Annual Performance Report

Regulatory reporting 2019–20

from Southern Water

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Regulatory information and annual performance report

Introduction

We operate in accordance with an Instrument of Appointment (our 'Licence') issued, by the Secretary of State, to us as a water and sewerage undertaker under the Water Industry Act 1991. The Water Services Regulation Authority (Ofwat) has a duty under the Water Industry Act 1991 to ensure compliance with the conditions of this Licence.

The Annual Performance Report sets out the performance in 2019–20 of Southern Water's regulated business, as defined under our Licence, in financial terms and against our business outcome and performance commitments.

The Annual Performance Report comprises four sections:

1. Regulatory financial reporting
2. Price control and additional segmental reporting
3. Performance summary
4. Additional regulatory information.

It also includes a Board statement of company direction and performance and a compliance statement in relation to our compliance with relevant statutory, licence and regulatory obligations and how we are taking appropriate steps to manage and/or mitigate any risks we face.

In addition we have also published a data assurance summary on our website – **southernwater.co.uk/our-reports**. This sets out the results of the data assurance undertaken on our reporting for 2019–20.

Board Statement of Company Direction and Performance

This statement sets out how the Board of Southern Water set the direction of the company and ensures it is delivering performance that meets our customers' and stakeholders' expectations. It describes how we developed our longer-term vision and how we developed our Business Plan for the period 2020–25. It also describes how the Board monitors performance and risk and how performance affects the returns to shareholders and the pay of our executive team.

Details of our performance against our targets for this business plan period 2015–20 and in particular 2019–20 are provided in the Strategic Report section of our Annual Report and Financial Statements. In addition details of our performance against performance commitments are provided in the performance summary on page 47 of this report.

Preparing for the future

As part of our preparations for the new business plan period 2020–25, we were focused, in 2019–20, on doing the basics well. This included implementation of an ongoing transformation plan to deliver cost efficiencies before and during the new business plan period and improve the service we provide to customers and the environment.

During 2019–20 these changes included:

- introduction of a new Integrated Business Planning model, enabling us to take a more holistic approach to investment planning and decision making
- roll-out of a new Risk and Value process to ensure that at each stage of the investment cycle we provide best value for money for our customers
- further development of our Water First, Environment+ and Operational Excellence programmes, promoting cross-team collaboration, with a focus on compliance and cost efficiency
- modernisation of our pension arrangements to allow more flexibility at the same time as delivering efficiency savings
- a halt on projects that were not adding value so resources could be redirected to more critical tasks
- reshaping our organisational structure, including removal of a number of management roles
- the promotion of our innovation lab, bluewave, as a problem-solving resource for the business
- embedding our revised company values to drive culture change within the business
- investment in our IT infrastructure to bring outsourced services back in house.

Our vision and business plan for 2020–25

Our ambitious vision remains to create a resilient water future for customers in the South East. This vision was developed based on analysis of the key influences on our sector and within our region. These include:

- The future challenges facing our sector, our region and society
- The future direction of regulation and Government policy
- The views of our stakeholders and customers

To inform development of our long-term vision we commissioned a groundbreaking report from futurist Peter Kingsley called "Water Futures in the South East: Towards 2050". This report identified six major trends that would affect our business over the next thirty years. This work, along with reports from many other organisations including the World Economic Forum provided a clear context for the challenges and opportunities we face, and the need to move beyond conventional water sector thinking to tackle them.

Alongside these future challenges, it was clear that political and regulatory expectations were increasing. For example, in 2018 the government published its 25-year plan to improve the environment, in which water companies will have a key role to play. The government and Ofwat have also made clear that a step change in transparency and governance of the sector is required.

Our stakeholders and customers also played a key role in shaping our vision and our business plan for the period 2020–25. We carried out over 42,000 direct interviews with customers and other stakeholders to inform our strategy and develop our business plan. We also developed our new Customer Participation Strategy, which is designed to put customer insight at the heart of our everyday decision making (see the section on Customer Expectations below for more details).

In developing our business plan and our participation strategy, we widened the traditional definition of a customer to encompass all users of water, not just those who pay a water bill to Southern Water. This reflects the vital role that water plays in all of our lives and recognises that as a monopoly water company, we have a special responsibility to society as a whole. This broader sense of our role and the wider value of water to society is reflected in the 2019 refreshed branding 'Water for Life' which forms part of a wider mission to ensure that we recognise the true value of water in our lives.

This longer-term vision formed the ambition for the five-year business plan, covering 2020–25, which we submitted to Ofwat in September 2018.

In the development of our business plan 2020–25, our customers told us that as well as thinking about the challenges of the future, they have an expectation that we will continue to deliver on the basics – clean, high quality drinking water and effective wastewater systems. These twin goals of delivering the basics brilliantly and planning for the future are reflected in our plan which is built around five service-based outcomes and five transformational programmes.

The original plan that we submitted to Ofwat included significant performance improvements, including a 15% reduction in leakage, improving 537 kilometres of rivers and supporting 155,000 customers through financial assistance schemes, with bills reducing by 3% in real terms. Following Ofwat's initial review and challenge we revised the plan in April 2019, to include additional efficiency savings over and above those in our original plan. The revised plan would have delivered the same outcomes for customers, alongside a 5% reduction in bills.

Ofwat's final determination was published in December 2020. Ofwat largely accepted the ambitious improvement targets that we set in our business plan, but significantly reduced the level of funding available to deliver these improvements and in some cases required improvements to be made more quickly. The result was that bills will fall by an average of 18% in 2020–21 (including the impact of the financial penalties associated with our historic mis-reporting of wastewater compliance data). While we were disappointed by the outcome of Ofwat's review, we chose not to appeal the decision to the Competition and Markets Authority. An appeal would have taken at least six months to conclude and acted as a significant draw on the time of the Board and management team. While we now have a delivery plan that will enable us to deliver within the financial and operational constraints of the final determination, there is nonetheless a significant risk that we will be unable to deliver all of the service improvements required, resulting in financial penalties under Ofwat's Outcome Delivery Incentive rules.

During 2020–21, the first year of the plan, we are committed to delivering significant improvements across the whole of our business, with improvement targets including a reduction of more than 25% in supply interruptions, a 20% increase in the level of renewable energy generation and a halving of the number of external sewer flooding incidents. We will also see the introduction of a new, broader comparative assessment of our customers' satisfaction with Ofwat's new C-MeX measure.

Our delivery of these ambitious improvements in 2020–21 will inevitably be impacted by the restrictions imposed as a result of the COVID-19 pandemic. The extent of this impact will need to be carefully assessed once the immediate crisis is over and the implications for our business plan delivery discussed with Ofwat. During the pandemic our focus has been on ensuring the continuity of essential services to customers, while ensuring we support those customers who find themselves in vulnerable circumstances, physically and financially.

Delivering the utility of water

Delivering as a water utility

CONTINUED PROGRESS OVER TIME

OUR AMBITIOUS VISION IS

To create a resilient water future for customers in the South East

defined by five long-term outcomes

Resources
We work together to recycle every drop of water.

Environment
We keep rivers, lakes, reservoirs and coasts healthy and clean.

Economy
We collaborate to build a resilient economy for the South East.

Communities
We innovate together to create sustainable communities.

Value
We recognise the value of water in our daily lives.

AND ADD FIVE TRANSFORMATIONAL PROGRAMMES

Target 100
Reducing average daily consumption to 100 litres per person.

Catchment First
Ensuring catchments are at the heart of decision making and delivery.

Networks 2030
Creating a more resilient supply network for future generations.

Resource Hubs
Transforming wastewater treatment works into community assets.

Sustainable Drainage 2030
Creating capacity across the sewer network.

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WE START BY BEING BRILLIANT AT THE BASICS

Quality
Clean, safe and sustainable water.

Network
Services effective and fit for the future.

Vulnerability
Support for customers in vulnerable circumstances.

Experience
A refreshingly easy customer experience.

Affordability
Bills are affordable for our customers.

Delivering for our customers

2019–20 was the final year of the five-year business plan agreed with Ofwat in 2014. As part of that plan we committed to 33 explicit performance targets for each year of the period, with financial penalties and rewards attached to 21 of these. The Board and the Executive Leadership Team (ELT) have closely monitored performance against these commitments through a business promises dashboard, directing corrective action where performance is not on target. In addition, up until early 2020 we had an independent Customer Challenge Group (CCG) which monitored and challenged our performance against our business plan commitments.

Our 2019–20 performance against all of our business plan targets is set out in Table 3A on page 47.

Across the five-year period as a whole, performance has been mixed, with some good performance in a number of areas, but significant challenges in others. For example, we have delivered excellent performance in reducing per capita consumption, beating our targets, and providing a strong platform for our industry-leading Target 100 initiative. For this we earned a financial reward of £6.9 million. Following a disappointing start to the AMP on bathing water performance, which earned a penalty in 2015–16 we finished the period with a total of 62 bathing waters at Excellent water quality standard, beating our target of 61.

We have improved customer service performance significantly from a very poor position in recent years, though we recognise that there is still more to do in this area and early indications from the new C-MeX measure suggest we continue to lag behind many of our peers.

Significant challenges remain. Our performance in respect of leakage and pollution incidents has not been as good as we would have liked and we will pay financial penalties for missing targets in both of these areas (£2.737 million and £2.160 million respectively). Our performance in respect of pollution incidents is particularly disappointing, with a total of 434 Category 1-3 incidents in 2019–20, the highest level for a number of years. We must also improve the resilience of our drinking water supply works to ensure we can maintain high levels of compliance with quality standards in all circumstances.

To address our performance and reporting challenges, in 2018 we established a company-wide transformation programme, with a number of sub-programmes to address specific areas of improvement. These programmes include:

- **Water First** – our long-term improvement programme, developed in collaboration with the Drinking Water Inspectorate (DWI), to embed public health protection at the heart of our water services.
- **Environment+** – our holistic Environment+ programme is building on work already underway to improve how we manage our risk and assets to improve our performance, capabilities and compliance.
- **Modern Compliance Framework** – we are working with leading experts in ethical business practice to adapt their work into our transformation and guide the development of specific activities under the Modern Compliance Framework.

We also have a dedicated work programme focused on addressing performance in relation to pollution incidents and sewer flooding, where we have particular challenges to improve current performance and meet the ambitious improvement targets in our plan.

The Board has been instrumental in the establishment of the transformation programme and is closely tracking progress. Together, these programmes will enable us to get the basics right and ensure we are better able to meet the challenges of the 2020–25 business plan period and beyond.

Aligning performance and rewards

The regulatory regime provides incentives for us to deliver more of what our customers want for less. Many of our performance targets include financial penalties and rewards associated with delivering for our customers. If we beat our operational targets, delivering more of what customers want, we can earn rewards, which means shareholders enjoy higher returns. Conversely, if we fail to meet our performance targets we can incur penalties, meaning shareholders receive a return below market rates. These incentive mechanisms provide a strong alignment between the interests of our shareholders and our customers.

We are also strongly incentivised to deliver efficiently. At each price review Ofwat assesses the efficient costs for delivering our business plan. If we are able to beat these, we share the benefits of that outperformance with our customers. From 2020–21, for every pound that we save, around 64 pence is returned to customers via lower bills, while 36 pence is retained by the company.

Our employees are incentivised to deliver for customers through a company-wide bonus scheme, 'yourBonus'. 55% of the measures associated with the bonus scheme relate to delivering excellent customer and environmental service while the remainder is focused on efficient delivery of our plan. It aligns the incentives for all employees with the interests of our customers.

Our executive remuneration policy has been updated during the year. It complies fully with Ofwat's guidance and now demonstrates more clearly how executive pay is linked to overall and individual performance, and how annual bonuses are based on targets relating to customers, stakeholders and communities. For 2020–21, under our updated remuneration policy at least 50% of variable pay will be directly linked to customer outcomes (and in practice this will be significantly more). As part of our Section 19 Undertakings to Ofwat in connection with our historic misreporting we are also required to review the bonus arrangement for individuals in our wastewater business and to ensure that non-compliance is not being rewarded.

As well as ensuring the right incentives are in place, it is important that we strike the right balance between providing a fair return to shareholders and investing for customers. Our updated dividend policy for the 2020–25 period incorporates a wide range of measures, including financial and customer performance measures. It also explicitly considers the financial resilience of the company and whether any financial outperformance should be re-invested to benefit our customers. Given the challenges of the Ofwat PR19 determination and managing the impacts of COVID-19, in April 2020, the board resolved that the company will not pay any dividends until it is clear that to do so would not be detrimental to the company's financial resilience.

We have responded to public concerns about the complexity of financial structures in the sector, in particular the use of offshore holding and finance companies, and are closing our Cayman Islands finance subsidiary to enhance customer trust and confidence in our company.

Ofwat Board Leadership, Governance and Transparency principles

In 2019 Ofwat published its Board leadership, transparency and governance principles ('Ofwat Principles'), which represented a major update of the principles published in 2014 and these incorporate many of the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council (FRC) in July 2018. In addition, since July 2019, meeting the objectives of the Ofwat Principles has been a requirement under Southern Water's licence.

Accordingly, we seek to apply both the Ofwat Principles and the relevant principles and provisions of the UK Corporate Governance Code.

In its initial assessment of companies' compliance with the Ofwat Principles carried out in late 2019, Ofwat highlighted Southern Water as being an example of best practice in some areas, such as disclosure of matters reserved to shareholders.

We believe that we have met the objectives of the Ofwat Principles and further details of how we have done so can be found in our Annual Report for 2019–20.

In addition, we have strengthened the work we do to satisfy Ofwat Licence Condition I of our licence. This requires us to demonstrate that the Board has made appropriate diligent enquiry into the activities of the business and can evidence that the company will, for at least the next 12 months, have sufficient financial resources and facilities, management resources and methods of planning and control in place to meet our statutory duties. The Condition I requirements are also a key part of our Section 19 Undertakings to Ofwat in connection with our historic misreporting (see page 9).

Annual risk and compliance statement

The purpose of the annual risk and compliance statement is to give assurance to Ofwat, customers and other stakeholders that we have understood their expectations in relation to compliance with all our relevant statutory, licence and regulatory obligations and are taking appropriate steps to comply or manage and mitigate any risks identified.

Customer expectations

The Business Plan that we originally submitted to Ofwat for the period 2020–25 had involved engaging with more customers than ever before (over 42,000 direct interviews). To drive a deeper understanding of customers we used innovative techniques such as ethnographic mobile apps and integrated ‘willingness to pay’ surveys to provide a single triangulated view of our customers’ preferences. In September 2018 we also launched our Customer Participation Strategy - to drive customer insight into continuous everyday decision making.

Our Customer Participation Strategy was designed with our leadership team, Board and CCG by using 12 guiding principles under each of our core company values; ‘**doing the right thing**’, ‘**succeeding together**’ and ‘**always improving**’.

In **doing the right thing** we have expanded the reach of our engagement by using customer segmentation to help design solutions for different customer needs and worked harder to reach audiences and stakeholders in our approaches. We have focused on the areas our business plan engagement showed will impact our customers most – such as continuous review of our handling of loss of supply incidents. We have integrated new data sources to provide a more holistic view of our customers, which has included using social media interactions, campaign metrics and actual consumption data for our behaviour change campaigns.

Within the **succeeding together** strand, we’ve been running joint projects and sharing insight with other water companies. This includes: a joint programme with South East Water and the Behavioural Insights Team on water efficiency; setting up a regional project with the Water Resources in the South East group; and an insight sharing session with 12 water companies, Waterwise and the Environment Agency on drought management.

Our commitment to **always improving** is demonstrated through our innovative approaches to customer participation, for example in the use of our Customer Action Group Panels. These bring together customers in an ongoing dialogue around a specific topic area for a number of weeks. Members use different tools and technologies to participate through a deliberative process and the tasks set allow them to engage with their family and friends to reach a wider audience. We introduce new panellists to keep the discussions fresh and then mine the language used between older and newer members to gain richer insight.

As we move into 2020–21 our Customer Participation Strategy continues to evolve with changing trends and expectations. The COVID-19 pandemic not only means we are adapting our approach, but it is also changing the priorities of our customers. Our agile approach means we are able to tap into these trends and understand not only the desired outcomes for our customers but the reasons for change.

Statutory and regulatory obligations

Our primary obligations and duties are set out in the Water Industry Act 1991, the Water Resources Act 1991 and our Instrument of Appointment (the Licence).

