

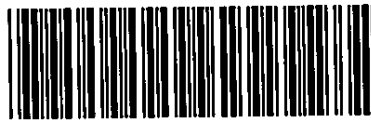
Scottish Water Solutions 2 Limited

Annual Report and Financial Statements

Registered number SC365084

31 March 2013

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About Us

Scottish Water Solutions 2 Limited (Solutions) was incorporated on 4th September 2009 by Scottish Water in anticipation of awarding a contract for the management and delivery of a programme of projects under its Quality & Standards 3b (Q&S 3b) Capital Investment Programme. This programme is aimed at improving Scotland's water quality and wastewater treatment processes during the 2010 to 2015 period.

In April 2010, following commercial negotiations, the share capital of Solutions was increased and Thistle Water Limited acquired a 49% interest with Scottish Water holding the remaining 51%. Solutions' structure is a joint venture partnership and follows the successful joint venture Scottish Water established in 2003 with Scottish Water Solutions Limited. The business model – a limited company within a publicly owned organisation – brings global best practices from each partner to the Scottish water industry, particularly in the fields of asset management, engineering, programme management and construction. Solutions was awarded an investment programme of some £450m for commencement during April 2010.

Thistle Water Limited is owned by Veolia Water Outsourcing Ltd, Jacobs Engineering U.K. Limited and Laing O'Rourke Construction Limited.

Solutions has no employees and is operated by seconded staff from the partner companies, augmented by people hired from consultants and agencies.

All of Solutions activities are directed towards supporting Scottish Water deliver its Capital Investment Programme.

Chairman's Statement

The third year of trading has proved very successful. Three years into a five year delivery programme, significant benefits are now being delivered to communities across Scotland in the form of clearer fresher drinking water and environmental improvements. At 31 March 2013 37% of the organisation's projects were completed, with a further 46% under construction.

We will continue to work closely with our supply chain in planning and delivering all of the 344 projects within our portfolio. Closer collaboration with our suppliers, improved front end planning, design and delivery processes is delivering efficient and effective solutions.

Above all we will continue to set high expectations in relation to standards of health and safety management.

We work on the basis that everyone who works on one of our sites, or in one of our offices, has the right to go home to their families safe and without injury. Of utmost importance to me, the Board and everyone within Solutions is ensuring exemplary health and safety processes and procedures are in place and complied with. This year the risk profile has increased as more projects move into construction. Mindful of this the Board has set Solutions the target of being seen as one of the leaders in the field of health and safety best practice. I am particularly pleased to report that during the year we achieved an Accident Frequency Rate (AFR) of 0.1 for the year, which is amongst the highest level of performance in the construction industry.

Finally I would like to express my thanks to everyone in the business for a successful year and look forward to robust delivery of our investment programme during 2013/14.



Geoff Aitkenhead
Chairman
Scottish Water Solutions 2 Limited

Business Review

Solutions 2 operates from four offices located in Edinburgh, Glasgow, Dundee and Inverness staffed mainly by secondees from the shareholder organisations. Where required, to augment resource levels and add required skill sets, the business engages consultants or agency personnel on project specific assignments.

Solutions 2 is working to deliver a programme of projects for its sole client, Scottish Water. These projects form part of Scottish Water's programme of capital works under the Quality and Standards 3b determination as set out in Ministerial Directions. The programme comprises capital maintenance and enhancement capital projects in waste and clean water assets. The final value of the programme has yet to be determined as projects are potentially de-scoped and new projects added to the programme.

During the year additional capital maintenance and enhancement projects were allocated to our portfolio by Scottish Water, taking the overall programme to a total of 344 projects. Three years into a five year delivery programme, overall progress follows the planned profile, spread across the design, construction and project close-out phases. By the end of this year we had completed 158 projects, of which 76 were completed within the year. 128 projects were under construction at March 2013, with the remainder of the programme progressing through front end planning and design.

Design and construction works are undertaken mainly by in-house shareholder organisations and companies that have pre-qualified on to Scottish Water's procurement frameworks.

