368.1	397.84	29.71

Table 2.2: OPA Performance

Each of the OPA elements and their scores are discussed below.

Percentage of Properties Subject to Inadequate Water Pressure

A total of 175 properties were removed from the low pressure register over the year, reducing the total number from 604 (2012/13 reported value) to 429. However, properties that are within 10.5m of the bottom water level of the supplying service reservoir have been excluded from OPA calculation, in line with England & Wales reporting, and as such 373 properties are excluded. This reduces our 2013/14 reported OPA value to 56.

Connected Properties Experiencing Unplanned Interruptions

Table 2.3 shows the change in the number of properties that experienced unplanned interruptions compared to last year. A total of 10,569 weighted properties, or 0.41% of total population, received a supply interruption greater than 6 hours.

In this reporting year 4 large incidents caused 2,572 properties to lose supply for greater than six hours.

In April 2013, 334 properties were affected by an incident at Tomachrocher, Boat of Garten with supply being restored within 10 and a half hours.

In June 2013, 332 properties were affected by an incident in Bow Cottage, High Street, Ceres near Cupar with supply being restored within 8 and a half hours.

In July 2013, 438 properties were affected by a planned Interruption to supply by a contractor over running its planned duration. The supply was restored to affected properties within just over 11 and a half hours.

In August 2013, 1,468 properties were affected by an incident on Townhead Farm, Lesmahagow in Lanark with supply being restored to 221 properties within 9 hours and the remaining 1,247 properties within 11 hours.

Table 2.3: Unplanned Interruptions to Supply

	2012/13	2013/14
Properties interrupted for 6 to 12 hours	11,267	8,849
Properties interrupted for 12 to 24 hours	1,301	820
Properties interrupted for more than 24 hours	212	20
Total number of properties interrupted for more than 6 hours	12,780	9,689
Total number of properties interrupted for more than 12 hours	1,513	840
Total 'weighted' properties interrupted for more than 6 hours	14,717	10,569

Hosepipe Restrictions

We have maintained unconstrained supplies to customers and have not required any hosepipe restrictions since Scottish Water was formed in 2002.

Security of Supply Index (SOSI)

a) SOSI absolute performance.

Absolute performance is measured on total SOSI score. Our score improved in 2013/14, rising from 74 to 89, retaining our banding of 50-89 SOSI banding and giving us 7.5 OPA points.

b) SOSI performance against target.

We are also measured in terms of our SOSI performance against our annual target. For 2013/14 our target was 86 points. We scored 89 SOSI points in 2013/14 and exceeded our target. Our SOSI score remained at the maximum 12.5 points.

Percentage of Water Samples that Comply with Parameters

Our water quality performance is discussed in Section 2.2 below.

Leakage

Our MLE reported leakage for 2013/14 is 565.84 MI/d which is a 9.4 MI/d reduction on our reported MLE leakage of 575.2 MI/d for 2012/13, successfully out-performing our 2013/14 Delivery Plan target of 600 MI/d. SW has also maintained the agreed Economic Level of Leakage (ELL) of 600 MI/d since achieving it in 2012/13, one year ahead of regulatory expectation.

Our leakage performance is discussed more fully on page 27.

Number of Incidents of Sewer Flooding Caused by Overloading of Main Sewers

In 2013/14 there were 41 Incidents of flooding from overloaded mains sewers that caused internal flooding of customers’ properties. This was a decrease of 48 incidents from 2012/13.

Number of Incidents of Sewer Flooding from Other Causes on Main Sewers

In 2013/14 there were 92 incidents of flooding from other causes on main sewers that caused internal flooding of customers’ properties. This was a decrease of 30 incidents from 2012/13.

Sewer Flooding (properties at risk)

The number of properties on the “At-risk of flooding from overloaded sewers” register is 392 in 2013/14. This gives a score of 12.44 OPA points.

Table 2.4: Properties at Risk of Flooding from Sewers

	2013/14
At risk of flooding twice in ten years	166
At risk of flooding once (but less than twice) in ten years	226
Total number of properties at risk of flooding at least once in ten years	392

Customer Contact

The Customer Contact measure consolidates 4 sub-elements as described below.

a) Percentage Written Complaints Responded to within 10 days

Our performance for 2013/14 was 100% with all written complaints responded to within 10 days.

b) Percentage Telephone lines busy

A total of 9 lines were reported as busy in 2013/14, down 4,105 from 4,114 in 2012/13. This improved performance from 99.83% to 99.997% over the year.

c) Percentage Telephone calls abandoned

During 2013/14 the total number of abandoned calls increased from 2,191 to 2,358. This decreased our performance in this measure from 99.38% to 99.29%, against a reduction in the number of contacts we received in the year (330,285 in 2013-14 compared with 351,541 in 2012-13).

d) Customer Service Survey

Our telephone customer survey scored 4.67 out of a maximum of 5.00 for 2013/14, a decrease from 4.69 in 2012/13.

Assessed Customer Service

Our performance increased to 8 points in 2013/14 and retains maximum 37.5 OPA points. With the dissolution of Waterwatch in August 2011, Scottish Water has produced an Assessed Customer Service Report for 2013-14.

Environmental Pollution Incidents (EPIs)

The position for all EPIs has been agreed with SEPA.

a) Wastewater Category 1&2 EPIs

We reported a decrease in Category 1&2 incidents in 2013/14 from 9 to 5. This increased our OPA performance by 1.28 points to a maximum of 25 points for this indicator.

b) Wastewater Category 3

We reported a decrease in the number of Category 3 incidents in 2013/14, from 322 to 259. This increased our OPA performance by 0.84 points.

c) Water Category 1&2

There was 1 water pollution incident in 2013/14 decreasing our OPA performance by 1.29 points and reducing our score to 11.21 points.

Sewage Sludge Disposal

All sewage sludge from Scottish Water is disposed of through approved routes in compliance with all relevant legislation.

Percentage of Population Equivalent Served by Non-compliant Sewage Treatment Works

The compliance of Scottish Water's waste water treatment works increased in 2013/14. In 2013/14 [0.29%] of the connected population equivalent was served by a non-compliant works, this improved our score by 7.31 points to 47.39. SEPA has confirmed that the figures included in our OPA assessment represent our 'worst case' position and therefore the OPA position will not out-turn below that shown above.