Our purpose is to deliver water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. In order to achieve this we must deliver on our customers’ expectations.

We have failed to do this in the past, and our historic performance has not been as good as our peers in the industry or as good as our customers might expect. Our organisation has been the subject of ongoing investigations by our regulators, Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency. We have worked closely with them to understand past failings and implement fundamental changes to address those faults.

During the year Ofwat concluded its investigation into the management and operation of our wastewater treatment works. In October, Ofwat issued us with a financial penalty of £3 million. In addition, we agreed to make significant customer bill rebates and payments to former customers, totalling £123 million (in 2017–18 prices), in recognition of our failure to meet the expectations of our customers and wider stakeholders, as well as our regulators. We set out the details below.

The Environment Agency

The Environment Agency has recognised that we have made good progress in areas including discharge permit compliance, self-reporting of pollution incidents and our approach to catchment management. Our Environment+ programme focuses our improvement activities and continues to drive internal transformation across all environmental wastewater and water operations.

The Environment Agency has expressed concerns about our performance in a number of areas and we face continuing and fresh operational challenges, including an unacceptable number of pollution incidents. Whilst the wet weather last winter added to these problems we are working to understand the conditions that create these risks ahead of time, finding and fixing problems more quickly, and targeting investment at those sites most likely to fail. We have worked hard to understand and resolve many of the causes of those pollutions in order to minimise incidents and we have developed a Pollution Incident Reduction Plan which has been reviewed by the Environment Agency and approved by the Board.

In addition we have faced operational pressure in relation to changes to our abstraction licences in Western Hampshire which presented us with water supply challenges during last summer. We worked closely with the Environment Agency to monitor the situation and used public awareness campaigns to avoid the need for water restrictions in the area, to which our customers responded positively. During the last year we have also intensified and improved our performance across our abstraction operations and this improvement has been acknowledged by the Environment Agency. We recognise the need to improve in these areas and across other operations and are transforming significant parts of the business.

Like other wastewater operators, in the normal course of operations we occasionally face EA investigations regarding wastewater matters following incidents. In addition to those the company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works at two locations during the period 2010–15. In February 2020 the Environment Agency presented charges before the court and we have entered guilty pleas to these charges. We will be as open and transparent as possible and are committed to working with the Environment Agency to ensure a swift conclusion to resolve the case. We have been working hard to improve processes, systems and culture since 2016 to ensure that we and our stakeholders can have confidence in our reported wastewater performance information.

We also have assisted and continue to support the Environment Agency with its separate investigation into sampling compliance and reporting issues. As the investigation is ongoing, we are not able to say any more about it at this time.

In addition to the work we are implementing as part of Environment+ we are in the process of delivering a range of initiatives to improve our wastewater treatment compliance and wider compliance performance and culture which started in 2016. Some of these initiatives are within scope of the legal commitments we made in 2019 to Ofwat on the back of its investigation (see below) but the programme extends into other operational areas where we can see further improvement on performance is also required. Progress and the effectiveness of this programme of activity is being monitored by the Audit Committee and is independently assured and reported to Ofwat.

As mentioned above, we are also subject to a small number of investigations associated with specific pollution incidents. Monitoring of this risk has been tightened and is regularly reviewed.

Ofwat

As previously announced, our wastewater treatment compliance was under investigation by Ofwat for breaches of licence conditions and statutory obligations during the period from 2010 to 2017. Southern Water began investigating issues at its wastewater treatment sites in July 2016 before alerting Ofwat to deeper issues in March 2017. We fully supported these investigations and have simultaneously completed our own extensive internal review, which highlighted failures of people, processes and systems during that period. For full details of the Ofwat investigation, visit **southernwater.co.uk/ofwat-investigation**.

In October 2019, Ofwat published its final decision setting out the results of its investigations following a public consultation and, in undertakings given to Ofwat, Southern Water set out its commitment to make £123 million (at 2017–18 prices) in rebates to current customers and payments to some former customers, alongside a promise of greater transparency on environmental performance and a number of other measures.

On 8 October 2019 we signed the formal undertakings pursuant to Section 19 of the Water Industry Act 1991 relating to the numerous changes we have put in place, and are putting in place, to ensure that the issues identified in the investigation have been stopped and cannot be repeated.

The Undertakings contain a wide range of corrective actions and interventions across seven themes:

- Customer redress measures;
- Technical review of Wastewater Treatment Works;
- Organisational compliance process measures;
- Organisational cultural change measures;
- Ensuring Transparency;

- Condition I Certificate Assurance Undertaking; and
- Reporting on Compliance with the Undertakings.

As well as the plans to make financial reparations for the findings made by Ofwat, we have committed to implement a suite of improved organisational compliance measures and organisational culture change measures to prevent recurrence of the events identified by Ofwat. We have also put new systems in place to safeguard our services and ensure we meet the high standards our customers and regulators expect. Our whistle-blowing procedures have been enhanced and a new set of company values have been embedded. These actions, along with a modern compliance framework, are already successfully changing the culture in Southern Water.

In addition, we committed to plans for improved transparency on environmental performance. Information that is available on pollution incidents, flow and spill reporting, wastewater treatment works, final effluent compliance, regional bathing water compliance results, emissions and river levels was made accessible on our website by the end of March 2020. We also committed to ensure that employees will not receive bonuses and incentive payments for personal objectives linked to wastewater compliance should Southern Water fail to meet its relevant performance commitments.

To account for the avoided penalties and the consequential bill reductions that would have been given between 2015–16 and 2019–20, we have also committed to make payments to those who were wastewater customers for any part of that period, but who are not wastewater customers as at 1 April 2020.

Compliance with the Section 19 undertakings and progress of these actions was reported to Ofwat in our February 2020 Compliance Monitoring Report. They are also subject to a formal assurance regime which will be independently externally assured by PwC, and reported to both our Audit Committee and to Ofwat on a regular basis. The outcome of the first assurance from PwC stated that they agreed with our assessments of compliance with the undertakings, that we had made good progress so far against our plan and in delivery of the undertakings.

To ensure that there is a sustained change in culture of the business, we have introduced a number of organisational cultural change initiatives. These include a commitment to deliver a step change in mindset, skillsets, productivity, operational performance, ethical principles and practices, and employee engagement. Work areas include:

- Values: Refresh Southern Water vision, mission and purpose;
- Employee Engagement;
- Management Training;
- Ethical Business Practice;
- Speak up; and
- Employee Incentives.

We completed a refresh of our organisational values in 2019, and have been embedding the revised values across the business. In the same year we also launched our new Code of Ethics, a key element of our work to support ethical business practice. We have worked with the Institute of Business Ethics to develop training material including the development of 'dilemma scenarios' which we have used at workshops with our senior management and Board members.

We have promoted ethical behaviour and initiatives on 'Doing the right thing' through communications and other employee engagement events. It is critical that we are able to monitor the impact of these interventions and how these have impacted the values and behaviours of front line staff. As part of our employee engagement survey staff were questioned about ethics and values for our January 2020 Gallup surveys. Analysis of the responses and feedback is providing insight on areas we can further improve and focus activities. We are aware that cultural change can only be achieved over long periods of time, and are therefore developing measures that can be collectively viewed to provide an indication of the culture of our business.

In addition the Section 19 undertakings require us to provide additional assurance on Board compliance with Condition I of our Ofwat licence (please refer to page 14 for more detail).

The Drinking Water Inspectorate

We continue to be under scrutiny from our drinking water quality regulator, the DWI. We started the year subject to two Final Enforcement Orders (FEO), one regarding a final asset improvement scheme at Shoreham water supply works and another in relation to water quality sampling and information management.

In January 2020 we were able to close the Section 18 Final Enforcement Order for water quality and information management. We have a broad programme of activity helping to improve our information management systems and process, including a risk-based review of monitoring, procedures, and manual intervention involved in all critical information systems. This package of work, which commenced in 2018 will continue through to 2025 and includes a programme of asset and IT improvements designed in cooperation with the DWI. This work is within the scope of our Section 19 Information Management Undertaking with the DWI which formalises this element of our programme.

We have submitted the final report to the DWI for the asset improvement FEO and we are working closely with the DWI to close this remaining FEO.

Separately we have continued to work with the DWI to improve our documentation and mitigation of water quality risk. As part of this activity we have surveyed and identified water quality risks at all our water production sites. These "HazRev" reviews were identified in the DWI Chief Inspector's report as "showing real outcome improvements". We have undertaken to complete the required improvements over the next six years.

We are also subject to two legal investigations, one from 2014–15 and one due to operational issues in 2018 on which we are awaiting decisions from the DWI.

Reporting our performance

We provide a significant amount of data to the Environment Agency and Ofwat about the performance of our assets, and any wastewater or sewage discharges we make into what is known as the 'water environment' such as rivers, streams and coastal waters. We are committed to transparent reporting of high-quality data that can be trusted by our customers, stakeholders and regulators.

Following historic failings in the quality of our reporting to our regulators, we have put in place a detailed improvement programme to ensure our regulators and other stakeholders can trust the data that we report. These improvements are being led by our Risk and Compliance directorate which is ensuring compliance reporting to our regulators is subject to increased internal review and assurance. Further information on this programme can be found in our Data Assurance Summary 2019–20, which is available at: **southernwater.co.uk/our-reports.**

We continually review performance information against a wide range of measures. Reporting to the Board and the ELT focuses on delivery of our regulatory and statutory obligations. For the business plan period 2015–20, this information was provided to the Board by way of a detailed performance dashboard, including our business plan promises and additional regulatory targets. The performance dashboard reporting for the current business plan 2020–25 has been updated and is still evolving.

The Audit Committee has monitored the completion of a risk-based programme of assurance activities during the year, as part of a three-year rolling programme, covering the practices, procedures and systems used to secure compliance with our Licence and related statutory obligations.

Each year we also seek to engage with our customers, employees and stakeholders to help us identify any risks, strengths and weaknesses associated with our reporting. We published the findings of this exercise in November 2019, with an invitation to stakeholders to comment on the findings. The publication set out how we would respond to stakeholders' feedback and detailed how our corporate assurance practices would meet our reporting compliance obligations. Our Final Assurance Plan was published on 30 March 2020. It set out how we planned to assure the financial and non-financial information that we publish in our Annual Performance Report.

In line with the Final Assurance Plan, PwC, as our independent non-financial assurer, completed the audits of our Performance Commitments and Outcome Delivery Incentives.

PwC have provided Southern Water with an ISAE 3000 opinion for the last four years over the Performance Commitments (PCs) in Section 3 of the Annual Performance Report. In two years as Technical Auditors (2016–17 and 2017–18 reporting year), their opinion was qualified as they were unable to obtain the evidence to confirm the accuracy of certain PCs. As a result of ongoing and material improvements in processes and controls in the regulatory reporting process, and a cultural shift in the organisation, PwC have been able to issue Southern Water with an unqualified ISAE 3000 opinion for the last two years across all PCs. The process and control improvements have underpinned wider improvements in our reporting control environment.

In the Technical Audit report in June 2019, PwC reported improvements to processes and controls and at June 2020 they have reported that management has sustained their improvements and continued to deliver additional enhancements to process, controls and culture. In particular, the increased level of engagement and accountability for reporting has led to better data quality and a streamlined audit process.

PwC has recognised that continued improvements have been made in the year. Areas of further improvement have been identified, including further improvements to the control environment. The issues identified will be a focus of the work to be addressed in the forthcoming year. For more detail see our Data Assurance Summary 2019–20.

As required by Ofwat, an audit was also performed on sections 1 and 2 of the Annual Performance Report by our auditor, Deloitte LLP together with agreed upon procedures in relation to section 4.

In approving the Annual Report and Financial Statements, each director has confirmed that he or she has taken all the steps that he or she ought to have taken as a director in order to be aware of any relevant audit information and to establish that our auditor is aware of the information. So far as the directors are aware, there is no relevant audit information of which the company's auditor is unaware.

Senior managers and ELT members are accountable for the provision and sign-off of information from their business areas. This includes ensuring adequate procedures and processes are in place for data collection and reporting. Data providers are accountable for submitting accurate data to set timescales. Subject matter experts within the relevant business areas are accountable for ensuring that this data, and the processes and procedures used in collating it, comply with Ofwat's reporting requirements. This process is managed through our Regulatory Compliance Framework (RCF) which is a system of controls that has been rolled out for data capture, collation and reporting within the business to make sure information used to measure compliance is complete, accurate and reliable.

The RCF framework is subject to external assurance by PwC as part of our annual data submission to Ofwat. As part of our work to improve the robustness and quality of our regulatory reporting we have implemented a number of improvements to strengthen our annual non-financial regulatory reporting processes and controls.

Compensation payments are made to customers for failures to deliver against a number of commitments within Southern Water's Customer Charter, some of which are covered by the "Water Supply and Sewerage Services (Customer Service Standards) Regulations" as amended in 2017.

We have included within our transformation plan a review of our Customer Charter and the policy, procedures and monitoring in relation to customer appointments, which has focused on identifying past, current and future compliance with the Guaranteed Service Standards (GSS) regulations and further improving the customer experience. This review has provided confirmation that some appointments had not been made in full accordance with GSS during the period 2015–20. We have begun to make payments to all affected customers and have recognised a provision of £3.0 million in the financial statements for 2019–20 for these payments. A programme of immediate improvements consisting of process controls and clear accountabilities is being implemented to improve ongoing compliance and customer experience.

While the end-of-year audit of our reporting has highlighted improvements and progress in some areas, we need to work hard to embed changes throughout the organisation. It is important to ensure single points of accountability for data quality whilst everyone has responsibility for identifying and addressing issues, rather than specialist data and assurance teams. In addition, making improvements to our risk and control environment is an area that requires continued significant focus.

All members of the ELT are required, every six months, to provide a declaration that they and their teams are fully compliant with our procedures and controls for areas of the business for which they are accountable. An action plan is required to address any areas of non-compliance.

We have made improvements to this 'Statement of Compliance' process during the year. The updated process includes additional internal assurance and coordination of resulting action plans, and provides a compliance maturity assessment of each directorate.

Managing risks

Save for those matters mentioned on pages 8 to 11 above (where the company has identified shortcomings or potential shortcomings in the monitoring and effectiveness of its water and wastewater compliance controls, its reporting and data integrity, and where the company has set out the steps it is taking or will take to manage, mitigate and/or improve those), the Board confirms that the company has appropriate systems and processes in place to identify, manage and mitigate its material risks.

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company is managed to achieve its objectives.

As part of delivering better outcomes for our customers and regulators, and becoming a more resilient organisation, we are undergoing a transformation programme; we are working to materially improve processes and systems to ensure we are continually improving the way we carry out our business. In the past we have fallen short of meeting standards required by our regulators and ourselves. Our transformation programme ensures that the mistakes of the past are not revisited.

Through a comprehensive, and ongoing transformation process, the business is completely committed to delivering the level of service our customers, and all of our stakeholders, expect and deserve. The degree of transformation in itself brings with it both some risk and significant opportunity which will be closely monitored and reflected in the relevant principal risks reported in this and future reports.

As part of our transformation, we have recognised the need to improve our approach to risk and resilience management. Last year we created a specific Risk Committee, a new Risk and Compliance Directorate and implemented a risk and resilience enhancement programme. Our risk management methodologies are still evolving and our next stage of improvements in risk and resilience management is in progress. In 2019–20 we submitted our plans to Ofwat to improve our resilience. The plan involved a comprehensive review of the key areas in our organisation responsible for our resilience, and subsequent recommendations for improvement. The plan was initiated in September 2019, and will continue until the end of 2021, with improvement plans in the key resilience areas of enterprise risk management, incident management and asset investment strategy. The aim is to embed an approach to enterprise risk management that allows us to deliver a more resilient service for our customers and stakeholders. We will continue to update our risk and resilience plans, gaining insight on emerging methodologies and recommendations, for example the recommendations of the National Infrastructure Commission in their May 2020 report 'Anticipate, React, Recover: Resilient infrastructure systems'.

Our approach to managing risk is to incorporate checks at every stage of our business so that they become part of our routine. Our Board is one of the drivers behind promoting a culture of assessing potential risks to every aspect of our business operations. Our Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve the strategic objectives of the company.

The most significant risks facing the organisation are those considered by the ELT and the Board to have the greatest potential to disrupt Southern Water's strategic objectives. These are referred to as the principal risks. Details of our principal risks and more information regarding our risk management process are provided under the Risks section on page 116 of the Annual Report and Financial Statements.