As mentioned in the Chairman's statement, Solutions is striving to become one of the leading companies in the field of health and safety best practice. The company's health and safety plan seeks to set out its strategy for improving health and safety throughout the business to ensure:

- All personnel take responsibility for their own health and safety and that of their colleagues;
- All managers visibly demonstrate leadership in health and safety in their day to day activities;
- All assets are safe to operate and all activities are managed;
- The programme is delivered safely and creates assets which are safe to operate and maintain; and
- All business decisions take account of any health and safety implications and are managed effectively.

To this end Solutions 2 has had early engagement with companies that have bid and won work, as well as those that are likely to bid for work, to explain the standards of health and safety procedures that we expect to see on each and every one of our sites. To ensure commonality of this important message, Solutions has also engaged with Scottish Water's health and safety teams. The linkages to Scottish Water's team will become ever greater as projects are handed over to Scottish Water and we and our contractors are required to address defect rectification with live operational sites.

A number of sites on which projects will be undertaken are in the heart of local communities. Solutions 2 is mindful of the disruption that can be caused when major capital project works are underway. As a consequence, during the year Solutions 2 has undertaken a number of community liaison meetings to explain aspects of forthcoming projects and receive customer feedback. During 2013/14, as the focus remains on construction activities, Solutions 2 will continue to engage with communities and will work with delivery partners to ensure that projects are undertaken to ensure minimal interruption, disturbance or disruption to customers and communities.

Directors and Advisers

Directors

On the Board during the year ended 31 March 2013

Geoff Aitkenhead

Martin Bradbury

Bob Duff

Nigel Earnshaw (Resigned 14th February 2013)

Stephen Jennings (Appointed 14th February 2013)

John Rae

Brian Strathie

Secretary

Tom Axford

Registered office

Castle House

6 Castle Drive,

Dunfermline,

Fife, KY11 8GG

Independent auditors

PricewaterhouseCoopers LLP

141 Bothwell Street

Glasgow, G2 7EQ

Bankers

Lloyds TSB Bank Plc

PO Box 72

Bailey Drive

Gillingham Business Park

Kent, ME8 OLS

Directors' report for the year ended 31 March 2013

The directors have pleasure in submitting their annual report and the audited financial statements for the year ended 31 March 2013.

Principal Activities

Scottish Water Solutions 2 Limited (Solutions) was incorporated on 4th August 2009 by Scottish Water in anticipation of awarding a contract for the management and delivery of a programme of projects under its Quality & Standards 3b (Q&S 3b) Capital Investment Programme. This programme is aimed at improving Scotland's water quality and wastewater treatment processes during the 2010 to 2015 period.

In March 2010, following commercial negotiations, the share capital of Solutions was increased and Thistle Water Limited acquired a 49% interest with Scottish Water holding the remaining 51% and Solutions was awarded a programme of investment of some £450m for commencement during April 2010.

Solutions' structure is a joint venture partnership and follows the successful joint venture Scottish Water established in 2003 with Scottish Water Solutions Limited. The business model – a limited company within a publicly owned organisation – brings global best practices from each partner to the Scottish water industry, particularly in the fields of asset management, engineering, programme management and construction.

Thistle Water Limited is owned by Veolia Water Outsourcing Ltd, Jacobs Engineering U.K. Limited and Laing O'Rourke Construction Limited.

Solutions has no employees and is operated by seconded staff from the partner companies, augmented by people hired from consultants and agencies.

All of Solutions' activity is directed towards supporting Scottish Water deliver its Capital Investment Programme.

Financial Results for the Year

The results for the year reflect the third year of trading and are set out in the attached financial statements. The directors recommend that no dividend be paid (2012: £nil).

With the exception of the tax liability arising, all expenditure incurred in relation to delivery of the capital investment programme is charged to Scottish Water as part of turnover. Total expenditure includes direct costs from both related and third parties, management fees and allocations of production overheads.

The gross profit shown on the profit and loss account represents the level of administrative overheads incurred by the business.

Turnover in 2012/13 was £128.0m (2013: £139.3m). The year has mainly involved undertaking design, construction activities and managing projects through to handover to Scottish Water. During the year Solutions commenced construction activities on 69 (2012: 151) projects and completed and handed over to Scottish Water 12 (2012: 17) projects with a value of £1.1m (2012: £1.7m).