2.2 Drinking Water Service

Compliance - Water Quality Compliance

Overall Water Quality Compliance

Overall compliance with water quality standards continues to be of a very high standard for the 2013 calendar year, with 99.91% of all water quality tests conducted in our sampling programme complying with quality standards (2012: 99.88%; 2011: 99.86%; 2010: 99.86%)

Microbiological Quality

Microbiological standards apply to water leaving treatment works, in service reservoirs and supplied at customers' taps.

a) water leaving treatment works

In 2013, 26,889 samples were taken for faecal and total Coliform analysis. Compliance with the faecal coliform standard was 99.99% and with the total coliform standard was 99.94%.

b) water in service reservoirs

In 2013, 51,597 samples were taken for faecal and total Coliform analysis. Compliance with the faecal coliform standard was 99.99% and the total coliform standard was 99.86%.

c) water at customers' taps

In 2013, 14,102 samples were taken for faecal coliforms total coliform analysis. Compliance with the faecal coliform standard was 99.99% and the total coliform standard was 99.65%.

The following summary table highlights performance in microbiological water quality from 2010 to 2013 based on regulation samples:

Table 2.5 - Microbiological quality of water

		2010 fails	2010 compliance	2011 fails	2011 compliance	2012 fails	2012 compliance	2013 fails	2013 compliance
Treatment Works	Coliforms	44	99.85%	49	99.83%	33	99.88%	17	99.94%
	Faecal Coliforms	8	99.97%	5	99.98%	3	99.99%	1	99.99%
Service Reservoirs	Coliforms	107	99.79%	122	99.77%	109	99.79%	73	99.86%
	Faecal Coliforms	9	99.98%	13	99.97%	7	99.99%	5	99.99%
Customer Taps	Coliforms	69	99.52%	60	99.58%	61	99.57%	50	99.65%
	Faecal Coliforms	2	99.99%	2	99.99%	2	99.99%	3	99.98%

Chemical Sampling

Physical and chemical quality standards apply to water supplied at customers' taps. 116,806 tests were carried out at customers' taps for all parameters during 2013.

The following summary table highlights the performance of the key chemical parameters for 2010 to 2013.

Table 2.6 – Key Chemical Parameters

	2010 fails	2010 compliance	2011 fails	2011 compliance	2012 fails	2012 compliance	2013 fails	2013 compliance
THM Total	59	96.39%	42	97.33%	42	97.30%	13	99.14%
Iron	32	99.38%	46	99.09%	34	99.34%	35	99.32%
Colour	7	99.87%	3	99.94%	0	100%	0	100%
Manganese	31	99.40%	28	99.45%	32	99.38%	25	99.51%
Aluminium	12	99.77%	11	99.78%	2	99.96%	5	99.90%

Iron

The presence of iron in water at customers' taps can be attributed to the accumulation of residual amounts not removed by the water treatment process or corrosion of old cast iron mains in the distribution network. These deposits are dealt with by scouring and relining or replacing pipes in the distribution system. Iron compliance has deteriorated slightly from 99.34% in 2012 to 99.32% in 2013. We are continuing the work with the mains rehabilitation programme and have also begun a programme of additional targeted flushing in identified supply zones to manage the risk of failures. In addition, work is ongoing to understand how quickly deposits build up in the mains thereby dictating the frequency of flushing to maintain water quality.

Aluminium

Aluminium compounds occur naturally in soils and are also used as coagulants to remove colour and impurities from the raw water. The coagulated material is subsequently removed prior to the water entering supply. Failures of the aluminium standard are generally due to failures of these processes. In 2013, 5 failures of the aluminium standard were reported from 5,124 samples compared to 2 samples in 2012. Compliance has decreased from 99.96% in 2012 to 99.90% in 2013. Two failures were caused by disturbance of sediment in the associated network and another two failures were attributed to a single event at one WTW. The associated WTW was optimised for low colour raw water, and when the raw water colour tripled due to a period of heavy rainfall, the filtration process became overwhelmed and aluminium was able to break through the filters. Following recovery of the process, we investigated the event and identified a number of improvements, which we are working to implement.

Abstraction Licensing

We have submitted our annual Water Resource data return to SEPA. This covers abstraction and impoundment activities authorised under the Controlled Activities Regulations (CAR) in approximately 300 Water Use Licences. It is a legal requirement of the Water Use Licence to provide SEPA with our abstraction and compensation data to enable SEPA to monitor our compliance against the conditions of the licence – typically maximum abstraction limits from our sources and minimum compensation flow requirements from our reservoirs.

There were 9 sites reported as non-compliant with abstraction limits most or all of the time. 5 of these have investment drivers within SR10 and 1 in SR15. The remaining 3 are under

further investigation with SEPA. Our performance is now assessed by SEPA as part of their Compliance Assessment Scheme and we continue to work with SEPA to analyse the data and discuss final CAS assessments to address reporting and compliance issues.

Sustainable Land Management

Scottish Water is taking an innovative approach to delivering high quality drinking water by seeking to protect the quality of raw water in 6 catchments across Scotland through sustainable land management. This offers the opportunity to enhance and maintain a high quality supply of drinking water, providing even greater value for money for our customers and delivering real environmental improvements.

To help us achieve this we have developed the Scottish Water Sustainable Land Management (SLM) Incentive Scheme. The scheme, which was launched in April 2012 and revised in April 2013, provides financial assistance for selected items to improve and protect drinking water sources within a catchment. These items go beyond regulatory compliance. We have recently expanded the scheme to include an additional four catchments in Orkney.

Across each of these catchments we monitor the water quality at a number of locations. This helps us understand the scale of the problem and identify any seasonal patterns. It also enables us to target our activities and provides baseline information to help evaluate the success of any land based measures.

The sustainable land management approach can also be applied to other catchments in Scotland. We have undertaken 25 additional catchment visits to determine if land management is having an impact on raw water quality. This includes catchments with problems due to cryptosporidium, algal blooms, nitrates, high colour and turbidity. The visit assesses the condition of the land around the watercourse and identifies any poor land management practices. It also makes suggestions to improve source water quality.

We are embedding sustainable land management (SLM) practices into our business-as-usual approach to drinking water quality and catchment management. We have identified 22 catchments in 2015-21 where we will implement SLM activities.

2.3 Wastewater Service

Compliance - Wastewater Serviceability

Wastewater Treatment

Wastewater Treatment Works compliance figures at 31 March 2014 are reported as 1 failing site against a Delivery Plan target of 18. This performance, which is awaiting final agreement from SEPA, is an improvement on the 2 failing works in 2012/13.