The ELT conducts a 'top down' identification of potential risks across the business on a quarterly basis. This supplements each directorate's 'bottom up' evaluation, performed quarterly. Teams are encouraged to formally and regularly consider any risks in their part of the business, how they might impact on outcomes, and ensure that, as far as possible, they are managed to within acceptable levels. In addition, consideration of risk is embedded into key processes such as budgeting, business planning and performance management.

All identified risks are captured in the corporate risk system that details what each risk is, what might lead to it, the circumstances in which it might occur and its likely consequences. The impact and likelihood values of risks are assessed over an annual timeline, using a five-point severity scale. This allows reliable and consistent measurement and comparison of risks on a like-for-like basis.

All risks are assessed from three perspectives:

- Inherent risk – assuming the controls and mitigating activities do not exist or do not work as intended.
- Residual risk – assuming controls and mitigating activities already in place work as intended.
- Targeted risk – capturing the desired level of risk appetite and risk exposure.

Assessing risks in this way supports an understanding of the reliance placed on existing controls and mitigation, the worst case scenario for the risk, and how acceptable current levels of exposure are compared to target positions.

This helps inform the focus of management oversight and challenge as well as prioritisation of responses.

Where the residual severity of a risk exceeds acceptable levels (i.e. is not aligned with target levels) then appropriate actions may need to be selected and implemented to bring the residual risk position in line with the target risk position.

Risks are reviewed each month and the highest are reported to our ELT and the Board as appropriate, with updates to the Risk Committee three times a year.

The company's appetite for risk – the Board's expression of the types and amounts of risk it is willing to take or accept in pursuit of its objectives – is also a key consideration. Having a corporate understanding of how much risk the company is prepared to accept overall, determines which individual risks we believe are an acceptable part of running a business and those which we consider pose an unacceptable threat. The latter require management responses, escalation and reporting.

We have developed a risk appetite for each of our principal risks, which forms a key element of our governance and reporting framework and is reviewed regularly by the Board.

We seek to employ sound enterprise risk management principles, transparent decision-making, and effective communication to prioritise risk. We aim to minimise our exposure to compliance, operational and regulatory risk, while accepting and encouraging more risk in pursuit of our mission and objectives. Our acceptance of risks is subject to ensuring that potential benefits and risks are fully understood before developments are authorised, and that sensible measures to mitigate risk are established.

This means we will not seek to intervene in all situations; rather our approach is based on judgment and the circumstances of each potential intervention and an assessment of its impact. We prioritise our actions in terms of risk, cost and perceived benefits in a consistent and transparent way, choosing the most appropriate course of action.

Regulatory matters

The following regulatory accounting statements, and required regulatory information, are provided to comply with Condition F of our Licence, which requires that regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat.

There are differences between statutory accounting reporting frameworks, International Financial Reporting Standards and the Regulatory Accounting Guidelines. Where different treatments are specified under each, the Regulatory Accounting Guidelines take precedence.

A particular point of definition is worth noting. Southern Water Services Limited is appointed by its Licence to be a water and wastewater undertaker – the 'Appointed Business'. Southern Water Services Limited has other functions and activities which are not regulated by the Licence. These activities are termed the 'Non-Appointed Business'.

Ring fencing statement

Under paragraph 3.1 of Condition K of the Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company. In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2020.

Certificate of adequacy (Licence Condition I17 Certificate)

In order to meet the Licence Condition I Certificate requirements and the Ofwat Section 19 undertakings the Southern Water Board need to be able to clearly evidence the level of diligent enquiry that the Board has undertaken, to ensure that they are able to demonstrate that the company will have, for at least the next 12 months, sufficient:

- Financial resources and facilities
- Management resources
- Methods of planning and control.

The directors declare that, in their opinion:

i) The company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, its regulated activities (including the investment programme necessary to fulfil its obligations under its appointments)

ii) The company will, for at least the next 12 months, have available to it:

a) management resources; and

b) methods of planning and internal control which are sufficient to enable it to carry out those functions.

In providing this certificate, the directors have taken into account:

- the company's financial performance during 2019–20, the liquidity position based on projected operating and capital expenditure and working capital requirements, headroom against financial covenants, credit ratings and financial risks
- assurance outputs from our external auditor and our non-financial assurers
- the company's plans for the period from 2020–25, including the Execution Plan for 2020–21
- regular financial updates that are made to our Board (and its Finance Working Group)
- that the organisation has the management capability in place to deliver its plans
- that the Executive Team are rebuilding capability across the company
- a number of improvements already made to our compliance and reporting processes
- the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners
- the implementation of a three line of defence framework for reporting governance and assurance activity
- the need to continue making improvements to the monitoring and effectiveness of our water and wastewater compliance controls, reporting and data integrity

The Board has been fully aware of previous issues with the control environment of the company and has over the last three years worked with the executive to rebuild capability in this area. This work is ongoing and is on track but will require further work in coming years. Subject to this, the Board therefore confirms that the company has appropriate governance policies and procedures in place to maintain an effective control environment over the next twelve to eighteen months.

To support this process the Southern Water Board signed Condition I assurance statements in order to clearly demonstrate they have discharged their responsibilities with regard to the licence condition and have made diligent enquiry into the principal risks facing the wastewater business (to support the Section 19 undertakings). This process has been independently assured by our external auditor.

There are no contracts entered into, by the wholesale part of the company, with any associate company.

Directors' responsibilities for the preparation of the supplementary regulatory accounting statements and disclosure of information to auditors

In addition to their responsibilities to prepare accounts in accordance with the Companies Act 2006 and to disclose all relevant information to the auditor, described in the Corporate Governance section of the statutory accounts, the directors are also responsible under Condition F of the Licence for:

a) ensuring that proper accounting records are maintained by the company to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by Ofwat to the company from time to time

b) preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, having regard also to the terms of guidelines notified by Ofwat from time to time, which so far as is reasonably practicable have the same content as the annual accounts of the company prepared under the Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to those accounts

c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by Ofwat, from time to time

d) preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by Ofwat from time to time.

The directors approved the regulatory accounting statements (on pages 17 to 64) on 10 July 2020.

Section 35A of the Water Industry Act 1991

The company is required under section 35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to executive directors is linked to standards of performance. This statement is provided within the Directors' Remuneration Report section of the Annual Report and Financial Statements.

Long-term viability statement

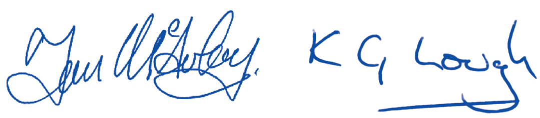
In accordance with provision 31 of the UK Corporate Governance Code, the Board has assessed the prospects of the business over a longer period than the 12 months required by the 'Going Concern' provision.

The Board has elected to conduct this review to 31 March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report section on page 135 of the Annual Report and Financial Statements.

Board statement

Save for those matters mentioned on pages 8 to 11 above (where the company has identified shortcomings or potential shortcomings in the monitoring and effectiveness of its water and wastewater compliance controls, its reporting and data integrity, and where the company has set out the steps it is taking or will take to manage, mitigate and/or improve those), the Board confirms, that having taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information, the company has:

1) a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations
2) sufficient processes and internal systems of control to fully meet its obligations
3) appropriate systems and processes in place to allow it to identify, manage and review its risks.



Ian McAulay
Chief Executive Office

Keith Lough
Chairman

10 July 2020

Regulatory financial reporting

1A – Income statement for the 12 months ended 31 March 2020

	Note	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Revenue		**877.982**	**(27.106)**	**10.467**	**(37.573)**	**840.409**
Operating costs		(667.065)	12.211	(7.880)	20.091	**(646.974)**
Other operating income		0.858	–	–	–	**0.858**
Operating profit		**211.775**	**(14.895)**	**2.587**	**(17.482)**	**194.293**
Other income		1.355	22.501	–	22.501	**23.856**
Interest income		41.576	–	–	–	**41.576**
Interest expense		(156.528)	(32.816)	–	(32.816)	**(189.344)**
Other interest expense		(4.200)	–	–	–	**(4.200)**
Profit/(loss) before tax and fair value movements		**93.978**	**(25.210)**	**2.587**	**(27.797)**	**66.181**
Fair value gains on derivative financial instruments		339.951	–	–	–	**339.951**
Profit/(loss) before tax		**433.929**	**(25.210)**	**2.587**	**(27.797)**	**406.132**
UK Corporation tax	3	(1.663)	–	–	–	**(1.663)**
Deferred tax		(103.579)	–	–	–	**(103.579)**
Profit/(loss) for the year		**328.687**	**(25.210)**	**2.587**	**(27.797)**	**300.890**
Dividends		(7.092)	–	(2.587)	2.587	**(4.505)**
Tax Analysis						
Current year		1.663	–	–	–	**1.663**
Adjustments in respect of prior years		–	–	–	–	**–**
UK Corporation Tax		**1.663**	**–**	**–**	**–**	**1.663**

Analysis of non-appointed revenue	
Imported sludge	–
Tankered waste	6.732
Other non-appointed revenue	3.735
Revenue	**10.467**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

Note: The signage convention for presentation of this table follows Ofwat guidance. Total adjustments comprise the difference between statutory and regulatory accounting definitions less the non-appointed activity.

1B – Statement of comprehensive income for the 12 months ended 31 March 2020

		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Profit/(loss) for the year	**328.687**	**(25.210)**	**2.587**	**(27.797)**	**300.890**
Actuarial gains on post-employment plans	111.632	–	–	–	**111.632**
Other comprehensive income	(17.484)	–	–	–	**(17.484)**
Total comprehensive income/(loss) for the year	**422.835**	**(25.210)**	**2.587**	**(27.797)**	**395.038**

1C – Statement of financial position for the 12 months ended 31 March 2020

	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Non-current assets					
Fixed assets	6,325.684	(216.876)	0.418	(217.294)	**6,108.390**
Intangible assets	42.090	(1.536)	–	(1.536)	**40.554**
Investments – loans to group companies	130.042	–	–	–	**130.042**
Investments – other	29.200	–	–	–	**29.200**
Financial Instruments	194.314	–	–	–	**194.314**
Total non-current assets	6,721.330	(218.412)	0.418	(218.830)	**6,502.500**
Current assets					
Inventories	5.061	–	–	–	**5.061**
Trade and other receivables	273.186	–	0.659	(0.659)	**272.527**
Cash and cash equivalents	129.281	–	–	–	**129.281**
Total current assets	407.528	–	0.659	(0.659)	**406.869**
Current liabilities					
Trade and other payables	(143.816)	1.101	(1.077)	2.178	**(141.638)**
Capex creditor	(104.176)	–	–	–	**(104.176)**
Borrowings	(715.923)	–	–	–	**(715.923)**
Current tax liabilities	(12.828)	–	–	–	**(12.828)**
Provisions	(40.696)	–	–	–	**(40.696)**
Total current liabilities	(1,017.439)	1.101	(1.077)	2.178	**(1,015.261)**
Net current liabilities	**(609.911)**	**1.101**	**(0.418)**	**1.519**	**(608.392)**
Non-current liabilities					
Trade and other payables	(13.073)	–	–	–	**(13.073)**
Borrowings	(2,843.225)	–	–	–	**(2,843.225)**
Financial instruments	(1,376.402)	–	–	–	**(1,376.402)**
Retirement benefit obligations	(62.500)	–	–	–	**(62.500)**
Provisions	(104.529)	–	–	–	**(104.529)**
Deferred income – grants and contributions	(19.656)	(1.101)	–	(1.101)	**(20.757)**
Preference share capital	(69.829)	–	–	–	**(69.829)**
Deferred tax	(368.725)	–	–	–	**(368.725)**
Total non-current liabilities	(4,857.939)	(1.101)	–	(1.101)	**(4,859.040)**
Net assets	**1,253.480**	**(218.412)**	**–**	**(218.412)**	**1,035.068**
Equity					
Called up share capital	0.056	–	–	–	**0.056**
Retained earnings and other reserves	1,253.424	(218.412)	–	(218.412)	**1,035.012**
Total equity	**1,253.480**	**(218.412)**	**–**	**(218.412)**	**1,035.068**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

1D – Statement of cash flows for the 12 months ended 31 March 2020

	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Operating profit	211.775	(14.895)	2.587	(17.482)	**194.293**
Other income	1.354	21.296	–	21.296	**22.650**
Depreciation	263.994	(7.605)	0.004	(7.609)	**256.385**
Amortisation – grants and contributions	5.728	(5.728)	–	(5.728)	**–**
Changes in working capital	20.831	–	(0.004)	0.004	**20.835**
Pension contributions	(16.731)	–	–	–	**(16.731)**
Movement in provisions	(7.640)	–	–	–	**(7.640)**
Profit on sale of fixed assets	(0.858)	–	–	–	**(0.858)**
Cash generated from operations	**478.453**	**(6.932)**	**2.587**	**(9.519)**	**468.934**
Net interest paid	(229.459)	–	–	–	**(229.459)**
Tax paid	(1.663)	–	–	–	**(1.663)**
Net cash generated from operating activities	**247.331**	**(6.932)**	**2.587**	**(9.519)**	**237.812**
Investing activities					
Capital expenditure	(473.510)	–	–	–	**(473.510)**
Grants and contributions	–	6.932	–	6.932	**6.932**
Disposal of fixed assets	0.490	–	–	–	**0.490**
Other	54.464	–	–	–	**54.464**
Net cash used in investing activities	**(418.556)**	**6.932**	**–**	**6.932**	**(411.624)**
Net cash generated before financing activities	**(171.225)**	**–**	**2.587**	**(2.587)**	**(173.812)**
Cash flows from financing activities					
Equity dividends paid	(7.092)	–	(2.587)	2.587	**(4.505)**
Net loans paid	(64.384)	–	–	–	**(64.384)**
Net cash used in financing activities	**(71.476)**	**–**	**(2.587)**	**2.587**	**(68.889)**
Decrease in net cash	**(242.701)**	**–**	**–**	**–**	**(242.701)**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

1E – Net debt analysis at 31 March 2020

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings (excluding preference shares)	676.856	330.000	2,672.465	3,679.321
Preference share capital				69.829
Total borrowings				3,749.150
Cash				(129.281)
Short term deposits				–
Net debt				3,619.869
Gearing				70.40%
Adjusted gearing				67.20%
Full year equivalent nominal interest cost	38.589	3.894	139.292	181.775
Full year equivalent cash interest payment	38.589	3.894	69.808	112.291
Indicative interest rates				
Indicative weighted average nominal interest rate	5.70%	1.18%	5.21%	4.94%
Indicative weighted average cash interest rate	5.70%	1.18%	2.61%	3.05%
Weighted average years to maturity	14.37	1.00	10.33	11.76

Adjusted gearing excludes preference shares and includes debt at nominal values along with any unpaid accretion and the accrued accretion on our financial instruments.

The borrowings and full year equivalent interest cost reflect the impact of our financial derivatives, excluding fair value movements.

A reconciliation between the borrowings reported in tables 1C and 1E is shown below.

Reconciliation of borrowings between table 1C and table 1E

	£m
1C – Current liabilities borrowings	715.923
1C – Non-current liabilities borrowings	2,843.225
Total Borrowings (table 1C)	3,559.148
Debt issue costs	11.484
Bond premium deferred	(8.198)
Deferred gilt lock proceeds	(4.647)
Deferred proceeds	(81.047)
Accrued swap accretion	202.581
Borrowings (table 1E)	3,679.321

The debt issue costs, bond premium, deferred gilt lock proceeds and deferred proceeds are amortised to the income statement and details are presented in note 20 to our statutory accounts.

The accrued swap accretion is an increase in the liability of the swap financial instruments which is presented within the financial instruments balance for statutory accounting purposes but included in borrowings as per table 1E guidance. This figure is also shown in table 4I.