Business Review

The information that fulfils the requirements of the business review can also be found in the Chairman's Statement on page 3 and the Business Review on page 4 which are incorporated in this report by reference.

Future developments

The Company is delivering a programme of works for Scottish Water for the current regulatory period ending on 31 March 2015. The company has commenced initial preparatory and preliminary work ahead of the next regulatory period.

Directors' report for the year ended 31 March 2013 (continued)

Financial risk management

The company's operations, with Scottish Water as the sole customer and with all work in progress sold to the customer on a monthly basis, are such that it does not carry credit, liquidity or interest rate cash flow risks.

The company is exposed to commodity price risk as a result of its operations. However, given the size of the company's operations and the large number of individual projects within the overall programme of works, the costs of managing exposure to commodity price risk exceed any potential benefits. The directors will revisit the appropriateness of this policy should the company's operations change in size or nature. The company has no exposure to equity securities price risk as it holds no listed or other equity.

Charitable donations

During the year the Company made no direct donations.

Going Concern

The financial statements have been prepared on a going concern basis.

The company is structured in such a way so as to ensure that any deficit arising is recoverable from its partners thereby ensuring adequate resources to continue in operational existence for the foreseeable future.

Share Capital

There was no change in the share capital in the year.

Directors and Directors Interests

The directors who were in office during the year and up to the date of signing the financial statements are noted on page 5. The directors had no interests in ordinary shares of £1 each of the company.

There is no remuneration for Directors (2012: £nil).

Independent auditors

So far as each director is aware, there is no relevant information of which the company's auditors are unaware. Relevant information is defined as "information needed by the company's auditors in connection with preparing their report".

Each director has taken all the steps that he ought to have taken in his duty as a director in order to make himself aware of any relevant audit information and to establish the company's auditors are aware of that information.

In accordance with Section 485 of the Companies Act 2006, a resolution for the re-appointment of PricewaterhouseCoopers LLP as independent auditors of the company is to be proposed at the forthcoming Annual General Meeting.

On behalf of the board

Geoff Aitkenhead
Director

Edinburgh
16 May 2013

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the members of Scottish Water Solutions 2 Limited

We have audited the financial statements of Scottish Water Solutions 2 Limited for the year ended 31 March 2013 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Accounting Policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 9 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2013 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Lindsey Paterson (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Glasgow
16 May 2013

Profit and loss account
for the year ended 31 March 2013

	Notes	2013 £000	2012 £000
Turnover		128,001	139,290
Cost of sales		(124,816)	(137,351)
		<hr/>	<hr/>
Gross profit		3,185	1,939
Administrative expenses		(3,185)	(1,939)
		<hr/>	<hr/>
Profit on ordinary activities before taxation	2	0	0
Tax on profit on ordinary activities	5	(1)	(2)
		<hr/>	<hr/>
Loss for the financial year	9	(1)	(2)
		<hr/>	<hr/>

The profit and loss account has been prepared on the basis that all operations are continuing operations.

There is no difference between the profit on ordinary activities before taxation and the loss for the year stated above and their historical cost equivalents.

The company has no recognised gains and losses other than those included in the results above, and therefore no separate statement of total recognised gains and losses has been presented.

No additional shares were issued during the current financial year.

**Balance sheet
at 31 March 2013**

	Notes	2013 £000	2012 £000
Current assets			
Debtors	6	29,435	36,107
Cash at bank and in hand		128	68
		<u>29,563</u>	<u>36,175</u>
Creditors: amounts falling due within one year	7	(29,562)	(36,174)
		<u>1</u>	<u>1</u>
Net current assets			
		<u>1</u>	<u>1</u>
Total assets less current liabilities			
		<u>1</u>	<u>1</u>
Net assets		<u>1</u>	<u>1</u>
Capital and reserves			
Called up share capital	8	1	1
Profit and loss account	9	(4)	(3)
Capital contribution		4	3
		<u>1</u>	<u>1</u>
Total shareholders' funds	10	<u>1</u>	<u>1</u>

No additional shares were issued during the current financial year.