It is noted that SEPA have advised the Scottish Government they will not assess performance in meeting the annual Phosphorus standard at 21 WWTWs. This is a consequence of SEPA's sampling difficulties resulting in an unrepresentative sample set, meaning that a representative assessment of performance for the year was not possible.

Scottish Water continues to focus on improving processes and alignment of operational and investment activities. This is supported and driven by a functional structure that supports continuous improvement in compliance.

Bathing Waters

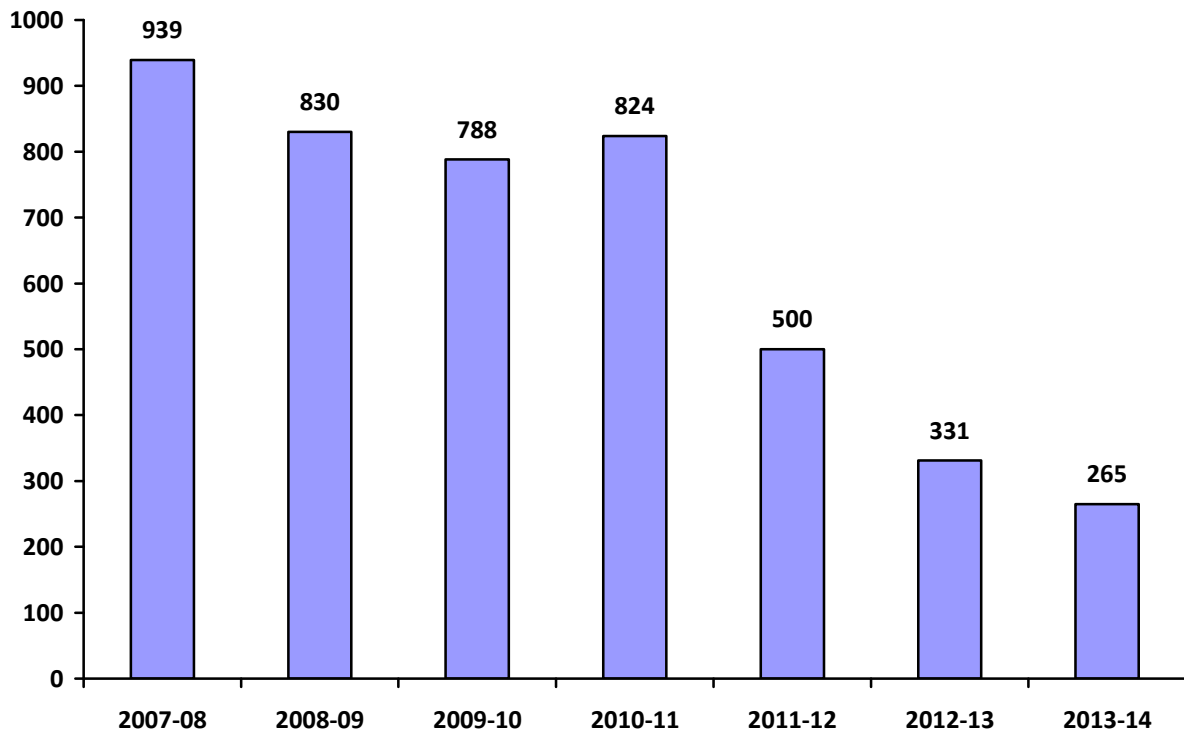
Collieston was designated as a bathing water under the EU Bathing Water Directive for the 2013 bathing season meaning Scotland had 83 bathing waters officially designated for 2013, of which 71 can potentially be affected by Scottish Water assets. Scottish Water undertakes extensive pre-season inspections of assets that may impact bathing waters to identify any issues and ensure they are managed to minimise the risk to the bathing water.

All bathing waters passed for the 2013 Bathing Season, which was characterised by generally dry and warm weather. This is similar to the conditions in 2006, the last time there were zero failing bathing waters. It is believed that the dry weather made a substantial contribution to Scotland's performance through reduced land runoff and diffuse pollution.

Pollution Incidents

There has been continued improvement in our performance with regards to wastewater Environmental Pollution Incidents (EPI), as shown below. Substantial improvements took place following 2009-10 when a new focus and dedicated team was established to better understand and improve our performance on EPIs. A key focus is to improve data and understand the root causes of EPIs in order to better deploy resources to prevent incidents occurring. The trend in overall wastewater EPI performance (Categories 1-3) is shown below:

Figure 2.7 – Number of Environmental Pollution Incidents (Category 1-3)



Performance has continued to improve during 2013/14 with a total of 265 wastewater EPIs reported. These include 5 Category 1&2 incidents and 259 Category 3 incidents, as agreed with SEPA. We are utilising improved data and intelligence from the field and we have been able to better allocate resources to avoid EPIs occurring and we continue to work to further reduce the number of incidents.

With respect to water assets there was 1 Category 1 EPI compared with none in 2012-13.

There is close liaison between Scottish Water and SEPA with weekly teleconference calls to review and agree EPI numbers.

During 2013-14 Scottish Water launched its 'Changing Behaviours' campaign. This seeks to engage customers in our challenges and a particular focus has been to avoid improper flushing of materials such as baby wipes, fats, oils and greases to sewer. These can present significant problems to the system leading to an increased risk of pollution events. Continued engagement may lead to fewer operational impacts and hence reduced pollution.

Wastewater Sludge

Each year, we are required to submit a register detailing our activities in relation to sludge recycling to agricultural land. The register is based on a calendar year and reports each recycling event, the sludge volumes, quality and soil conditions of the receiving farmland to demonstrate that it contributes to the soil nutrient and organic condition. The 2013 register identifies that all recycling activities complied with the Sludge (Use in Agriculture) Regulations, which specify the safe levels of potential contaminants such as metals.

Unsatisfactory Intermittent Discharges (UIDs)

During 2013/14, Scottish Water has delivered the final 6 Q&S3a UID outputs. A total of 306 UIDs have now been improved. The outputs comprise physical improvement, operational interventions, and those where modelling has confirmed no need for physical intervention. A further 36 UIDs have been resolved in 2013/14 through the Q&S3b programme bringing the total improved under this programme to 94.

Glasgow

In March 2013 we launched our Glasgow Strategic Study Wastewater Strategy. We remain committed to improving the Greater Glasgow area's wastewater system into a modern, sustainable drainage system which will play its part in improving the environment of the River Clyde and its tributaries and helping to tackle flooding and the effects of climate change.