1F – Financial Flows for the 12 months ended 31 March 2020 and for the price review to date (2012–13 financial year average RPI)

	12 months ended 31 March 2020					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.58%	4.52%	5.58%	90.201	73.081	73.081
Actual performance adjustment 2010–2015	1.49%	1.21%	1.49%	24.086	19.514	19.514
Adjusted return on regulatory equity	**7.07%**	**5.73%**	**7.07%**	**114.287**	**92.595**	**92.595**
Regulatory equity				1,616.507	1,616.507	1,309.692
Financing						
Gearing	–	1.05%	1.05%	–	13.739	13.739
Variance in corporation tax	–	(0.57%)	(0.70%)	–	(9.188)	(9.188)
Group relief	–	0.57%	0.70%	–	9.188	9.188
Cost of debt	–	1.21%	1.49%	–	19.501	19.501
Hedging instruments	–	(0.06%)	(0.08%)	–	(1.047)	(1.047)
Financing total	**7.07%**	**7.92%**	**9.53%**	**114.287**	**124.788**	**124.788**
Operational performance						
Totex out/(under) performance	–	(4.65%)	(5.73%)	–	(75.094)	(75.094)
ODI out/(under) performance	–	(0.19%)	(0.23%)	–	(3.047)	(3.047)
Retail out/(under) performance	–	(1.57%)	(1.93%)	–	(25.318)	(25.318)
Other exceptional items	–	–	–	–	–	–
Operational performance total	–	**(6.40%)**	**(7.90%)**	**–**	**(103.459)**	**(103.459)**
Total earnings	**7.07%**	**1.52%**	**1.63%**	**114.287**	**21.329**	**21.329**
RCV growth from RPI inflation	**2.59%**	**2.59%**	**2.59%**	**41.868**	**41.868**	**33.921**
Total shareholder return	**9.66%**	**4.11%**	**4.22%**	**156.155**	**63.197**	**55.250**
Net dividend	**4.00%**	**–**	**–**	**64.660**	**–**	**–**
Retained value	**5.66%**	**4.11%**	**4.22%**	**91.494**	**63.197**	**55.250**
Dividends reconciliation						
Gross dividend	4.00%	0.37%	0.46%	64.660	5.977	5.977
Interest received on intercompany loans	–	0.37%	0.46%	–	5.977	5.977
Net dividend	**4.00%**	**–**	**–**	**64.660**	**–**	**–**

Due to rounding, the figures presented above may not precisely reflect those calculated in accordance with Ofwat's methodology.

1F – Financial flows for the 12 months ended 31 March 2020 and for the price review to date (2012–13 financial year average RPI)

	Average 2015–20					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.61%	3.46%	5.61%	88.742	54.662	54.662
Actual performance adjustment 2010–2015	2.09%	1.29%	2.09%	33.061	20.364	20.364
Adjusted Return on regulatory equity	**7.70%**	**4.74%**	**7.70%**	**121.803**	**75.027**	**75.027**
Regulatory equity				1,581.853	1,581.853	974.371
Financing						
Gearing	–	3.25%	3.25%	–	31.639	31.639
Variance in corporation tax	–	(0.66%)	(1.07%)	–	(10.414)	(10.414)
Group relief	–	0.66%	1.07%	–	10.414	10.414
Cost of debt	–	0.41%	0.67%	–	6.527	6.527
Hedging instruments	–	0.11%	0.18%	–	1.751	1.751
Financing total	**7.70%**	**8.51%**	**11.80%**	**121.803**	**114.944**	**114.944**
Operational performance						
Totex out/(under) performance	–	0.03%	0.05%	–	0.480	0.480
ODI out/(under) performance	–	(0.47%)	(0.77%)	–	(7.498)	(7.498)
Retail out/(under) performance	–	(1.16%)	(1.88%)	–	(18.285)	(18.285)
Other exceptional items	–	0.13%	0.20%	–	1.994	1.994
Operational performance total	**–**	**(1.47%)**	**(2.39%)**	**–**	**(23.309)**	**(23.309)**
Total earnings	**7.70%**	**7.04%**	**9.40%**	**121.803**	**91.635**	**91.635**
RCV growth from RPI inflation	**2.52%**	**2.52%**	**2.52%**	**39.863**	**39.863**	**24.554**
Total shareholder return	**10.22%**	**9.56%**	**11.92%**	**161.665**	**131.497**	**116.189**
Net dividend	**4.00%**	**2.38%**	**3.87%**	**63.274**	**37.693**	**37.693**
Retained value	**6.22%**	**7.18%**	**8.06%**	**98.391**	**93.804**	**78.496**
Dividends reconciliation						
Gross dividend	4.00%	4.43%	7.19%	63.274	70.090	70.090
Interest received on intercompany loans	–	2.05%	3.32%	–	32.397	32.397
Net dividend	**4.00%**	**2.38%**	**3.87%**	**63.274**	**37.693**	**37.693**

Due to rounding, the figures presented above may not precisely reflect those calculated in accordance with Ofwat's methodology.

Commentary regarding table 1F – Financial Flows

Table 1F Financial Flows was reported in shadow form in 2017–18, and formally incorporated into reporting requirements for Section 1 of the Annual Performance Report from 2018–19 onwards.

The table aims to improve transparency and explain the elements that have the most significant impact on the financial flows to investors. As the analysis is designed to estimate the impact on equity return due to actual performance and capital structure, it includes some high level approaches to estimate the impact of regulatory mechanisms. This results in regulatory rewards and penalties, earned in the current price review period 2015–20 but not realised by shareholders until the next price review period 2020–25, being included in the table. A simplified approach is also adopted for the cost of debt, and replicated in hedging instruments in order to ensure consistency of approach.

The tables on pages 22 and 23 provide information in a three-column format:

- 'notional returns and notional regulatory equity' (column 1) – equivalent to our allowance in the Final Determination for 2015–20
- 'actual returns and notional regulatory equity' (column 2) – intended to be an extension of the RORE metric (see Table 4H, Line 5 and Lines 21 to 27), but with additional granularity, and changes of treatment in some areas
- 'actual returns and actual regulatory equity' (column 3) – an extension of column 2, designed to show the impact on shareholder returns where their investment in the company is smaller or larger than the regulatory assumption (with debt being correspondingly larger or smaller, respectively).

The base equity return for the current regulatory period, 2015–20, is adjusted to remove the returns (0.05% on notional equity) relating to our non-household retail business, following its disposal on 1 April 2017.

We also include adjustments relating to our performance in the 2010–15 regulatory period (AMP5). The net increase (1.49%) to shareholder returns is driven by our revenue collection shortfall during AMP5, when shareholders received no dividends.

The adjusted base return of 7.07%, plus inflation of 2.59% on the regulated equity, results in a total shareholder return of 9.66%. This is based on Ofwat's price review approach to determining returns, reflecting an efficient company with the regulatory notional gearing of 62.50%. The equivalent actual total shareholder return, reflecting our average gearing in 2019–20 of 69.62% and actual performance, was 4.22%.

Our actual return of 4.22% differed from the notional return of 9.66% due to financing outperformance of 2.46%, and operational underperformance of 7.90%.

The operational performance, covering wholesale totex, retail, and Outcome Delivery Incentives (ODIs), is discussed in our RORE narrative (see page 63), albeit in the above table we show the impact before adjusting for tax. The ODI entry above has previously excluded our projected SIM penalty due to performance in AMP6. Reflecting updated Ofwat guidance for 2019–20, the SIM penalty included in our PR19 determination is now included, allocated evenly over the first four years of AMP6 to reflect the period over which this incentive mechanism was assessed. As a result, the annual performance for 2019–20 is not affected by this reporting change, with the impact reflected in the average performance for AMP6.

The 'other exceptional items' row was introduced in 2018–19, and allows us to reflect the proceeds we received in 2017–18 following the disposal of our non-household retail business. Although having no impact in the current year, the impact on equity return appears in the cumulative average figures for the period 2015–20.

The Financial Flows analysis provides more detail on the financing aspects of our performance, which we discuss below.

Our average actual gearing of 69.62% has decreased further (from 74.03% in 2018–19) during the year, as a result of the financial restructuring exercise carried out in 2018–19 being in place for the entirety of 2019–20. This is higher than the regulatory assumption of 62.50%, and has the effect of amplifying percentage returns to shareholders. This is partly because the same value of return is applied to a smaller shareholder equity base, representing a greater proportion. This increases the volatility of returns, in both out-performance and underperformance scenarios, with the risk being borne entirely by shareholders.

The price setting process also allows us a return on equity between the notional gearing of 62.50% and our actual gearing of 69.62%, rather than the lower cost of debt. The impact of this relative cost of debt versus equity is estimated in the 'Gearing' returns adjustment of 1.05%.

Our 'Comparison between tax charge and allowance in price limits' (see page 32) provides a detailed narrative on our corporation tax charge and approach to using group relief. In summary, our PR14 determination includes no funding from customers for corporation tax and, having excluded the neutral cashflows relating to the inter-company loan to Southern Water Services Group (SWSG), we incurred no tax charge in the current year. The net impact on shareholder returns of corporation tax and group relief is 0.0%.

Our cost of debt, measured by reference to an implied real rate of interest, was lower than the amount allowed in our PR14 determination, increasing returns by 1.49%. Consistent with the guidance notes we have calculated this on a post-tax basis, although this may understate the extent of the outperformance as the tax impact is already captured in our corporation tax entry. If reflected on a pre-tax basis then the outperformance increases to 1.84%.

We have a portfolio of inflation linked swaps that match the cost we pay under our debt instruments to the cash flow we receive from customer bills. We have calculated the impact of these hedging instruments in a manner consistent with the prescribed calculation for cost of debt, by deflating to an implied real rate of net interest. This creates a negative impact for the year of 0.08%, counter to the nominal net receipt actually realised through our swaps, but ensures consistency of approach with the reported impact of our cost of debt. We also report the impact of these hedging instruments on a post-tax basis, aligning with treatment for cost of debt. If reported pre-tax the adverse impact increases to 0.10%.

With the exception of the dividend paid as part of the SWSG intercompany loan (see below) no dividends were paid in 2019–20.

Over the five years of the AMP6 regulatory period, and including the 2.52% average annual inflationary growth of the RCV, the total shareholder return averages 11.92%. Excluding the inflationary RCV return, which is long-term in nature and cannot be immediately realised, the average annual return potentially available to shareholders is 9.40%, exceeding the 7.70% return allowed by Ofwat in the price determination by 1.70%.

The main driver of the additional returns is our gearing although, following the financial restructure in 2018–19, this has decreased. Over the five years of AMP6, gearing increased the allowed returns by 3.25%, by concentrating them in a smaller shareholder equity base than assumed under Ofwat's price review approach. Our cost of debt, including the impact of our hedging instruments, has also been beneficial, increasing returns by 0.85%. This 4.10% increase to returns due to financing performance is partially offset by our operational performance, particularly in our retail household business. Cost overruns reduced returns by 1.88%, and the household customer Service Incentive Mechanism comprised 0.66% of the 0.77% adverse performance on ODIs. We received a one-off receipt on the disposal of our non-household business in April 2017, resulting in an average increase to returns of 0.20% over the five year AMP6 period.

The average net dividend of 3.87% is lower than the 4.00% base dividend in the price determination. Of the potential 9.40% return available to shareholders, only 3.87% has been released as dividends, with the remainder being retained in the business.

Note:

To ensure consistency with treatment in the PR14 determination, the neutral cashflows relating to the SWSG intercompany loan have been excluded from the above analysis. The interest income on the intercompany loan is excluded from net interest costs; group relief payments for the interest loss at SWSG are not reflected in the corporation tax and group relief sections; and the gross dividend has been reduced by the amount of dividend paid to SWSG under this arrangement. This ensures that these items do not distort the reporting of returns to shareholders.

Notes to the regulatory financial statements For the year ended 31 March 2020

1 Accounting policies

a) Basis of preparation

The regulatory accounting statements have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines (RAGs) published by Ofwat, the accounting policies set out in the statement of accounting policies and under the historical cost convention.

The accounting policies used in the regulatory accounting statements are the same as those adopted in the statutory historical cost accounts, except as set out below.

The regulatory accounting statements are separate from the statutory financial statements of the company. The statutory financial statements are prepared under FRS 101 'Reduced Disclosure Framework'. There are differences between International Financial Reporting Standards under FRS 101 and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in respect of:

- revenue recognition
- capitalisation of borrowing costs.

Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require the company's statutory accounting framework to be followed. Financial information other than that prepared wholly on the basis of IFRS, FRS 101 or FRS 102 may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 2006.

b) Fixed assets

Interest – To meet the requirements of RAG 1.08 the interest capitalised within the statutory accounts under IAS 23 'Borrowing Costs' has been reversed and charged through the income statement.

Capitalisation policy – Costs that are either directly attributable to bringing an asset into working condition or subsequent expenditure that provides an enhancement of the economic benefits of a fixed asset are treated as capital expenditure. In order to aid classification of expenditure the following rules are applied:

Non-infrastructure assets

- Expenditure on a single item of equipment, including installation costs, exceeding £3,000 is treated as capital expenditure. Individual items purchased for less than £3,000 are charged to operating costs unless they form part of a capital scheme.
- All repairs, replacements and improvements to non-infrastructure fixed assets costing in excess of £3,000 and which extend the life of the asset are charged to capital.

Infrastructure assets

- All repairs and maintenance to infrastructure assets will generally be treated as operating expenditure
- Large repairs, involving the replacement of a significant length of pipe, are treated as capital expenditure after review with the Finance Team
- Planned renewals to replace significant lengths of pipe in relation to a specific asset are treated as capital expenditure.

Private sewers – The ownership of and responsibility for private sewers in Southern Water's region were transferred to the company on 1 October 2011.

Following the adoption of FRS 101, expenditure in relation to private sewers has been treated as an expense and charged to the income statement.

c) Revenue

Revenue represents the income receivable in the ordinary course of business (excluding value added tax) for goods and services provided in the year by the regulated activities of the business.

Revenue relates to charges due in the year and includes charges billed to customers for water and sewerage services, which are recognised in the period in which they are earned, and an accrual in respect of unbilled charges. Revenue excludes payments received in advance which are recorded as deferred revenue.

Unmetered bills for water and wastewater services are based on either the rateable value of the property, an assessed volume of water supplied or on a Fixed Licence Fee.

Metered bills for water and wastewater services are based on actual or estimated water consumption. Metered revenue is dependent upon the volumes supplied and includes an estimate of the consumption between the date of the last meter reading and the period end. Meters are read on a cyclical basis and the company recognises revenue for unbilled amounts based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. Where there is insufficient historical information, estimation is based on average consumption for defined levels of occupancy.

Within the accrual, adjustments to billing are made for changes to occupancy dates and where consumption levels are in excess of certain tolerances. No other amendments are made between revenue and billing.

Charges on income arising from court, solicitors and debt recovery agency fees are credited to operating costs and added to the relevant customer account. They are not recognised within revenue.

In the statutory accounts, reported under IFRS 15 – 'Revenue from Contracts with Customers', revenue is only recognised when it is probable that economic benefits will result to the company. RAG 1.08 requires that no judgment is applied to the probability of collection. Following a review of the collectability of revenue for the bad debt provision charge for 2019–20, revenue has been recognised in full in the statutory accounts and therefore there is no difference this year between the revenues reported for statutory and regulatory purposes.

Charging policy

Water and sewerage charges fall into the following three categories:

1) Charges which are payable in full

2) Charges which are payable in part

3) Not chargeable (void properties)

The circumstances in which each of the above applies are set out below. All of the charges covered in categories 1) and 2) are included in revenue.

Charges payable in full

Charges are payable in full in the following circumstances:

i) Occupied and furnished

Water (and sewerage) charges are payable in full from the date of connection or change of customer on all properties which are recorded as occupied and furnished.

ii) Unoccupied and furnished

Water (and sewerage) charges are payable in full on unoccupied, furnished premises. These include properties:

- left with bedding, a desk or other furniture
- used for multiple occupation with shared facilities
- used as holiday, student, hostel or other accommodation
- used for short-term occupation or letting where the occupation or terms of tenancy is less than six months.

Exceptions to this, where water (and sewerage) charges are not payable, include where the customer is:

- in a care home
- in long-term hospitalisation
- in prison
- overseas long term
- deceased.

iii) Unoccupied and unfurnished

Water (and sewerage) charges are payable in full on unoccupied, unfurnished premises where water is being consumed. This includes:

- premises where renovation, redecoration or building work is being undertaken
- premises being used as storage
- premises not normally regarded as being occupied such as cattle troughs and car parks
- non-household agricultural properties.

Charges payable in part

The following charges only are payable in certain circumstances:

- Metered standing charges – Payable on unoccupied, metered properties which are still connected
- Surface water charge – Payable on unmeasured properties which are temporarily disconnected
- Sewerage unmeasured tariff – Payable on unmeasured, occupied properties where the water supply is disconnected but sewerage is still provided
- Surface water and highway drainage – Payable on furnished properties where the water supply is disconnected.