These financial statements on pages 11 to 18 were approved by the board of directors on 16 May 2013 and were signed on its behalf by:

G. Aitkenhead

Geoff Aitkenhead
Chairman
Scottish Water Solutions 2 Limited
SC365084

Cash flow statement

For the year ended 31 March 2013

Reconciliation of operating profit to net cash inflow from operating activities

	2013	2012
	£000	£000
Operating profit	-	-
Decrease/ (Increase) in debtors	6,672	(17,523)
(Decrease)/ Increase in creditors	(6,610)	17,543
	<hr/>	<hr/>
Net cash inflow from operating activities	62	20
	<hr/>	<hr/>

Cash flow statement

	2013	2012
	£000	£000
Net cash inflow from operating activities	62	20
Taxation: Corporation tax paid	(2)	(1)
Financing:		
Financing:		
Capital contributions received	-	-
	<hr/>	<hr/>
Increase in cash	60	19
	<hr/>	<hr/>

Analysis of changes in net funds

	As at 1 April	Increase in	As at 31
	2012	cash	March 2013
	£000	£000	£000
Cash at bank and in hand	68	60	128
	<hr/>	<hr/>	<hr/>

Notes (forming part of the financial statements) for the year ended 31 March 2013

1 ACCOUNTING POLICIES

Basis of Accounting

These financial statements are prepared on the going concern basis, under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards in the United Kingdom. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

Turnover

Turnover comprises charges made to Scottish Water in relation to work undertaken by Scottish Water Solutions 2 on the capital investment programme exclusive of value added tax. Turnover includes management fees earned by the company on work performed in delivering Scottish Water's capital investment programme. All turnover is from continuing activities.

Cost of Sales

Cost of sales comprises expenditure incurred on projects and includes charges from related parties, other third parties and allocations of production related overhead costs. Cost of sales expenditure is based on the value of measured work performed and is inclusive of any construction materials procured which are attributable to projects.

Recognition of Project Gains and Losses

Under a pain/gain share incentivisation agreement Scottish Water and Thistle Water Services Limited share cost efficiencies or cost overspends arising on projects up to a maximum of twice the management fee earned by Thistle Water Services. Thereafter any additional loss or gain is for the account of Scottish Water. In accordance with the agreement, any projected net gain or loss arising on individual projects is recognised in the Balance Sheet as an asset or liability based on the proportion of the programme that has been completed.

Recognition of gains in the Profit and Loss Account under the incentivisation agreement occurs when their outcome can be foreseen with reasonable certainty. Losses on the programme as a whole are recognised when forecast.

Financial Instruments

Outside of cash and working capital to facilitate the operation of the company, Scottish Water Solutions 2 has no other financial instruments. Where financial instruments are held they are reported on the balance sheet at cost when an obligation is identified and released as the obligation is fulfilled.

Taxation

Current tax is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Segmental reporting

The company's activities consist solely of one class of business, supporting Scottish Water deliver its Capital Investment Programme in the United Kingdom.

Notes (forming part of the financial statements) for the year ended 31 March 2013 (continued)

2 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is

		2013	2012
		£000	£000
Auditors' remuneration	- audit services	42	41
	- non-audit services	-	-

3 Employees

The company has no employees (2012: nil). All staff involved in the company are seconded from the related party organisations, or are agency workers. Staff secondment costs and associated services such as office accommodation and support services are charged to the company at cost.

The expenditure incurred by Solutions on seconded and agency workers in the year amounted to £9.5m (2012: £9.6m).

4 Remuneration of directors

There are no directors' emoluments (2012: £nil).

5 Tax on profit on ordinary activities

	2013	2012
	£000	£000
Current tax		
UK corporation tax on profits for the year	1	2
Adjustment in respect of prior year	-	-
	<hr/>	<hr/>
Current tax charge for the year	1	2

Factors affecting the tax charge for the current year

The current tax charge for the year is the small company rate of corporation tax in the UK 20% (2012: 20%). The differences are explained below.