The investment planned supports the Scottish Government's objectives to comply with the Urban Waste Water Treatment Directive and to achieve Water Framework Directive 'Good' Ecological Status or 'Good' Ecological Potential for the River Clyde and its tributaries. It will also help Greater Glasgow continue to grow and prosper, supporting delivery of economic growth and benefiting the area's economy and environment for generations to come.

With the strategy complete we are completing the detailed studies to progress the unsatisfactory intermittent discharges across the sewerage network. This will confirm the appropriate measures required to improve more than 200 UIDs across the network, from discrete projects to major strategic projects such as the Shieldhall tunnel.

In light of the scale of the programme it is inevitable that the communities will experience disruption and extensive community engagement is underway to work with those communities.

Commonwealth Games 2014

We continue to support a successful Glasgow Commonwealth Games in 2014. We have worked closely with Glasgow City Council to ensure that our projects do not impact on the Games. The majority of our projects in and around the key games sites have been completed ahead of the Games. We have gained special agreement to progress at some low risk sites, within the zone of influence, but all other work will be closed down for the duration of the Games.

With regard to the games venue at Strathclyde Loch, we have re-assured the Games' organisers and the OMG that we are confident that our assets will continue to meet their licence requirements. We continue to engage with key stakeholders on this matter to support the successful improvement of the water quality in Strathclyde Loch.

2.4 Capital Programme Delivery

The capital programme is monitored quarterly by the Outputs Monitoring Group, and the associated Working Group, with progress reported to Scottish Ministers.

Investment

During 2013/14 investment totalled £475m, comprising £466m on Q&SIIIb projects and £9m on completion (Q&S2 and Q&S3a) projects.

Completion Programme (Q&S2 and Q&S3a)

We have delivered a total of 312 completion projects since April 2010. The final Q&S2 project was completed in September 2013. Killylour is the last remaining Q&S3a project and will be delivered in 2014/15.

Q&S3b

The Overall Measure of Delivery (OMD) provides a high-level measure of progress in implementing the Q&S3b enhancement investment programme financed in the 2010-15 period. At the end of March 2014, the OMD score is on target at 230 points.

Our Delivery Plan forecast the delivery of outputs across 30 programmes by the end of 2013/14. At the end of 2013/14 we had delivered outputs on 31 programmes. 9 programmes are complete, 12 of the programmes had delivered more outputs than forecast and 5 programmes are in line with forecast. 6 programmes delivered fewer outputs than forecast. Table 2.7 shows the output sign-off position of each of the 33 programmes.

OMGWG Grouping	Quarterly monitored programme areas	Q4 2013/14 Target	Q4 2013/14 Actual	Q4 2013/14 Position
Drinking Water Quality	Km of mains rehabilitated to improve drinking water quality	2,542	[2,606]	See note 1 below
	Number of WTW receiving improved disinfection control	19	24	Ahead of target
	Number of WTW improved to meet quality standards	7	3	Behind Target
	Number of sites with reduced risk from cryptosporidium	29	22	Behind Target
	Number of zones with reduced lead levels	64	61	Behind Target
	Number of DMA subject to investigations	143	143	Complete
	Type A Raw water supplies provided with treatment	3	3	Ahead of target
	Number of raw water sample points installed	0	216	Ahead of target
	Number of lead comms pipes removed	0	0	No outputs forecast
	Number of backflow prevention devices installed	222	267	Ahead of target
	Number of sites covered by drinking water safety plans	174	196	Complete
	Number of tanker fill points installed	14	14	Complete
	Number of sites with increased security	603	606	Ahead of target
	Number of WRZs receiving company standard for security of supply (under 7 stage)	10	9	Behind Target
Number of WRZs receiving company standard for security of supply	1	1	Complete	
Environmental Protection	Improvements to the Wastewater Network (properties)	15	15	Complete
	Number of properties with environmental improvements to support the 2014 Commonwealth Games	68	68	Complete
	Number of UIDs improved (under 7 stage)	57	71	Ahead of target
	Number of UIDs improved (excluding 7 stage)	23	22	Behind Target
	Number of dual manhole systems upgraded	11	11	Complete
	Number of WWTW discharges improved to meet new licence requirements	65	45	Behind Target
	Number of WWTW upgraded to meet existing licence requirements	22	22	On target
	Number of WWPS upgraded to comply with existing licence requirements	19	19	On target
	Number of WWTW brought into compliance with licence non-sanitary requirements	56	60	Ahead of target
	Number of wastewater network assets made compliant with licence requirements	180	189	On target
	Number of surface water systems upgraded	0	3	Ahead of target
Number of environmental studies undertaken	112	112	On target	
Malodour	Number of sites where malodour is reduced	2	4	Ahead of target
Customer Service	Properties removed from low pressure register	2,309	2,533	Ahead of target
	Properties removed from low pressure register (Exclusions under 1980 Act)	128	585	Ahead of target
Flood Management	Number of assets protected from flood risk	25	25	Ahead of target
	Number of models to support the Flooding Bill	67	67	Complete
	Number of flooding asset risk assessments	294	294	Complete

Table 2.7 Q&S3b Output sign-off

The OMG was aware that seven programme areas were at risk of not achieving their year-end targets.

Note 1 - 2,606km is the length of mains that have been rehabilitated and passed the post installation testing requirements. However, we are aware of an emerging issue regarding the long term reliability of materials that have been used in 115km of this programme. Until we are satisfied that we have a robust and enduring solution we are keeping under review the outputs claimed and have not claimed the associated OMD points (0.5 points) for the affected zones.

2.5 Wholesale Service

Scottish Water provides water and sewerage services to Licensed Providers who in turn provide services to non-household premises. The number of Licensed Providers active in the market has increased significantly over the period, and with further applicants in the pipeline the number is expected to continue to grow in the coming year. At the end of 2013-14, there were thirteen companies awarded water and sewerage licences and with whom Scottish Water had signed a Wholesale Services Agreement. Since then a further Licensed Provider has been granted a licence by the Commission, although a Wholesale Services Agreement has not been agreed with Scottish Water.

All new Licensed Providers were offered a one-day training session on the practical and operational aspects of inter-working with Scottish Water after signing the Wholesale Services Agreement.