Not chargeable

Properties which are unoccupied, unfurnished and disconnected are not chargeable for water and sewerage therefore no billing is raised and no revenue recognised in respect of these properties.

Definition and treatment of properties

Occupied properties

The occupier is any person who owns a premises or who has agreed with us to pay water and sewerage services in respect of the premises. The property management process is followed to identify whether the property is occupied or not and, if occupied, to identify the chargeable person and raise a bill.

Notes to the regulatory financial statements For the year ended 31 March 2020

The property management process may comprise some or all the following:

- Physical inspection
- Mailings
- Customer contacts
- Meter readings for metered properties
- Checks with third parties, e.g. credit agencies.

When a new customer is identified, the company process aims to establish the date that they became responsible for water and sewerage charges at the property. This is normally the date at which they moved into the property. The new customer will be charged retrospectively from the date at which they became responsible for water and sewerage charges of the premises.

Where evidence exists that a property is occupied the property management process is followed until occupancy details are obtained. Bills are not issued in the name of 'The Occupier' to try to generate confirmation of occupancy and therefore there is no billing in the name of 'The Occupier' within revenue.

Unoccupied properties

A property is deemed to be unoccupied when the company has completed the property management process and not identified the property as occupied. To be classified as unoccupied a property must meet at least one of the following criteria:

- A new property has been connected but is empty and unfurnished
- The company has been informed that the customer has left the property, it is unfurnished and not expected to be reoccupied immediately
- It has been disconnected following a customer request
- The identity of the customer is unknown
- The company has been informed that the customer is in a care home, long-term hospitalisation, prison, overseas long term or deceased.

If the property management process confirms that the property is unoccupied, the property may be declared void and the supply turned off.

New properties

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as revenue.

If the developer is no longer responsible for the property and no new occupier has been identified, the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

d) Revenue disclosures

In accordance with RAG 3.11 we highlight the following comments in respect of turnover for the year:

i) The value of household billings raised in the year ended 31 March 2020 for consumption in prior years was £129.2 million. The value of these billings was lower than the metered income accrual made at 31 March 2019. The estimation difference was £5.8 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.

ii) No changes have been made to the accrual methodology in the year.

e) Bad and doubtful debts

The bad debt provision is calculated by applying estimated recovery rates, based on the past collection experience of other customers who share similar characteristics.

Higher provisioning percentages are applied to customers which are, based on their characteristics, considered to be of greater risk. These include those with a poor payment history as well as to those with older debts. Bad debt provisioning rates are updated annually to reflect the latest collection performance data from the company's billing system. Actual amounts recovered may differ from the estimated levels of recovery, which could impact on operating results.

The company operates a comprehensive debt recovery process and bad debt is only written off when the recovery of such debt has been exhausted through routine collection, debt recovery or litigation processes or where it would be uneconomical to undertake further recovery action.

Situations where this may arise and where debt may be written off are as follows:

- Where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted
- Where the customer has died without leaving an estate or has left an insufficient estate from which to recover the debt
- Where the age and/or value of the debt makes it uneconomical to pursue
- Where county court proceedings and attempts to recover the debt by debt collection agencies have proved unsuccessful

- Where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received.

Write-off rules apply primarily to customers to whom the company has ceased to supply a service. Only in exceptional circumstance or as part of specific debt recovery assistance programmes is debt relating to continuing customers considered for write-off.

For debt to be written off there must be a legitimate charge against the debtor. If it is considered that part or all of the debt is incorrect or unsubstantiated, then such elements are dealt with through the issue of a credit note.

The company's bad debt provisioning and write-off policies have remained unchanged and have been consistently applied during the year. The value of debt written off over the past year has remained low due to the continuation of projects aimed at reducing bad debt before the point of write-off.

The value of trade and other receivables of the appointed business decreased to £272.5 million (2019: £331.8 million). This decrease largely results from the increased provision for bad debt relating to COVID-19 of £16.0 million together with a reduction in the balance on the inter-company debtor with Southern Water Services (Finance) Limited of £54.4 million. This inter-company arrangement is used to pay the interest on our loans, the balance reduced this year as a number of interest payments are made at 31 March and in 2019 this fell on a weekend resulting in a higher than normal debtor balance.

f) Price control segments

The notes to the regulatory accounting statements analysing revenues, operating costs and fixed assets by price control segment have been drawn up in accordance with the guidance provided by Ofwat in RAG 2.07 and our accounting separation methodology statement which is published separately on our website.

The methods for undertaking cost allocations to produce this information are summarised below:

Operating expenditure

Most direct costs are specific either to water, wastewater or retail services. Where costs cannot be directly attributed to a sub-function an apportionment has been made on an appropriate basis, using the most accurate allocation method available. Examples of allocation methods include the use of time recording devices, headcount, operational site data and management estimates.

The allocation methods adopted have been agreed following review meetings held across the business with management and technical experts.

The information relating to non-appointed business, including an allocation of overhead cost, has been excluded in line with the guidance.

Fixed assets

The fixed asset data has predominantly been directly attributed to the price control segments based on an assessment of the overall nature of each scheme.

Where a scheme relates to more than one price control segment it has been allocated to the price control unit where the principal use occurs. For corporate assets, the price control of principal use is wholesale wastewater as this is our largest price control and recharges to the other price control units are made for the use of these assets.

New expenditure incurred during the year is allocated to business units within each price control based on an analysis of the scheme design.

Revenues

Revenue streams have been directly attributed to price control segments where they have been recorded as such in our systems. Classification of household and non-household revenues has been made in line with the classifications in place when the business plan was completed in accordance with the guidance from Ofwat.

Revenues that could not be directly attributed to a price control segment have been assessed and allocated to the appropriate price control segment based on the nature of the income.

g) Provisions

Environment Agency – wastewater sites

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations following wastewater incidents. In addition to those, the company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and we have entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation.

The Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the company's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, it does recognise that there will be a minimum liability associated with the charges before the court and has therefore recognised a provision of £1.0 million reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

There is a wide range of possible outcomes which reflects the uncertain and disputed levels of culpability and environmental harm (both being amongst a number of key criteria that the court uses to help determine the level of the fine), the lack of a similar precedent, and the extent of the applicability of the Sentencing Council's Guidelines to the company which vary very widely. Further, as the company is a Very Large Organisation, there is a requirement for the court to examine the financial circumstances of the organisation in the round. The court has a very broad discretion to assess the level of fine and the minimum provision the company has made is not intended to indicate or predict any particular level. The Board will continue to review the level of provision made as more information becomes available.

The company is working proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues between 2010 and 2017 (inclusive). The Board, supported by external legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

The Board has taken these investigations extremely seriously and has continued to monitor and support the work of the Risk and Compliance directorate, which continues to deliver a programme of improvements to the company's non-financial regulatory reporting including the collection, verification, reporting and assurance of data.

h) Leases

As reported in the Annual Report and Financial Statements, IFRS 16 'Leases' became effective for accounting periods beginning on or after 1 January 2019. Full details of the impact of implementation of this new standard can be found on page 223 of our Annual Report and Financial Statements.

2 Differences between statutory and regulatory reporting

Statutory reporting reflects the financial performance of Southern Water Services which comprises appointed and non-appointed activities. The appointed business relates to those activities which are necessary for the company to fulfil its function and duties as a water and sewerage undertaker. The non-appointed business relates to activities we undertake that are not covered by our Licence but are related to our business. For regulatory reporting the activities of the non-appointed business have been separated from those of the appointed business.

In addition there are differences between regulatory accounting definitions and those applied for statutory reporting under FRS 101. These are summarised below:

Income statement

	Revenue £m	Operating costs £m	Other income £m	Interest expense £m
i) CHP income	(4.6)	4.6	–	–
ii) Grants and contributions	(22.5)	–	22.5	–
iii) Borrowing costs	–	7.6	–	(32.8)
Total	(27.1)	12.2	22.5	(32.8)

i) Income generated from Combined Heat and Power (CHP) processes, which convert methane into electricity, is recorded as revenue within the statutory accounts. For regulatory reporting this income is reported as a negative operating cost. As a result £4.6 million of revenue has been re-classified as a negative operating cost.

ii) As required by RAG 1.08 section 1.8, grants and contributions received and recognised in the income statement are reported under other income in the Annual Performance Report financial tables. As a result £22.5 million has been transferred from revenue to other income in the income statement. See table 2E for further information.

iii) For statutory reporting, borrowing costs associated with capital expenditure are capitalised. Regulatory reporting does not permit interest to be capitalised. As a result operating costs are reduced by £7.6 million, reflecting the removal of depreciation on interest capitalised and the interest charge has been increased by £32.8 million reversing the element of interest capitalised in the year.

Statement of financial position

	Fixed Assets £m	Intangible Assets £m	Current trade and other payables £m	Deferred income – grants and contributions £m
i) Borrowing costs	(216.9)	(1.5)	–	–
ii) Grants and contributions	–	–	1.1	(1.1)
Total	(216.9)	(1.5)	1.1	(1.1)

i) As borrowing costs cannot be capitalised under regulatory reporting, fixed and intangible assets have been reduced by £216.9 million and £1.5 million respectively, reflecting the removal of cumulative borrowing costs capitalised. There is a corresponding reduction to retained earnings.

ii) Grants and contributions relating to requisitions of £1.1 million classified within current trade and other payables in the statutory accounts have been transferred to deferred income for regulatory reporting.

Statement of cash flows

	Operating profit £m	Other income £m	Depreciation £m	Amortisation – grants and contributions £m	Grants and contributions £m
i) Grants and contributions – income statement	(22.5)	21.3	–	1.2	–
ii) Depreciation	7.6	–	(7.6)	–	–
iii) Grants and contributions – cash	–	–	–	(6.9)	6.9
Total	(14.9)	21.3	(7.6)	(5.7)	6.9

i) The re-classification of grants and contributions received in the income statement of £22.5 million from operating profit to other income together with the transfer of £1.2 million of grant contribution and amortisation which is also reclassified as other income.

ii) There is a £7.6 million adjustment made to both operating profit and depreciation relating to the removal of capitalised borrowing costs.

iii) In the statutory accounts for 2019–20, contributions received and held on the Balance Sheet have been presented as operating cashflows. These have been included within the amortisation of grants and contributions row of table 1D. For regulatory purposes £6.9 million, reflecting the cash received for specific capital assets, has been reclassified to grants and contributions within investing activities.

3 Corporation tax reconciliation

The tax assessed for the year is different to the standard rate of corporation tax in the UK and the reconciliation is shown in the table below.

Corporation tax reconciliation

	Appointed £m	Non-appointed £m
Profit before tax and fair value movement	66.2	2.6
Tax at the UK corporation tax rate of 19%	12.6	0.5
Permanent differences	2.2	–
Fixed asset timing differences	9.0	–
Other short-term timing differences	(8.1)	–
Pension cost relief in excess of pension charge	(3.1)	–
Group relief received for nil payment	(10.9)	(0.5)
Adjustment in respect of prior years – current tax	–	–
Tax charge for year	1.7	–

Details of factors affecting future tax charges:

Reductions in the main rate of corporation tax to 17% from the 1 April 2020 were enacted in the Finance Bill 2016, and deferred tax balances at 31 March 2019 were calculated based on these reduced rates. It was subsequently announced in March 2020 that the corporation tax rate would instead increase to 19% from 1 April 2020. This increase has been substantively enacted in Finance Bill 2020 at the Balance Sheet date, and deferred tax balances at 31 March 2020 have been calculated using this increased rate. A £40.3 million charge has been recognised in the income statement in the period to reflect the increase in the deferred tax liability as a result of the rate change. In addition, a credit of £1.5 million has been recognised in the statement of other comprehensive income to reflect the increase in the deferred tax asset relating to the pension deficit.

Based on current capital investment plans, the company expects to continue to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

Comparison between tax charge and allowance in price limits

A comparison of the current appointed tax charge with the allowance in price limits is shown in the table and associated notes below:

Comparison between tax charge and allowance in price limits

	Current tax charge £m	Current tax charge (excluding SWSG loan) £m
i) Final Determination allowance	–	–
ii) Price determination – tax not charged on forecast tax losses	0.1	0.1
iii) Earnings before interest and tax	(8.5)	(8.5)
iv) Net finance costs, including taxable fair value movements	4.7	3.0
v) Depreciation and capital allowances claimed	15.0	15.0
vi) Group relief claimed	(12.5)	(10.8)
vii) Change in tax rate	(0.7)	(0.7)
Other	1.9	1.9
Current tax before payments for group relief and prior year adjustments	–	–
viii) Payments for group relief	1.7	–
Appointed current tax charge	1.7	–

i) In the price review process for the current regulatory period, 2015–20, there was no corporation tax forecast to be paid in the wholesale business and therefore there is no allowance for corporation tax in customer bills.

ii) For 2019–20 the price determination included taxable losses in the wholesale business and no allowance was provided for these in price limits. The price determination also included forecast taxable profits in the retail business, resulting in an overall tax charge for the appointed business of £0.1 million, but a specific allowance for tax is not provided in price limits for the retail business.

iii) Actual earnings before interest and tax are lower than those in the Final Determination. This is mainly driven by additional operating expenditure in both the wholesale and retail businesses, alongside a shortfall on revenue recovery.

iv) Net finance costs are lower as a result of lower interest costs and the inclusion of interest receivable on our derivative financial instruments and interest income on the inter-company loan from Southern Water Services Group (SWSG) (see fig. 1 on page 114 of the Annual Report and Financial Statements for further explanation). This is partially offset by taxable fair value losses relating to debt indexation.

The cash flows relating to the inter-company loan to SWSG are neutral to Southern Water and its customers as we receive interest and pay an equal amount of dividend and group tax relief back to SWSG. The effect of removing this loan (consistent with the treatment in the price determination) is shown in the table above.

v) Lower capital allowances were claimed as a result of lower taxable profits and prioritising the use of group losses over capital allowances.

vi) We were able to use losses from other companies within the Greensands group in order to reduce the current tax charge for Southern Water.

Payment of £1.7 million was made for the losses at SWSG, but no payment was made for the benefit of the remaining losses received from other companies in the Greensands group. Capital allowances not claimed are available to Southern Water as a deduction against future taxable profits.

vii) The Final Determination assumed that corporation tax would be payable at a rate of 20%. From 2017–18 the actual tax rate reduced to 19% reducing our current tax charge.

viii) The group relief payment for the year reflects payment at the current tax rate, for the tax losses received on the inter-company interest income from SWSG. Remaining losses are received for nil payment.

Taxation policy and strategy

We manage our tax affairs in an open and transparent way and contribute materially to the Exchequer each year.

Our tax policy is consistent with the overall values and strategy of the company and will consider financial risk, reputational risk, and social responsibilities. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders rather than using tax planning to drive or determine business decisions. Our focus is therefore on compliance, and our tax planning is always aligned with our commercial and economic activity. The very nature of our business means we take a long term view on all the activities we undertake and as a result we also ensure our tax strategy is sustainable.

Our approach to tax management is compliant with tax laws, rules, regulations and reporting requirements in all of its operations. A culture of doing the right thing is embedded in our core values and our approach to tax embodies this by ensuring we pay the right amount of tax, in the right place at the right time. Management of our tax affairs is carried out by an experienced internal tax team with the support of professional tax advisers and specialist tax support. Professional tax advisers are used in circumstances when additional advice is deemed appropriate (for example, to ensure compliance with new legislation and tax planning). We use specialist tax support in the preparation of our capital allowances.

Risk is managed by ensuring there are sufficient processes, systems, governance and appropriate controls in place. Internal assurance for the company is carried out by our Internal Audit team and we have also used the services of professional tax advisers to assist us with our tax compliance. Our tax policy extends to the wider group and ensures all companies within the Southern Water and Greensands groups are subject to UK tax, and all companies are UK tax resident irrespective of their place of incorporation.

A key factor in managing tax is our relationship with HMRC. We meet all statutory and legislative requirements and we manage our tax affairs in an open and transparent way. This extends to us sharing information with HMRC, such as internal audit findings. HMRC share our view of our low risk approach to the management of our tax affairs with an assessment of us as a ‘low-risk’ company.

Further information is available in our Annual Report and Financial Statements on page 106.