	2013	2012
	£000	£000
Current tax reconciliation		
Profit on ordinary activities before tax	-	-
	<hr/>	<hr/>
Current tax at 20% (2012: 20%)	-	-
Effects of:		
Expenses not deductible for tax purposes	1	2
	<hr/>	<hr/>
Total current tax charge (see above)	1	2

Notes (forming part of the financial statements) for the year ended 31 March 2013 (continued)

6 Debtors

	2013	2012
	£000	£000
Amounts owed by related parties	28,130	36,732
Other taxation and social security	1,297	(630)
Prepayments and accrued income	8	5
	<hr/>	<hr/>
	29,435	36,107
	<hr/>	<hr/>

7 Creditors

	2013	2012
	£000	£000
<i>Amounts falling due within one year</i>		
Trade creditors	581	5,780
Amounts owed to related parties	1,612	88
Corporation tax	1	2
Accruals and deferred income	27,367	30,304
	<hr/>	<hr/>
	29,562	36,174
	<hr/>	<hr/>

8 Called up share capital

	2013	2012
	£000	£000
<i>Authorised, allotted and fully paid</i>		
1,000 ordinary shares of £1 each (2012: 1,000)	1	1
	<hr/>	<hr/>

9 Profit and loss account

	2013	2012
	£000	£000
At beginning of year	(3)	(1)
Loss for the financial year	(1)	(2)
	<hr/>	<hr/>
At end of year	(4)	(3)
	<hr/>	<hr/>

Notes (forming part of the financial statements) for the year ended 31 March 2013 (continued)

10 Reconciliation of movements in shareholders' funds

	2013	2012
	£000	£000
Loss for the financial year	(1)	(2)
Shareholders' funds at start of year	1	1
Capital contribution	1	2
	<hr/>	<hr/>
Shareholders' funds at end of year	1	1
	<hr/>	<hr/>

Capital contribution comprises amounts recoverable from shareholders in respect of the current year tax charge.

11 Related party disclosures

In the course of normal operations, Scottish Water Solutions 2 Limited contracted on an arms length basis with the following related parties. The aggregate transactions which are considered to be material and which have not been disclosed elsewhere in the financial statements are summarised below:-

	2013	2013	2012	2012
	£000	£000	£000	£000
	Transactions	Amounts (due	Transactions	Amounts (due
	in year	to)/due by	in year	to)/due by
Purchases from Scottish Water	(8,032)	(50,971)	(8,581)	(41,334)
Sales to Scottish Water	128,139	414,506	139,310	259,986
Advances from Scottish Water	(157,207)	(343,663)	(139,930)	(186,456)
Purchases from Thistle Water Services Ltd	(5,275)	(512)	(6,135)	(466)
Purchases from Jacobs	(8,212)	(719)	(18,876)	(467)
Purchases from Laing O'Rourke	(16,034)	(0)	(3,661)	0
Purchases from Veolia Water Outsourcing	(3,439)	(56)	(3,836)	(19)

The related party disclosure noted above excludes any amount that may become due or payable under the pain/gain share incentivisation agreement due to the uncertain nature of such items.

Included within these are arms length transactions and balances that have taken place between the company and 100% owned partner subsidiaries. Previous year's balances have been restated to reflect this change in disclosure.

All related party balances due to, or due by, Scottish Water included within the disclosure note above are cumulative since the inception of the company.



Notes (forming part of the financial statements) for the year ended 31 March 2013 (continued)

12 Other commitments

The company had no provisions for liabilities or charges at the year end other than those disclosed in the financial statements (2012: nil). Appropriate provision has been made in these financial statements for all liabilities that are, in the opinion of the directors likely to materialise.

Solutions enters into contracts for the delivery of each of its capital investment projects. The value of unfulfilled contracts awarded at 31 March 2013 amounted to £68.0m (2012; £18.4m).

13 Controlling party

Scottish Water is the majority owner with 51% of the shares in Solutions. The balance is owned by Thistle Water comprising Jacobs Engineering U.K. Limited, Laing O'Rourke Construction Limited and Veolia Water Outsourcing Limited.