In April 2013, a number of changes to market processes were implemented to enable Licensed Providers to select accredited entities to undertake defined work in relation to metering activities. This was in addition to the changes made the previous year to allow accredited entities to undertake work in relation to connections and temporary disconnections activities.

During the period, changes were made to the Trade Effluent processes. Until recently, the approach taken was that Licensed Providers were required to undertake the calculation of Trade Effluent volumes and submit those to the CMA for settlement calculation. Following a series of Change Proposals to the Technical Panel made by Scottish Water, the Market and Operational Codes were changed to allow the CMA to calculate the volumes, based on all the relevant information. This change was implemented in October 2013, with effect from 1 April 2013. One of the data changes made to support this measure was the establishment of information about private effluent meters at the CMA.

The two incentive schemes relating to vacant sites, namely the Vacancy Charging Admin Scheme and the Vacant Properties Incentive Scheme, continue to have a beneficial impact on the market. The latter is particularly beneficial in view of the number of additional Licensed Providers who are reviewing sites to which they are not the registered provider. The data changes made under the auspices of the Commission's Data Alignment project, specifically the de-registration of Supply Points which are not eligible premises, have also been helpful in bringing greater clarity in this regard.

A change to the Gap Site Incentive Scheme was implemented in March 2014. This took account of the impact of a project being undertaken by the Central Market Agency (CMA) to match Supply Points registered in the market with Scottish Assessors' Association references, where there is one. One outcome of the project will be the identification of candidate gap sites for review and processing into the market. The other outcome will be that the references captured will be stored in the CMA's central systems, following a Technical Panel change proposal made by Scottish Water in the interests of improving market data quality.

Another change to market processes implemented in the period was to allow Scottish Water access to the identity of the Licensed Provider and the customer registered at Supply Points. While the measure will have operational benefits, it should also have a positive impact on data quality, for example the identity of the customer name will assist the review of gap site candidates.

Scottish Water has been continuing to work with the Commission and market participants in the context of the Commission's Data Alignment project. The project had a number of workstreams; a one-off alignment of Licensed Provider customer billing services data; a review of premises which were candidates for deregistration from the market; and a review of meter

data. The bulk of the project is complete, with remaining issues generally being related to access issues at premises and resolution of certain complex data issues.

Under the Wholesale Scheme of Charges for 2014-15, a temporary measure has been adopted in relating to the application of changes to Rateable Valuations. Where premises have been modified, and the valuation has been amended accordingly by the Scottish Assessors, Licensed Providers are normally expected to update the valuation at the CMA. Under the 2014-15 Scheme of Charges, Licensed Providers have until 1 April 2015 to update the records at the CMA where they have not already been updated, and bring all Supply Points correctly into charge.

Scottish Water has participated in the Open Water programme which aims to facilitate the implementation of market reform in the water sector in England. We are members of the Programme Development Board and have contributed to a number of the workshops as well as in more detailed experience-sharing meetings.

3. Expenditure, Performance and Efficiency

HCA financial results

The table below compares the Historical Cost Accounting results for Scottish Water's activities to 31 March 2014 excluding subsidiaries. The financial results below exclude all of the statutory adjustments required under the International Accounting Standards (IAS), including IAS 19 'Employee Benefits'.

Table 3.1

	2013/14	2012/13	Change
	£m	£m	£m
Turnover	1,078.2	1,053.0	25.2
Operating costs	515.3	499.3	-16.0
Depreciation / amortisation	331.2	333.6	2.4
Gain on sale of assets	-10.3	-2.1	8.2
Total costs	836.2	830.8	-5.4
Operating surplus before interest	242.0	222.2	19.8
Net interest	155.9	154.4	-1.5
Profit before tax – Regulated	86.1	67.8	18.3
Profit before tax – Non Regulated	0.2	0.5	-0.3
Profit before tax – Scottish Water	86.3	68.3	18.0
Taxation credit	71.6	3.4	68.2
Profit after tax	157.9	71.7	86.2

For the year ending 31 March 2014 Scottish Water's costs (excluding subsidiaries and statutory adjustments under IAS) totalled £836.2 million. Costs included in tables E1 (£399.9 million), E2 (£282.5 million) and E3 (£154.1 million) total £836.5 million. The £0.3 million difference relates to costs recharged to Business Stream under Service Agreements. These costs have been netted off Scottish Water's expenditure in line with group inter-company transaction reporting.

The surplus before tax in the year for Scottish Water was £86.3 million, £18.0 million higher than in 2012/13 (£68.3 million). The regulated surplus before tax was £18.3 million higher at £86.1 million.

Revenue

Regulated revenue for the year totalled £1,078.2 million (2013 - £1,053.0 million) and is analysed by category in table 3.2 below:

Table 3.2

	2013/14	2012/13	Change
	£m	£m	£m
Household	778.9	750.9	28.0
Wholesale	293.6	296.7	-3.1
Other	5.7	5.4	0.3
Total regulated revenue	1,078.2	1,053.0	25.2

Revenue from services supplied to household customers increased by £28.0 million or 3.7% to £778.9 million reflecting the 2.8% tariff increase (0.4% below RPI) effective from 1 April 2013 and the increase in connected properties. Revenue from wholesale services supplied to Licensed Providers decreased by £3.1 million or 1.0% to £293.6 million. Revenue from other sales increased by £0.3 million to £5.7 million.

Total costs

Total costs of £836.2 million were £5.4 million higher than in 2012/13.

Operating costs of £515.3 million were £16.0 million higher than 2012/13. Within these costs, regulated operating costs of £365.0 million were 4.5% or £15.7 million higher than in 2012/13 and PFI costs were £0.3 million higher at £150.3 million.

From a regulatory perspective, like-for-like costs actually reduced in real terms by £3.5 million or 1.3%. Compared with 2012/13, inflation of £7.8 million, increased costs associated with the exceptionally dry weather earlier in the year, increased energy prices, a charge of £5.5 million for landfill taxes and new operating costs associated with new capital investment were absorbed. Table 3.3 below summarises this movement:

Table 3.3

	2013/14	2012/13	(inc)/dec	
	£m	£m	£m	%
Regulated operating costs	365.0	349.3	-15.7	-4.5%
Dry weather related costs	-2.5		2.5	
Restructuring costs	-0.6	-3.5	-2.9	
Average inflation (2.9%)		7.8	7.8	
New operating costs	-2.7		2.7	
Like-for-like costs	359.2	353.6	-2.6	-1.6%
Power price increase	-4.6		4.6	
Land fill tax	-5.5		5.5	
Local Authority rates charges	-61.0	-61.7	-0.7	
SEPA and WICS costs	-14.6	-14.9	-0.3	
Like-for-like real controllable costs	273.5	277.0	3.5	1.3%

Depreciation, including infrastructure depreciation, decreased by £2.4 million to £331.2 million, due to the profile of the capital investment and lower levels of accelerated depreciation in the year. The gain on sale from asset disposals was £8.2 million higher than in 2012/13 at £10.3 million primarily due to the disposal of land at the Fairmilehead site in Edinburgh.