Price control and other segmental reporting

2A – Segmental income statement for the 12 months ended 31 March 2020

	Wholesale					
	Water resources £m	Water network + £m	Water total £m	Wastewater network + £m	Sludge £m	Wastewater total £m
Revenue – price control		181.354	**181.354**	594.223		**594.223**
Revenue – non price control		5.264	**5.264**	0.948		**0.948**
Operating expenditure	(12.087)	(100.844)	**(112.931)**	(175.508)	(21.808)	**(197.316)**
Depreciation – tangible fixed assets	(4.247)	(53.685)	**(57.932)**	(164.583)	(19.594)	**(184.177)**
Amortisation – intangible fixed assets	(1.794)	(0.501)	**(2.295)**	(9.118)	(0.014)	**(9.132)**
Other operating income	0.032	0.268	**0.300**	0.496	0.062	**0.558**
Operating profit before recharges			**13.760**			**205.104**
Recharges from other segments	(0.190)	(6.203)	**(6.393)**	–	(1.106)	**(1.106)**
Recharges to other segments	–	–	**–**	12.189	–	**12.189**
Operating profit			**7.367**			**216.187**

	Retail			
	Household £m	Non-household £m	Total £m	Wholesale and Retail total £m
Revenue – price control	56.072	2.548	**58.620**	**834.197**
Revenue – non price control	–	–	**–**	**6.212**
Operating expenditure	(79.785)	(0.557)	**(80.342)**	**(390.589)**
Depreciation – tangible fixed assets	(1.515)	–	**(1.515)**	**(243.624)**
Amortisation – intangible fixed assets	(1.334)	–	**(1.334)**	**(12.761)**
Other operating income	–	–	**–**	**0.858**
Operating (loss)/profit before recharges	**(26.562)**	**1.991**	**(24.571)**	**194.293**
Recharges from other segments	(4.690)	–	**(4.690)**	**(12.189)**
Recharges to other segments	–	–	**–**	**12.189**
Operating (loss)/profit	**(31.252)**	**1.991**	**(29.261)**	**194.293**
Surface water drainage rebates				**0.090**

2B – Totex analysis for the 12 months ended 31 March 2020 – Wholesale water and wastewater

	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Total £m
Operating expenditure					
Power	3.956	12.962	35.708	(2.394)	**50.232**
Income treated as negative expenditure	–	–	–	(4.606)	**(4.606)**
Abstraction charges/discharge consents	3.862	0.102	4.062	–	**8.026**
Bulk supply/bulk discharge	–	0.359	–	–	**0.359**
Other operating expenditure					
– Renewals expensed in year (Infrastructure)	–	21.870	25.770	–	**47.640**
– Other operating expenditure excluding renewals	2.607	51.845	96.602	27.044	**178.098**
Local authority rates	0.983	11.114	13.366	1.764	**27.227**
Total operating expenditure excluding third party services	**11.408**	**98.252**	**175.508**	**21.808**	**306.976**
Third party services	0.679	2.592	–	–	**3.271**
Total operating expenditure	**12.087**	**100.844**	**175.508**	**21.808**	**310.247**
Capital expenditure					
Maintaining the long term capability of the assets – infrastructure	0.261	21.734	35.663	–	**57.658**
Maintaining the long term capability of the assets – non-infrastructure	4.605	66.480	145.355	14.573	**231.013**
Other capital expenditure – infrastructure	2.223	10.670	50.502	–	**63.395**
Other capital expenditure – non-infrastructure	5.657	11.811	71.238	5.604	**94.310**
Infrastructure network reinforcement	–	0.205	11.349	–	**11.554**
Total gross capital expenditure excluding third party services	**12.746**	**110.900**	**314.107**	**20.177**	**457.930**
Third party services	1.033	1.834	6.959	–	**9.826**
Total gross capital expenditure	**13.779**	**112.734**	**321.066**	**20.177**	**467.756**
Grants and contributions	0.504	7.740	13.469	–	**21.713**
Totex	**25.362**	**205.838**	**483.105**	**41.985**	**756.290**
Cash expenditure					
Pension deficit recovery payments	0.183	4.823	10.104	0.819	**15.929**
Totex including cash items	**25.545**	**210.661**	**493.209**	**42.804**	**772.219**

Price control and other segmental reporting

2C – Operating cost analysis for the 12 months ended 31 March 2020 – Retail

	Household £m	Non-household £m	Total £m
Operating expenditure			
Customer services	25.593	–	**25.593**
Debt management	14.170	–	**14.170**
Doubtful debts	29.422	0.160	**29.582**
Meter reading	3.635	–	**3.635**
Services to developers		0.397	**0.397**
Other operating expenditure	6.965	–	**6.965**
Total operating expenditure excluding third party services	**79.785**	**0.557**	**80.342**
Third party services operating expenditure	–	–	**–**
Total operating expenditure	**79.785**	**0.557**	**80.342**
Depreciation – tangible fixed assets	1.515	–	**1.515**
Amortisation – intangible fixed assets	1.334	–	**1.334**
Total operating costs	**82.634**	**0.557**	**83.191**
Debt written off	1.901	–	**1.901**

Movement in costs from 2018–19

Household retail operating expenditure has increased by £21.0 million to £79.8 million (2019: £58.8 million). This is principally due to an increase in the bad debt charge of £19.8 million to £29.4 million (2019: £9.6 million). The bad debt charge was increased by £16.0 million as a result of the action taken by the business in response to the COVID-19 lockdown of suspending debt collection activities, and the subsequent assessment of the collectability of our outstanding debt in light of the anticipated impact of the pandemic on the economy. The remaining increase in the bad debt charge of £3.8 million is a result of fewer new litigation initiatives during the year. Customer services costs have increased by £4.6 million due to a one-off restructuring activity to transition customer services to an outsourced supplier.

Other operating expenditure has reduced by £3.1 million as a result of lower overhead allocation to the business unit following this outsourcing event.

Comparison to the business plan

Household

Total household retail costs of £82.6 million are £32.1 million higher than allowed in the Final Determination.

The increase is due to the following factors:

During 2019–20 the business has continued to spend more on debt management than assumed in the business plan in order to reduce the cost of bad debt. If it were not for the impact of COVID-19 on the bad debt charge, this charge would have been £10.6 million lower than the business plan.

Over the past three years we have undertaken transformational activities in order to deliver operational efficiencies. Metering costs are in line with business plan assumptions but Customer Services costs are significantly higher than the business plan due to the one-off restructuring costs incurred this year.

The charge for depreciation and amortisation of tangible and intangible assets for the household retail business is £1.6 million higher than the allowance in the Final Determination. This is because the charge for legacy assets of £2.6 million was included within the wholesale price control in the Final Determination. Depreciation and amortisation, in 2019–20, for assets delivered as part of our capital programme for 2015–20 was £0.2 million. This is lower than the allowance in the Final Determination of £2.2 million.

Non-household

On 1 April 2017 we exited the non-household retail business and our customers transferred to a specialist retail company, Business Stream. Costs have been incurred during the year to collect outstanding non-household debt relating to the period to 31 March 2017 and for the provision of certain developer related services.

2D – Historic cost analysis of tangible fixed assets – Wholesale and retail

	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2019	201.325	1,794.198	5,972.868	573.746	31.543	–	**8,573.680**
Disposals	(10.598)	(13.770)	(31.572)	(0.866)	–	–	**(56.806)**
Adjustments	–	0.791	32.326	0.027	0.036	–	**33.180**
Additions	10.796	112.599	307.386	20.078	1.257	–	**452.116**
Assets adopted at nil cost	–	–	7.843	–	–	–	**7.843**
At 31 March 2020	**201.523**	**1,893.818**	**6,288.851**	**592.985**	**32.836**	**–**	**9,010.013**
Depreciation							
At 1 April 2019	(73.087)	(544.348)	(1,825.108)	(252.100)	(20.164)	–	**(2,714.807)**
Disposals	10.597	13.770	31.575	0.866	–	–	**56.808**
Adjustments	–	–	–	–	–	–	–
Charge for year	(4.247)	(53.685)	(164.583)	(19.594)	(1.515)	–	**(243.624)**
At 31 March 2020	**(66.737)**	**(584.263)**	**(1,958.116)**	**(270.828)**	**(21.679)**	**–**	**(2,901.623)**
Net book amount at 31 March 2020	**134.786**	**1,309.555**	**4,330.735**	**322.157**	**11.157**	**–**	**6,108.390**
Net book amount at 1 April 2019	128.238	1,249.850	4,147.760	321.646	11.379	–	**5,858.873**
Depreciation charge for year							
Principal services	(4.027)	(53.086)	(164.205)	(19.593)	(1.515)	–	**(242.426)**
Third party services	(0.220)	(0.599)	(0.378)	(0.001)	–	–	**(1.198)**
Total	**(4.247)**	**(53.685)**	**(164.583)**	**(19.594)**	**(1.515)**	**–**	**(243.624)**

The net book value of tangible assets includes £860.7 million in respect of assets in the course of construction.

During the year we have implemented IFRS16 'Leases'. This has resulted in leases previously reported as operating leases in relation to offices, outfall pipes and vehicle, being reclassified as finance leases. As a result, there is an increase to the value of our fixed assets of £33.2 million in 2019–20, and this has been presented in the adjustment line within table 2D above.

Price control and other segmental reporting

Historic cost analysis of intangible assets – Wholesale and retail

Although not required by RAG 3.11, an intangible asset note is presented below in order to assist with the reconciliation of the capital expenditure presented in tables 2B, 4D and 4E.

Historic cost analysis of intangible assets – Wholesale and retail

	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2019	9.815	4.856	87.678	0.125	22.224	–	**124.698**
Disposals	–	–	(0.002)	–	–	–	**(0.002)**
Adjustments	–	–	–	–	–	–	**–**
Additions	2.983	0.135	5.837	0.099	(0.005)	–	**9.049**
Assets adopted at nil cost	–	–	–	–	–	–	**–**
At 31 March 2020	**12.798**	**4.991**	**93.513**	**0.224**	**22.219**	**–**	**133.745**
Depreciation							
At 1 April 2019	(6.509)	(1.145)	(61.526)	(0.067)	(11.185)	–	**(80.432)**
Disposals	–	–	0.002	–	–	–	**0.002**
Adjustments	–	–	–	–	–	–	**–**
Charge for year	(1.794)	(0.501)	(9.118)	(0.014)	(1.334)	–	**(12.761)**
At 31 March 2020	**(8.303)**	**(1.646)**	**(70.642)**	**(0.081)**	**(12.519)**	**–**	**(93.191)**
Net book amount at 31 March 2020	**4.495**	**3.345**	**22.871**	**0.143**	**9.700**	**–**	**40.554**
Net book amount at 1 April 2019	3.306	3.711	26.152	0.058	11.039	–	**44.266**
Depreciation charge for year							
Principal services	(1.792)	(0.493)	(9.118)	(0.014)	(1.334)	–	**(12.751)**
Third party services	(0.002)	(0.008)	–	–	–	–	**(0.010)**
Total	**(1.794)**	**(0.501)**	**(9.118)**	**(0.014)**	**(1.334)**	**–**	**(12.761)**

The net book value of intangible assets includes £17.7 million in respect of assets in the course of construction.

2E – Analysis of capital contributions and land sales for the 12 months ended 31 March 2020 – Wholesale

	Fully recognised in income statement £m	Capitalised and amortised (in the income statement) £m	Total £m
Grants and contributions – water			
Connection charges	4.213	–	**4.213**
Infrastructure charge receipts	1.763	–	**1.763**
Requisitioned mains	0.057	0.227	**0.284**
Other contributions (price control)	–	1.624	**1.624**
Diversions	0.360	–	**0.360**
Total	**6.393**	**1.851**	**8.244**
Grants and contributions – wastewater			
Infrastructure charge receipts	8.042	–	**8.042**
Requisitioned sewers	(0.743)	(0.103)	**(0.846)**
Other contributions (price control)	0.686	–	**0.686**
Diversions	0.279	–	**0.279**
Other contributions (non-price control)	–	5.308	**5.308**
Total	**8.264**	**5.205**	**13.469**
Value of adopted assets	7.843	–	**7.843**

	Water £m	Wastewater £m	Total £m
Movements in capitalised grants and contributions			
Brought forward	9.521	5.740	**15.261**
Capitalised in year	1.851	5.205	**7.056**
Amortisation (in income statement)	(1.029)	(0.531)	**(1.560)**
Carried forward	**10.343**	**10.414**	**20.757**

	Water £m	Wastewater £m	Total £m
Land sales			
Proceeds from disposals of protected land	0.046	0.434	**0.480**

IFRS 15 'Revenue from Contracts with Customers' became effective for financial period commencing on or after 1 January 2018.

The effect of applying IFRS 15 results in the immediate recognition, on completion of the performance obligation, of developer related revenue relating to diversions, requisitions and adoptions, previously treated as deferred revenue. Until the performance obligation is completed the revenue for these activities will be deferred on the Balance Sheet.

Grants and contributions recognised in the statutory income statement as revenue have been reclassified to other income for regulatory purposes in table 1A. These include the amounts of £6.4 million and £8.3 million disclosed above for water and wastewater respectively together with £7.8 million of adopted assets.

2F – Household – revenues by customer type

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of customers 000's	Average household retail revenue per customer £
Unmeasured water only customer	2.101	0.297	2.398	15.644	19
Unmeasured wastewater only customer	80.777	4.210	84.987	264.282	16
Unmeasured water and wastewater customer	39.838	3.664	43.502	112.015	33
Measured water only customer	14.771	1.981	16.752	72.265	27
Measured wastewater only customer	173.187	12.356	185.543	638.361	19
Measured water and wastewater customer	309.756	33.564	343.320	830.286	40
Total	**620.430**	**56.072**	**676.502**	**1,932.853**	**29**

2G – Non-household water – revenues by tariff type for the 12 months ended 31 March 2020

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per connection £
Non-default tariff					
Total non-default tariff	–	–	–	–	–
Default tariffs					
Standard Water – Unmetered	1.259	–	1.259	3.843	–
Standard 0-1Ml p.a. Water Metered	10.982	–	10.982	41.806	–
Standard 1-5Ml pa Water Metered	19.278	–	19.278	5.384	–
Water supplies 5 to 50 Ml	5.556	–	5.556	0.465	–
Water supplies 50 Ml and over	6.258	–	6.258	0.112	–
Total default tariffs	**43.333**	–	**43.333**	**51.610**	–
Total	**43.333**	–	**43.333**	**51.610**	–

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**51.610**	–

2H – Non-household wastewater – revenues by tariff type for the 12 months ended 31 March 2020

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per connection £
Non-default tariff					
Total non-default tariff	–	–	–	–	–
Default tariffs					
Standard Sewerage Unmetered	4.007	–	**4.007**	5.500	–
Standard 0-1Ml pa Sewerage Metered	39.782	–	**39.782**	62.044	–
Standard 1-5Ml pa Sewerage Metered	31.513	–	**31.513**	7.084	–
Wastewater services 5 to 50 Ml	24.737	–	**24.737**	1.156	–
Wastewater services 50 Ml and over	11.165	–	**11.165**	0.078	–
Total default tariffs	**111.204**	**–**	**111.204**	**75.862**	–
Total	**111.204**	**–**	**111.204**	**75.862**	–

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**75.862**	–

2I – Revenue analysis and wholesale control reconciliation for the 12 months ended 31 March 2020

	Household £m	Non-household £m	Total £m
Wholesale charge – water			
Unmeasured	15.627	1.259	**16.886**
Measured	121.784	42.074	**163.858**
Third party revenue		0.610	**0.610**
Total water	**137.411**	**43.943**	**181.354**
Wholesale charge – wastewater			
Unmeasured	107.090	4.007	**111.097**
Measured	375.929	107.197	**483.126**
Total wastewater	**483.019**	**111.204**	**594.223**
Wholesale total	**620.430**	**155.147**	**775.577**
Retail revenue			
Unmeasured	8.171	–	**8.171**
Measured	47.901	–	**47.901**
Other third party revenue	–	2.548	**2.548**
Retail total	**56.072**	**2.548**	**58.620**
Third party revenue – non-price control			
Bulk supplies – water			**3.231**
Bulk supplies – wastewater			**0.671**
Other third party revenue			**2.060**
Principal services – non-price control			
Other appointed revenue			**0.250**
Total appointed revenue			**840.409**

	Water £m	Wastewater £m	Total £m
Wholesale revenue governed by price control	181.354	594.223	**775.577**
Grants & contributions	7.884	7.882	**15.766**
Total revenue governed by wholesale price control	**189.238**	**602.105**	**791.343**
Amount assumed in wholesale determination	198.927	618.731	**817.658**
Adjustment for in-period ODI revenue	–	–	**–**
Adjustment for WRFIM	–	–	**–**
Total assumed revenue	**198.927**	**618.731**	**817.658**
Difference	**(9.689)**	**(16.626)**	**(26.315)**

Actual wholesale revenue governed by the price control was £26.3 million (3.2%) lower than allowed in the wholesale determination.

When split into service level, the actual wholesale water revenue was lower than allowed revenue by £9.7 million (4.9%) and the actual wholesale wastewater revenue was lower than allowed revenue by £16.6 million (2.7%).

The adverse variance in both water and wastewater relates to:

- an unforeseen increase in vacant properties in both household and non-household
- lower water consumption than forecast in household
- lower billing of £5.8 million regarding 2018–19 than anticipated
- less revenue from grants and contributions
- a net reduction of £0.7 million for the expected impact of COVID-19 on water usage.

In non-household revenue, the charges setting assumed we would charge 53,300 properties for water and 81,500 properties for wastewater. We actually charged 51,600 for water and 75,900 for wastewater. The reason for fewer properties being billed than expected was due to a change in the market code that allowed for retailers to flag properties as 'vacant' in the central billing system (CMOS) when the end customer was switching retailers.

The overall higher actual revenue than allowed in the wholesale price control will be adjusted via the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) when setting the 2021–22 wholesale prices.

2J – Infrastructure network reinforcement costs for the 12 months ended 31 March 2020

	Network reinforcement capex £m	On site / site specific capex (memo only) £m
Wholesale water network + (treated water distribution)		
Distribution and trunk mains	0.205	4.924
Pumping and storage facilities	–	–
Other	–	–
Total	**0.205**	**4.924**
Wholesale wastewater network + (sewage collection)		
Foul and combined systems	10.596	3.494
Surface water only systems	–	–
Pumping and storage facilities	0.753	0.140
Other	–	–
Total	**11.349**	**3.634**

2K – New connections – infrastructure charges reconciliation for the 12 months ended 31 March 2020

	Water £m	Wastewater £m	Total £m
Impact of infrastructure charge discounts			
Infrastructure charges	1.763	8.042	9.805
Discounts applied to infrastructure charges	0.076	–	0.076
Gross infrastructure charges	**1.839**	**8.042**	**9.881**
Comparison of revenue and costs			
Variance brought forward			2.821
Revenue	1.839	8.042	9.881
Costs	(0.205)	(11.349)	(11.554)
Variance carried forward	**1.634**	**(3.307)**	**1.148**

Infrastructure charges are received when new connections are made to the network and represent a contribution to the incremental impact additional connections have on the overall network. Network reinforcement costs represent the capital expenditure undertaken generally on our network as a consequence of new connections/developments. The table above compares infrastructure charges received in the year with the level of general network reinforcement work. The variance in the year relates to the timing difference of completing these activities and is expected to even out over time.

Independent auditor's report to the Water Services Regulation Authority ('WSRA') and directors of Southern Water Services Limited.

Report on the audit of the Regulatory Accounting Statements

Opinion

We have audited certain tables within Southern Water Services Limited's ("the Company") Annual Performance Report for the year ended 31 March 2020 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), Lines 1F.1 to 1F.9, Line 1F.13, Line 1F.19, Line 1F.21 to Line 1F.23 of the statement of financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K) and the related notes.

We have not audited Lines 1F.10 to 1F.12, 1F.14 to 1F.18, and 1F.20 of Table 1F, the Outcome performance table (tables 3A to 3S) and the additional regulatory information in tables 4A to 4W.

In our opinion, Southern Water Services Limited's Regulatory Accounting Statements within the Annual Performance Report have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.11, RAG 4.08 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.11, appendix 2), set out on page 26.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standard as applied to public interest entities, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – contingent liability in respect of Environment Agency investigation

We draw attention to note 1g in the Regulatory Accounting Statements concerning the uncertain outcome of the investigation from the Environment Agency regarding the performance of certain wastewater sites and the reporting of relevant compliance information. The ultimate obligation arising from this matter cannot presently be determined because of the very wide range of possible outcomes in the sentencing guidelines, the uncertain and disputed levels of culpability and environmental harm, the lack of precedence, and that Southern Water would be considered a very large organisation meaning that the court has broad discretion in determining the penalty that might be applied. Management, supported by legal advice, was not able to make a reliable overall estimate of the financial obligation that will arise from the EA investigation, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches management have therefore recognised a provision of £1 million for the 51 cases brought to date, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. Our opinion is not modified in respect of this matter.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.11, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 17 to 43 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRS. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

The Regulatory Accounting Statements are prepared in accordance with a special purpose framework for the specific purpose as described in the Responsibilities for the audit of the Regulatory Accounting Statements section below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is not appropriate; or
- the directors have not disclosed in the Regulatory Accounting Statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Regulatory Accounting Statements are authorised for issue.

Other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 15, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.11, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Annual Performance Report, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounting Statements are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Regulatory Accounting Statements.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council's website at **frc.org.uk/auditorsresponsibilities.** This description forms part of our auditors' report.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on other legal and regulatory requirements

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2020 on which we reported on 15 July 2020, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP.

Deloitte LLP

Chartered Accountants and Statutory Auditors

London, United Kingdom

15 July 2020

Performance Summary

3A – Outcome performance table — Wholesale water

Performance commitment		Status	Unit	2018–19 performance level – actual	2019–20 performance level – actual	2019–20 Committed Performance Level met?
W1:	Water asset health		category	Stable	Unstable	No
W2:	Water use restrictions		number	0	0	Yes
W3:	Leakage (five-year average)		megalitres /day	101.8	91	No
W4:	Interruptions to supply		mins/prop /year	7	11	No
W5:	Drinking water quality – Mean Zonal Compliance (MZC)		%	99.98%	99.95%	No
W5a:	Drinking water quality – discolouration contacts		number/ 1,000 popn	0.68	0.67	Yes
W6:	Low water pressure		number	209	203	Yes
W7:	Distribution input		megalitres /day	558.75	541.78	No
W8:	Per capita consumption (PCC) (five-year average)		litres per head/day	129.9	129.3	Yes

3A – Outcome performance table — Wholesale wastewater

Performance commitment		Status	Unit	2018-19 performance level – actual	2019–20 performance level – actual	2019–20 Committed Performance Level met?
WW1:	Wastewater asset health		category	Stable	Stable	Yes
WW1a:	Category 3 pollution incidents[1]		number	144	427	No
WW2:	Internal flooding incidents		number	389	453	No
WW3:	External flooding incidents		number	8,255	9,386	Yes
WW4:	Sewer blockages		number/ per km	0.52	0.53	Yes
WW5:	Odour complaints (Portswood and Tonbridge treatment works)		number	54	12	No
WW6:	Wastewater treatment works numeric compliance		%	99.7%	99.4%	No
WW7:	Proportion of energy from renewable sources		%	15.8%	16.1%	No
WW8:	Bathing waters with 'excellent' water quality (part 1)		number	57	56	Yes
WW9:	Bathing waters with 'excellent' water quality (part 2 – additional number of bathing waters)		number	5	6	No
WW10:	Bathing waters with 'excellent' water quality (part 3)		£m	N/A	27	Yes
WW11:	Serious pollution incidents (Category 1 and 2)[1]		number	7	7	No
WW12:	Avoiding blocked drains (awareness survey)		%	83%	81%	No
WW13:	Thanet sewers		N/A	N/A	Not delivered	No
WW14:	Woolston wastewater treatment works		N/A	N/A	Delivered	Yes
WW15:	Millbrook sludge		tonnes	N/A	0	No

3A – Outcome performance table — Retail

Performance commitment		Status	Unit	2018–19 performance level – actual	2019–20 performance level – actual	2019–20 Committed Performance Level met?
R1:	First-time resolution of customer contacts[2]	✗	%	65%	63%	No
R2:	Dealing with customers' individual needs (awareness survey)	–	%	64%	64%	No
R3:	Awareness of water hardness measures (awareness survey)	–	%	55%	50%	No
R4:	Where your money goes (awareness survey)	–	%	59%	52%	No
R5:	Billing queries	✗	number	131,726	153,870	No
R6:	Take up of assistance schemes	✓	number	269,926	296,516	Yes
R7:	Value for money (awareness survey)	–	%	60%	58%	No
R8:	Service Incentive Mechanism (SIM)	N/A 2019–20	score out of 100	80	56	No

Notes:

- Per capita consumption and leakage ODIs are based on five-year average measures. The figure shown in the table for 2019–20 for these two measures is the five-year average. Leakage in 2019–20 was 94.0 Ml/d. Per capita consumption for 2019–20 was 126.5 l/head/day
- Leakage is shown in the table to one decimal place. Consistent with the presentation of the performance commitment in the final determination, the ODI penalty was calculated on the basis of zero decimal places
- Thanet sewers and Millbrook sludge schemes were delivered after the ODI deadline of 31 March, as a result of restrictions imposed due to COVID-19. We show no penalty against these schemes
- Ofwat discontinued the SIM metric in 2018–19. The 2019–20 score shown in the table is based on a proxy methodology, using elements of Ofwat's new C-MeX measure. It is therefore not comparable to the 2018–19 score

[1] As reported previously, we have identified a number of issues with spill data. The details of the steps taken and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the EA and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%

[2] The method for reporting First Contact Resolution has been based on using a 30-day window and is consistent with the figure reported for the prior year. This is inconsistent with the methodology used to set the final determination target which used a 21-day window. We also note that the Final Determination specified that the measurement would be undertaken by a third party. In fact the calculation is carried out internally and assured by a third party. We advised Ofwat of this in June 2018.

Each performance commitment is shown with the assessed performance status (red, amber or green) which indicates performance against expectations. An explanation of each performance commitment, the definitions and the criteria for assessment is given in appendix 2.

Key

✓	Indicates where we have met or beaten the performance commitment.
–	Indicates where we are still on target to deliver the outcomes we promised to customers but we have missed our performance commitment for the year.
✗	Indicates where we have not met our performance target and have not delivered the outcomes we promised to customers. In one case we incurred a penalty for the shortfall.
N/A 2019–20	These performance commitments do not apply in 2019–20.

Details of the rewards and penalties incurred in the year and forecast for the AMP are shown below.

3A – Outcome performance table – Notional reward or penalty accrued at 31 March 2020

	2019–20 outperformance payment or underperformance penalty			
	In-period ODIs (indicator)	In-period ODIs (£m)	ODIs payable at the end of AMP6 (indicator)	ODIs payable at the end of AMP6 (£m)
W1: Water asset health	–	–	Underperformance payment	(0.1901)
W3: Leakage (five-year average)	–	–	Underperformance payment	(2.7374)
W8: Per capita consumption (PCC) (five-year average)	–	–	Outperformance payment	6.8750
WW1a: Category 3 pollution incidents 1	–	–	Underperformance payment	(2.1600)
WW5: Odour complaints (Portswood and Tonbridge treatment works)	–	–	Underperformance payment	(0.9480)
WW9: Bathing waters with 'excellent' water quality (part 2 – additional number of bathing waters)	–	–	Underperformance payment	(3.6400)

3B – Sub-measure performance table

Performance commitment	Status	Unit	2018–19 performance level – actual	2019–20 performance level – actual	2019–20 Committed Performance Level met?
W1: Water asset health		category	Stable	Unstable	No
Number of mains bursts per year		number	1,917	1,556	Yes
Distribution Maintenance Index (TIM)		%	99.97%	99.97%	Yes
Coliform compliance at Water Supply Works (WSW)		%	99.93%	99.90%	No
Coliform compliance at Water Service Reservoirs (WSR)		%	100%	100%	Yes
Turbidity compliance		number	–	–	Yes
WW1: Wastewater asset health		category	Stable	Stable	Yes
Sewer collapses		number	245	311	Yes
Wastewater Treatment Works (WWTW) population equivalent compliance[1]		%	100%	100%	Yes
External flooding – other causes		number	7,791	8,319	Yes

3C – Abstraction Incentive Mechanism (AIM)

Abstraction site	2019–20 AIM performance megalitres	2019–20 normalised AIM performance number	Cumulative AIM performance 2016–17 onwards megalitres	Cumulative normalised AIM performance 2016–17 onwards number
Otterbourne and Twyford abstraction	(104.91)	(0.04)	14.74	–
Total	**(104.91)**	**(0.04)**	**14.74**	**–**

Contextual information relating to AIM performance

Otterbourne and Twyford abstraction

Southern Water's River Itchen abstractions in 2019–20 were reduced primarily by the use of the Bulk Supply from Portsmouth Water. That transfer aided the abstraction reduction at Otterbourne and Twyford. Portsmouth Water supplied Southern Water a total of 428.85 Ml during September, with an average supply of 14.29 Ml/d.

The normalised AIM performance figures for 2018–19 and 2019–20 are both -0.04. However, when presented to more decimal places, the totals are -0.035 for 2018–19 and -0.045 for 2019–20, showing that performance was better in 2019–20, in line with the lower overall Otterbourne and Twyford abstraction.

3D – SIM score table

	Score
Qualitative Performance	
1st survey score	3.99
2nd survey score	3.87
3rd survey score	3.87
4th survey score	3.64
Qualitative SIM score (out of 75)	53.25
Quantitative Performance	
Total contact score	66.55
Quantitative SIM score (out of 25)	2.82
SIM Score	
Total annual SIM score (out of 100)	56.07

Ofwat discontinued the SIM metric in 2018–19. The 2019–20 score shown in the table is based on a proxy methodology, using elements of Ofwat's new C-MeX measure. It is therefore not comparable to the 2018–19 score.

Ofwat is introducing new customer and developer satisfaction measures (C-MeX and D-MeX) from April 2020 and these have been trialled for 2019–20. Our scores were C-MeX, 68.85, placing us 16th out of 17 companies and D-MeX, 78.45, placing us 14th.

Rewards and penalties for 2019–20

During AMP6 (2015–20) we had 21 wholesale financial Outcome Delivery Incentives (ODIs) included in our final price determination from Ofwat. We are incentivised to drive performance against these commitments by Ofwat's financial reward/penalty mechanism. Six of these ODIs had both financial rewards or penalties and the remaining 15 were penalty only. The final outcome is based on the results of our business performance each year for the five years of the AMP.

As a result of our performance in 2019–20 we have incurred penalties associated with four ODIs:

- Our performance in preventing category 3 pollution incidents resulted in a penalty of £2.160 million
- We received twelve complaints in relation to odour nuisance at our Portswood wastewater treatment works in Southampton, despite significant investment in odour management, resulting in a £ 0.948 million penalty
- One of the seven bathing waters within our bathing water enhancement programme did not achieve Excellent status for the 2019 bathing water season (though it had in 2018) resulting in a penalty of £3.640 million
- Finally, we incurred a penalty of £0.190 million for the coliform compliance at water supply works element of our water asset health ODI.

For a number of our ODIs, where annual performance can be particularly affected by weather fluctuations, performance is assessed over the five-year period as a whole. For one of these, leakage, we incurred a penalty of £2.737 million for exceeding our five-year average target of 87 Ml/d by 4 Ml/d. However, we earned the maximum available reward of £6.875 million for helping our customers reduce their water usage, beating our per capita consumption target of 131.7 litres per head per day by more than 4 litres.

Over the AMP as a whole we earned a net penalty of £5.138 million, consisting of total penalties of £13.000 million and rewards of £7.862 million. Based on forecast performance for 2019–20, Ofwat allowed a net ODI reward of £ 1.889 million in its Final Determination. The difference between the Final Determination forecast and the final penalty will be reflected in prices from 2021–22.

Reporting to customers

The information reported in this table is consistent with the information we have reported to our customers in our Annual Report and Financial Statements.

Assurance of performance commitments

As part of our Final Assurance Plan published on 31 March 2020 we stated that we would obtain independent assurance in relation to our 2019–20 performance commitment reporting. PricewaterhouseCoopers LLP has undertaken this work on our behalf and their statement is provided on page 54.