The average number of employees increased throughout the year by 55, or 1.7% to 3,327 (including SWS2 secondees).

Finance costs

As at 31 March 2014, the weighted average interest cost of the outstanding long-term debt was 4.93%, (2013 – 5.03%). Net interest payable during the year was £155.9 million, £1.5 million higher than in 2012/13.

During the year, net debt increased by £60.2 million to £3,084.0 million (being loans of £3,354.3 million less cash balances of £270.3 million). The increase was driven by a £85.0 million increase in borrowing from the Scottish Government, partly offset by a £24.8 million increase in cash balances.

Taxation

Scottish Water's tax credit was £71.6 million (2013 – £3.4 million). This was due primarily to the favourable impact of the change in UK corporation tax rate from 23% to 20% that will be effective from 1 April 2015 which meant the re-measurement of deferred tax balances.

Borrowing Limit

Scottish Ministers set Scottish Water's (consolidated) maximum net new borrowing limit at £26.5 million for 2013/14. Actual net new borrowings in 2013/14 were £26.5 million, reflecting a £85.0 million increase in Scottish Water partly offset by a £58.5 million reduction in Scottish Water Business Stream Holdings Limited.

Comparison to 2013/14 Projections within SR15 Business Plan Financial Model

A comparison of the outturn for 2013/14 compared to the forecast for that year included within the financial model for our SR15 Business Plan is shown in table 3.4 below. The underlying trends from 2013/14 are consistent with the forecasts in our SR15 Business Plan. Notable areas are:

- Revenue from wholesale services which out-turned at £8m higher than in our Business Plan. This is largely due to the impact of the WICS Data Improvement Project, the incentive schemes and the 'gap sites' project. Together, these initiatives have reduced the percentage of supply points flagged as vacant from 20.4% two years ago to 13.8% at the year end. An implication of this reduction in vacant properties is that the uplift in income from introducing charging for vacant properties from 2017 is likely to be lower than was assumed in the Business Plan.
- Operating and PFI costs, overall, were in line with expectations. Within this operating costs out-turned £5m higher than in our Business Plan as a result of new costs associated with landfill tax while PFI costs out-turned £5m lower primarily as a result of low flows due to the dry weather.

Table 3.4

Financing and Expenditure	Business Plan	Outturn	Change
	£m	£m	£m
Financed by:			
- Customer revenue	1,067	1,078	11
- Net new borrowing	85	85	0
- Infrastructure Charges Income	7	8	1
- Grants and Contributions	5	7	2
- Disposals	12	12	0
Total Financing	1,176	1,190	14
Capital investment	492	487	-4
Change in working capital	6	7	1
Operating & PFI costs	515	515	0
Interest	158	156	-2
Total Expenditure	1,170	1,164	-5

No logging submission is included as part of this return. Various changes to baseline costs have been recognised through Deliver Plan updates and in our SR 15 Business Plan while savings in baseline capital expenditure have been allocated to the financing available for OMG180 projects.

4. Supporting Information

Water Resources, Supply and Demand and Security of Supply Index

This year we have continued to provide unconstrained services with none of the population affected by hosepipe restrictions.

The SOSI is an indicator of the extent to which a company is able to guarantee provision of its planned level of service. Our SOSI score has continued to improve year on year as a result of the positive effects of the leakage reduction programme, growth and other water quality projects. Our SoSI score is now reported as 89.

Leakage

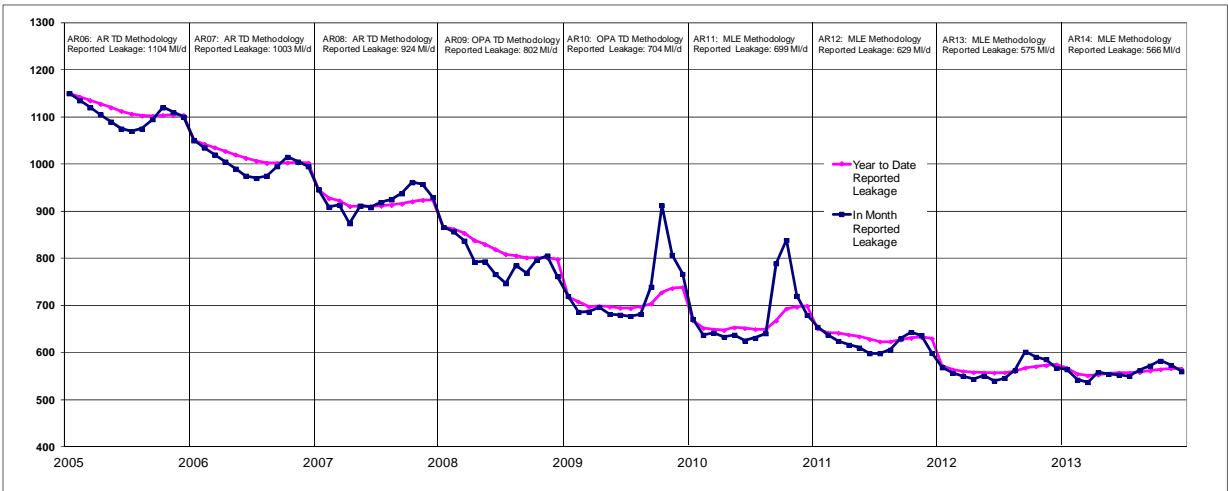
Our MLE reported leakage for 2013/14 is 566 MI/d which is a 9 MI/d reduction on our reported MLE leakage of 575 MI/d for 2012/13, successfully out-performing our 2013/14 Delivery Plan target of 600 MI/d. Table 4.1 below details the leakage reduction we have achieved in recent years.

Table 4.1 - Leakage

Description (ML/d)	2009/10	2010/11	2011/12	2012/13	2013/14
Regulatory Reported leakage (OPA)	704	699	629	575	566
Leakage Target (OPA)	730	720	670	670	600
MLE adjusted leakage	738	699	629	575	566

Figure 4.1 below demonstrates the improvements in leakage over previous years. The spikes in late 2009 and 2010 correspond with the extreme winter weather that caused extensive disruption across Scotland and caused operational challenges for us.

Figure 4.1 – Leakage Profile (ML/d)



Customer Satisfaction

We have been monitoring customer satisfaction since 2010 through a postal survey. Over 52,000 customers have taken part to provide insight and understanding and direct access to the voice of our customers. This valuable bank of customer information is being used to inform and shape a continuous service improvement programme.

Customer satisfaction has increased again this year and reached a score of 90.1%. This has been achieved through a determined focus on listening to customers, combined with the delivery of a number of considerable improvement projects in our main contact areas, such as those on Sewer Flooding, Repeat Customer Contact and Avoidable Complaints. We continue to focus on customer satisfaction and further improve the customer experience for all our customers.

Climate Change

The Climate Change (Scotland) Act sets a duty on public bodies to contribute to the Government's goals for carbon reduction and adapting to climate change. We have continued to take action over the past year to meet these expectations.

Our Delivery Plan for 2010-15 includes a number of projects focussed on climate change adaptation and carbon mitigation, notably to install 25GWh of hydropower and renewables, and pilot sustainable treatment options.

The climate adaptation projects were completed in 2012-13 and have helped us to determine adaptation measures for the next investment period. The studies identified a need for improved long term monitoring of the environment and our assets, which we are seeking to progress in Q&S4. This will help us to understand better the way in which the climate is changing, its effects on our service, and reduce the uncertainty presented by Climate Change models in order to make appropriate adaptation choices.

We have completed the majority of carbon mitigation studies and are working closely with SEPA on the remaining two, which involve field trials into more sustainable treatment options. A key project delivered was the carbon assessment tool which provides the capability for investment planners and capital delivery teams to quantify the operational and embodied carbon associated with capital projects.

We have been reporting our annual operational carbon footprint (CFP) for seven years. Over that time there have been improvements in data but also changes in method and in carbon factors. The CFP can be reassessed to incorporate these changes. When we did this, in 2012, we found our CFP had been consistently reducing over the 6 years we had been measuring it. This is in spite of continued quality enhancement, which has in the past driven up electricity consumption.

Emission factor changes in 2012/13 were relatively minor. As guidance advises against continual re-baselining we did not repeat this exercise in 2012/13. Consequently our 2012/13 CFP is not directly comparable to past years. Defra has indicated a major change to emission factors from 2013/14. We are therefore undertaking a major re-baselining exercise in 2014 to take account of these revised emissions factors from Defra.

Our CFP for 2012/13, the most recently reported year, was 442,905 tonnes of carbon dioxide equivalent (tCO₂e). This shows a decrease of nearly 5%, or over 22,000 tCO₂e, compared to 2011/12. The main factors in this decrease were: a reduction in the amount of sludge recycled/disposed of; a reduction in the amount of chemicals purchased (it is likely that not all chemicals purchased in 2011/12 were used in 2011/12, those left over being used in 2012/13, reducing the amount purchased in 2012/13); and an increase in the amount of self-generated renewable electricity that was REGO accredited. The report was produced in-house and verified by Carbon Trust accredited consultants.

Research and Innovation

During 2013/14 we developed our Innovation Strategy to formalise our strategic approach to research & development, accelerating the adoption of new technologies and developing a corporate culture that supports innovation in all areas of the business.

Innovation is key to sustaining high performance and delivering ever higher service standards. We continue to work with academia to develop new knowledge to improve services and with our supply chain to explore better ways to deliver increased value for customers. Our strategic research and innovation programme is progressing and will further improve our services to customers:

- Enhancing water quality compliance
- Value recovery from wastewater
- Sustainable rural communities

Alongside this, we are also pursuing single topic issues such as leakage, sewer flooding and carbon reduction through the UKWIR programme.

Research engagement

During 2013/14, we continued to develop our research portfolio to support the strategic focus of the business. Working with Scottish and UK universities we are:

- Supporting 16 engineering doctorate projects through STREAM, the industrial doctorate programme for the water sector led by Cranfield Water Science Institute. Projects include:
 - Resilient small works – Cranfield University
 - Investigating new ways to detect and predict leakage – University of Sheffield
 - Citycat – Urban Flood Risk Management – University of Newcastle
 - Value from waste – University of Newcastle
- Variable consenting – matching wastewater works performance to environmental capacity – University of Exeter
- Developing research programmes with Water@Glasgow with University of Glasgow
- PhD with Sheffield University developing an optimised flushing programme based on determination of biofilm formation to prevent discolouration
- Assessment of novel filter media for water treatment – Glasgow Caledonian University
- Range of short policy related research projects through CREW.

European research programme

We continue to seek European partnerships through the EU Framework Programme that support our strategic aspirations. We are currently engaged (to varying degrees) in 5 EU funded projects covering:

- Transition to future sustainable urban treatment systems
- Managing water demand through integrated network management including gamification with customers
- Developing an autonomous ultrasonic unit to manage algal blooms in water sources
- Understanding the source and fate of pharmaceuticals from domestic use in our wastewater systems
- Understanding the effectiveness of vertical wetlands as a low carbon wastewater treatment solution for small scale systems

Innovation in action

We already starting to see benefits from some key innovations we introduced during 2013/14.

We have developed a sustainable land management approach to allow us to work with land managers. This is reducing the impacts of land uses in our catchments which reduce contamination of water sources. This reduces the amount of treatment required at our treatment works.

We have extended the level of renewable energy generation across our asset base through a combination of wind & hydro schemes.

We are testing a primary wastewater treatment technology at a plant in East Lothian that recovers cellulose based material from the wastewater. This can be used as a biomass fuel and bulking of plastics. The technology also reduces the downstream load on the wastewater treatment plant resulting in improved operation and reduced energy demand. We are working with SEPA and Zero Waste Scotland to determine further high value uses for the recovered material.

We are working with a Scottish based biomimicry treatment company to evaluate their technology for treating wastewater streams for beneficial use. This will be deployed across 6 trial sites in the north of Scotland.

Innovation Panel

The Commission established an Innovation Panel, independent of the Commission, with the role to:

- advise the Customer Forum on the adequacy of the innovation being built into Scottish Water's Business Plan for 2015-21, and
- set out to establish whether there are further regulatory or systemic barriers to innovation and, where these exist, propose solutions.

The work includes an assessment of how best to enhance the opportunities offered by the 'Section 29e' mechanism to drive greater innovation in the industry.

The panel is chaired by Dr. Jerry Bryan, Executive Chairman of Albion Water, who has experience of non-standard supply arrangements in England and Wales, and includes:

- Steve Whipp, an independent water innovation consultant who until 2012 was Head of Innovation and Asset Strategy at United Utilities,
- Paul Fletcher, Head of Corporate Engagement at the University of Edinburgh who works in the business school and is an expert in innovation cultures,
- Martin Shouler, currently an associate director of Arup's, and
- Geoff Aitkenhead; Professor Simon Parsons and Alan Scott.

The Panel produced an interim report which is positive about Scottish Water's approach to innovation and reports a leading position in comparison to England and Wales.

Health & Safety

The RoSPA awards recognise the organisations that have demonstrated the best health and safety management performance within specific industry sectors. In April 2014 we were informed that we are the overall winner for the Water Industry Sector for the third year in a row having demonstrated a consistently excellent and continuously improving performance across a wide range of key performance measures. Our continued focus on improving all aspects of health and safety has resulted in a 54% reduction in Lost Time Accidents during 2013/14.

Board Changes

In September 2013 Mr Alan P Scott was appointed Finance Director.

In March 2014 Mr Chris Banks left Scottish Water.

During 2013/14 Mr Douglas Reid and Mr Matt Smith were appointed as non-executives board members.

The current Board therefore consists of:

- Ronnie Mercer - Chair
- Douglas Millican - CEO
- Andrew Wyllie – Non-Executive Director
- Alan Bryce - Non-Executive Director
- James Spowart - Non-Executive Director
- Donald Emslie - Non-Executive Director
- Lynne Peacock - Non-Executive Director
- Douglas Reid – Non-Executive Director
- Matt Smith - Non-Executive Director
- Alan P Scott – Finance Director
- Peter Farrer – Chief Operating Officer
- Geoff Aitkenhead – Asset Management Director

Governance

We have retained the methodologies and processes used for producing the detailed information in Scottish Water's Annual Return to the Water Industry Commission developed over previous years. Black and Veatch have again audited the information reported in the Annual Return as part of the normal assurance to the Scottish Water Board and consequently the Commission.

This approach has ensured that this submission continues to be based on sound processes and assumptions.

Please find our Board assurance statement at Appendix 1.

5. Looking Forward

During 2013/14 we continued to transform the way we deliver service to customers and to drive through further improvements to our services during 2010-15.

Delivery Plan Update 2010-15

We are committed to delivering and outperforming the 2010-15 regulatory contract and remain confident about the pace and effectiveness of our delivery. Achieving out-performance will enable Scottish Water to progress considerably towards our vision.

SR15

As part of the Strategic Review of Charges 2015, we published our long term Strategic Projections and Draft Business Plan for 2015-2021. Our strategic projections and plan were informed by extensive research with our customers, discussions with the Customer Forum and our stakeholders, and the responses to our 'Your Views Count' consultation.

We agreed the detail of our Business Plan with the Customer Forum, along with some modifications. The agreed plan provides price certainty for our customers as we make further improvements to the services we provide. We received the Water Industry Commission's draft Determination of Charges on 20 March 2014.

To be successful over the 2015-21 period we will need to be at the leading edge of the UK water industry in terms of performance and efficiency.

Research and Innovation

Innovation is key to sustaining high performance and delivering ever higher service standards.

Our Innovation Strategy contains our strategic approach to research and development, accelerating the adoption of new technologies and developing a corporate culture that supports innovation in all areas of the business.

We will continue to work with academia, the UK Water Industry Research programme and the EU Framework Programme to develop new knowledge to improve services. We will also work closely with our supply chain to explore better ways to deliver increased value for customers.

Future activity

We have identified 2 additional strategic research themes in the 2015-21 period to look at reducing economic levels of leakage and benefiting from developments in automation and control.

We will use these initiatives to engage more effectively and build strategic relationships with academia and research providers. We will also continue to work with the enterprise community to develop relationships with suppliers which can help us achieve our aspirations over the short, medium and long term.

We will continue to work with the Scottish Government and the enterprise community on their plans for a water innovation service and will continue to support this.

Through the UK Water Industry Research (UKWIR) Programme, we will work collaboratively with the wider industry on common research programmes to reduce leakage, prevent sewer flooding and reduce our carbon footprint.

Appendix 1:

Annual Return 2013/14 ASSURANCE STATEMENT

Background

The Board is required to confirm that it has endorsed the Overview to the Annual Return.

The Board has charged the Chief Executive, with the responsibility to establish and maintain sound systems of internal control that support the completion of the Annual Return submission to the Water Industry Commission.

The systems of internal control that support completion of the Annual Return are designed to ensure:

- The accuracy and consistency of reporting
- That soundly based assumptions and judgements are used
- Audit trails are maintained for origination and approval of all data in the Annual Return
- The identification, understanding and reporting on material data exceptions
- The reliability of information for decision making and for performance assessment.
- Compliance with applicable regulatory and legislative reporting requirements.

The systems of control are designed to reduce the risk of material error and to provide effective assurance on the completion of the Annual Return.

Process

The Board gains assurance as to the effectiveness of internal control through:

- the controls and assurance process put in place by the Executive Directors to ensure that the Annual Return is consistent with the requirements of regulatory reporting;
- a signed assurance statement from the Chief Executive concerning the operation of the systems of internal control;
- reporting from Executive Directors on associated matters;
- the results of both internal and external audit, and other internal and external review agencies;
- the adequacy of management response to issues identified by audit and review activity; assurances relating to the corporate governance requirements for the organisation; and
- the operation of anti-fraud policies, whistle-blowing processes, and arrangements for special investigations.

Outcomes

Based on the Board's knowledge of the effectiveness of the systems of internal control, that support the completion of the Annual Return, the Board has endorsed the Overview to the Annual Return. The Board has been assured that the assumptions, judgements and confidence grades used are appropriate, reasonable and consistent with the requirements of regulatory reporting.


SIGNED

(On behalf of the Board of Scottish Water)

CHIEF EXECUTIVE OFFICER

Date

5/6/14