Independent Limited Assurance Report to the Directors of Southern Water Services Limited

The Board of Directors of Southern Water Services Limited (Southern Water) engaged us to provide limited assurance on the information described below and set out in Southern Water's Annual Performance Report 2020 for the year ended 31 March 2020.

Disclaimer

- PwC's report was prepared with Southern Water Services Limited's (Southern Water) interests in mind. It was not prepared with any other recipient's interests in mind or for its use. PwC's report is not a substitute for any enquiries that a recipient should make. PwC's report is based on historical information. Any projection of such information or PwC's opinion or views thereon to future periods is subject to the risk that changes may occur after the report is issued. For these reasons, such projection of information to future periods would be inappropriate;
- PwC accepts no liability (including liability for negligence) to each recipient in relation to PwC's report. The report is provided to each recipient for information purposes only. If a recipient relies on PwC's report, it does so entirely at its own risk;
- No recipient will bring a claim against PwC which relates to the access to the report by a recipient;
- Neither PwC's report, nor information obtained from it, may be made available to anyone else without PwC's prior written consent, except where required by law or regulation;
- PwC will be entitled to the benefit of and to enforce these terms; and
- These terms and any dispute arising from them, whether contractual or non-contractual, are subject to English law and the exclusive jurisdiction of English courts.

Our conclusion

Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the Selected Information for the year ended 31 March 2020 has not been prepared, in all material respects, in accordance with the Reporting Criteria.

This conclusion is to be read in the context of what we say in the remainder of our report.

Scope of our work

The scope of our work was limited to assurance over the following information in Southern Water's Annual Performance Report 2019–20 (the "Selected Information").

- 3A – Outcome performance table — wholesale water, wholesale wastewater and retail, excluding the following low risk PCs:
  - W2: Water use restrictions
  - WW12: Avoiding blocked drains
  - R2: Dealing with customers' individual needs
  - R3: Awareness of water hardness measures
  - R4: Where your money goes
  - R5: Billing queries
  - R6: Take up of assistance schemes
  - R7: Value-for-money
  - RA6: Service Incentive Mechanism (SIM)
- 3B – Sub-measure performance table;
- 3C – AIM table;
- Greenhouse gas emissions – $KgCO_2e$;
- $KgCO_2e$ per person supplied with treated water;
- $KgCO_2e$ per person supplied with wastewater services; and
- Odour Complaints (Total).

The Selected Information and the Reporting Criteria against which it was assessed are summarised **southernwater.co.uk/our-performance/reports/annual-reporting** and in Appendix 2 of the Annual Performance Report. Our assurance does not extend to information in respect of earlier periods or to any other information included in the Southern Water Annual Performance Report 2019-20.

Professional standards applied and level of assurance

We performed a limited assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) 'Assurance Engagements other than Audits or Reviews of Historical Financial Information' issued by the International Auditing and Assurance Standards Board.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

Our Independence and Quality Control

We have complied with the Institute of Chartered Accountants in England and Wales (ICAEW) Code of Ethics, which includes independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

We also apply International Standard on Quality Control (UK) 1 and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Understanding reporting and measurement methodologies

The Selected Information needs to be read and understood together with the Reporting Criteria, which Southern Water is solely responsible for selecting and applying. The absence of a significant body of established practice on which to draw to evaluate and measure non-financial information allows for different, but acceptable, measurement techniques and can affect comparability between entities and over time. The Reporting Criteria used for the reporting of the Selected Information for the 2020 reporting year.

Work done

We are required to plan and perform our work in order to consider the risk of material misstatement of the Selected Information. In doing so, we:

- Re-performed the calculation of the performance level arising from Southern Water's PCs in the year against Southern Water's reporting criteria;
- Verified, through limited testing on a selective basis, the underlying data or supporting information used to calculate each PC in the 'selected information';
- Made enquiries of relevant company management, personnel and third parties; and
- Considered significant estimates and judgements made by management in the preparation of the selected information.

Director's responsibilities

The Directors of Southern Water are responsible for:

- Designing, implementing and maintaining internal controls over information relevant to the preparation of the Selected Information that is free from material misstatement, whether due to fraud or error;
- Establishing objective Reporting Criteria for preparing the Selected Information;
- Measuring and reporting the Selected Information based on the Reporting Criteria; and
- The content of the Southern Water Annual Performance Report 2019-20.

Our responsibilities

We are responsible for:

- Planning and performing the engagement to obtain limited assurance about whether the Selected Information is free from material misstatement, whether due to fraud or error;
- Forming an independent conclusion, based on the procedures we have performed and the evidence we have obtained; and
- Reporting our conclusion to the Directors of Southern Water.

While the Selected Information may be informed by the need to satisfy legal or regulatory requirements, our scope of work and our conclusions do not constitute assurance over your compliance with those laws and regulations.

Intended users and purpose

This report, including our conclusions, has been prepared solely for the Board of Directors of Southern Water in accordance with the agreement between us dated 6 December 2019, to assist the Directors in reporting Southern Water's performance and activities. We permit this report to be disclosed in the Southern Water Annual Performance Report 2019-20 for the year ended 31 March 2020, to assist the Directors in responding to their regulatory responsibilities by obtaining an independent assurance report in connection with the Selected Information. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Board of Directors and Southern Water for our work or this report except where terms are expressly agreed in writing.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Gatwick
15 July 2020

Additional regulatory information

4A – Non-financial information for the 12 months ended 31 March 2020

Retail – household	Unmeasured	Measured
Number of void households ('000s)	25.184	42.922
Per capita consumption (excluding supply pipe leakage) litres/head/day	183.15	118.48

Wholesale	Water	Wastewater
Volume (Megalitres/day)		
Bulk supply export	22.413	–
Bulk supply import	3.730	0.540
Distribution input	541.78	

4B – Wholesale totex analysis for the 12 months ended 31 March 2020

	Current year		Cumulative	
	Water £m	Wastewater £m	Water £m	Wastewater £m
Actual totex	236.206	536.013	976.404	2,125.927
Less: Items excluded from the menu				
Third party costs	4.294	6.680	21.556	8.329
Pension deficit recovery costs	5.006	10.923	19.263	42.035
Other 'Rule book' adjustments	–	12.769	0.660	74.403
Total items excluded from the menu	**9.300**	**30.372**	**41.479**	**124.767**
Add: Transition expenditure				
Transition expenditure	(2.701)	–	(1.203)	14.255
Adjusted actual totex	**224.205**	**505.641**	**933.722**	**2,015.415**
Actual totex – base year prices	188.746	425.671	826.155	1,787.296
Allowed totex – base year prices	124.162	336.742	755.101	1,871.283

Wholesale totex analysis

Actual wastewater totex, which is presented in table 4E, includes an amount for the fair value of adopted assets. These assets are adopted at nil cost and therefore there was no allowance for these in our allowed totex. We have removed the fair value, recorded in totex, through the other 'rule book' adjustments in table 4B above.

In 2019–20, our total expenditure (totex) for water of £188.7 million in base year prices (2012–13) was £64.5 million higher than that allowed in our Final Determination (FD) of £124.2 million and our wastewater totex of £425.7 million was £89.0 million higher than the FD allowance of £336.7 million.

Cumulatively our totex for water of £826.2 million was £71.1 million above the FD allowance of £755.1 million and our cumulative wastewater expenditure of £1,787.3 million was £84.0 million below our allowance of £1,871.3 million.

The principal reasons for these variances are explained in the table and narrative below.

Allowed totex variance

£m (2012–13 prices)	Current year		Cumulative	
Description	Water	Wastewater	Water	Wastewater
i) Rates rebate	–	–	15.4	–
ii) Operating costs	(6.0)	(23.5)	19.0	(31.5)
iii) Infrastructure costs expensed	(4.6)	8.1	2.1	50.9
iv) IRE costs transferred to retail	–	–	–	2.6
v) Transferred to non-appointed	–	5.3	–	26.1
vi) Capex	(55.5)	(85.4)	(114.5)	28.0
vii) IFRS 16 – Leases	0.5	1.1	0.5	1.1
Other (third party)	1.1	5.4	6.4	6.8
Total	**(64.5)**	**(89.0)**	**(71.1)**	**84.0**

i) In 2017–18 we received a rebate of historic business rates charges totalling £2.9 million (2012–13 prices) for the water service. This followed a successful appeal of valuation of our water service assets and is in addition to the rebate of £12.5 million (2012–13 prices) received in 2015–16. These rebates result in a favourable variance when compared to our allowed totex.

ii) Over the five-year business plan period our operating costs, excluding the impact of the change in accounting for infrastructure maintenance costs, were £12.5 million higher in total than our determination (water £19.0 million lower, wastewater £31.5 million higher).

    2019–20 has been a challenging year as we have been preparing ourselves for the delivery of our ambitious plan for the next regulatory period 2020–25, while addressing historic performance and managing an increased number of operational issues that arose during the year.

    In order to prepare for the challenge of the next five-year period, improve our services and, ultimately, reduce our costs we have undertaken a number of restructuring activities during the year and these have added costs across the wholesale business.

    In addition, we incurred additional costs in the year in relation to:

    - a number of significant sewer bursts on our wastewater network which resulted in £4.8 million of additional costs, principally tankering and repairs to minimise disruption to our service
    - interventions at a number of wastewater sites to mitigate compliance risk totalling £4.6 million, including the repair of equipment at treatment works, the hire of additional back-up equipment and the provision of additional tankering to reduce the risk of spills to the environment
    - additional tankering and wastewater treatment costs of £4.5 million to deal with high groundwater levels following the storms and wet weather experienced this winter
    - reducing leakage on our water distribution network, resulting in additional costs of £3.2 million in our activity to find and fix leaks during the year.

    These cost increases have offset the savings we achieved in the first four years of the AMP through contract negotiations, lower pay awards, more efficient use of power, chemicals and employing our internal staff instead of contractors.

iii) Within our business plan submission we assumed that 75% of gross infrastructure expenditure, previously treated as capital expenditure under UK GAAP, would be treated as wholesale operating expenditure following the transition to IFRS. Having completed the transition in 2015–16 and considered in more detail the accounting treatment of the different activities undertaken, our revised view is that nearer 60% of this expenditure will be expensed.

    The result of this accounting variance from our original plan, along with lower levels of infrastructure repair costs incurred, is a favourable variance in totex for the five-year business plan period of £53.0 million in relation to infrastructure costs expensed (water £2.1 million, wastewater £50.9 million).

iv) As reported in the narrative supporting table 2B in previous years, our business plan submission assumed that all infrastructure costs, treated as operating costs following the transition to IFRS, would be wholesale costs. In accordance with RAG 2.07 an element of our infrastructure costs, relating to network enquiries, is treated as a retail cost rather than wholesale. This results in a cumulative favourable variance of £2.6 million when compared to the allowed wholesale totex.

v) Our business plan submission included costs within the appointed wastewater business for the haulage and treatment costs of tankered waste. In October 2016, Ofwat issued revised regulatory guidance in RAG 4.06 clarifying that these costs should be classified as part of the non-appointed business. This change in classification results in a cumulative favourable variance of £26.1 million when compared to our allowed wholesale totex.

vi) Our capital investment programme exceeded that set out in our business plan by £86.5 million over the five-year period. In part this is due to the difference in assumption regarding the level of infrastructure renewals expenditure that would be capitalised as mentioned above.

    In addition we have increased expenditure on our water treatment and storage facilities to improve water compliance, reducing levels of risk and improving water quality. This includes schemes to improve specific water supply sites, improve nitrate and pesticide removal and improve site security.

vii) During 2019–20 IFRS 16 ‘Leases’ became effective for the first time. As a result a number of our existing operating lease costs and rental payments are now treated as a finance lease rather than an operating lease. This reduced our annual operating costs and therefore totex by £1.6 million in total in 2012–13 prices (water £0.5 million, wastewater £1.1 million).

When comparing our actual totex to that allowed in the Final Determination we are required to make 'rule book' adjustments for certain costs, including fines and investigation costs. These are detailed in the table below:

Rule book adjustments

£m	Current year		Cumulative		
Description	Water	Wastewater	Water	Wastewater	Notes
Adoptions	–	7.9	–	57.5	The fair value of adopted sewers and pumping stations included in table 4E, but adopted at nil cash cost.
Ofwat penalty	–	–	–	3.0	Ofwat penalty following its investigation into our wastewater compliance and reporting.
Investigation costs and provisions	–	4.6	–	11.6	Costs of the investigations into wastewater compliance and reporting by Ofwat and the Environment Agency.
Fines and penalties	–	0.3	0.7	2.3	Fines and enforcement undertakings in relation to environmental incidents.
Total	**–**	**12.8**	**0.7**	**74.4**	

During the year we proposed a number of enforcement undertakings in relation to wastewater pollution incidents. The cost of these £0.3 million, together with the costs incurred during 2019–20 of implementing the rebates to customers following the Ofwat penalty imposed in 2018–19 and the ongoing Environment Agency investigation of £4.6 million have been included within the rule book adjustments.

Within our totex expenditure for wastewater, reported in table 4E, we have included the fair value of adopted sewers, in order to ensure that the capital expenditure reported aligns with the movements in fixed assets. As these assets are adopted at nil cost, we have also made an adjustment for them of £7.8 million, through the rule book adjustment line, in 2019–20 prices.

4C – Impact of AMP performance to date on RCV for the 12 months ended 31 March 2020

	Water £m	Wastewater £m
Cumulative totex over/(under)spend so far in the price control period	79.051	(125.790)
Customer share of cumulative totex over/(underspend)	38.530	(62.895)
RCV element of cumulative totex over/(underspend)	38.837	(67.950)
Adjustment for ODI outperformance payment or underperformance payment	(0.227)	(2.583)
RCV determined at FD at 31 March	1,090.755	4,051.256
Projected 'shadow' RCV	**1,129,365**	**3,980.723**

The RCV element of cumulative totex is calculated using a methodology prescribed by Ofwat and set out in the PR14 reconciliation rulebook. It is equal to the difference between actual totex and allowed totex for the price control period so far for both water and wastewater (inclusive of transition expenditure and third party costs; net of grants and contributions), multiplied by (1 – the weighted average pay-as-you-go rates for water and wastewater).

Total expenditure for the AMP6 period for water is £79.1 million above the final determination assumption. Approximately half of the overspend is shared with customers, through Ofwat's cost-sharing rules. This results in £38.8 million increase in the shadow water RCV. Expenditure for wastewater is £125.8 million below the level allowed for by Ofwat. This underspend reduces the shadow wastewater RCV by £67.9 million.

As part of the PR19 Final Determination, Ofwat made adjustments to the RCV based on our forecast totex for the AMP, included expected totex in 2019–20. Actual expenditure in 2019–20 is higher for both water (£15 million) and wastewater (£59 million) than that assumed in the Final Determination. These differences will be adjusted for at the 2024 price review.

ODI adjustments relate to coliform compliance (water asset health) and pollution incidents, see table 3A on page 47.

4D – Totex analysis for the 12 months ended 31 March 2020 – Wholesale water

	Water resources		Network +				
	Abstraction licences £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure							
Power	–	3.956	–	–	9.193	3.769	**16.918**
Income treated as negative expenditure	–	–	–	–	–	–	**–**
Abstraction charges / discharge consents	3.862	–	–	–	0.102	–	**3.964**
Bulk supply	–	–	–	–	–	0.359	**0.359**
Other operating expenditure							
– Renewals expensed in year (Infrastructure)	–	–	–	–	–	21.870	**21.870**
– Other operating expenditure excluding renewals	0.245	2.362	0.237	0.304	29.255	22.049	**54.452**
Local authority rates	–	0.983	0.128	–	1.561	9.425	**12.097**
Total operating expenditure excluding third party services	**4.107**	**7.301**	**0.365**	**0.304**	**40.111**	**57.472**	**109.660**
Third party services	0.274	0.405	–	–	1.096	1.496	**3.271**
Total operating expenditure	**4.381**	**7.706**	**0.365**	**0.304**	**41.207**	**58.968**	**112.931**
Capital expenditure							
Maintaining the long-term capability of the assets – infrastructure	–	0.261	0.472	(0.005)	2.333	18.934	**21.995**
Maintaining the long-term capability of the assets – non-infrastructure	0.788	3.817	–	–	49.092	17.388	**71.085**
Other capital expenditure – infrastructure	–	2.223	–	–	0.292	10.378	**12.893**
Other capital expenditure – non-infrastructure	0.337	5.320	–	–	10.139	1.672	**17.468**
Infrastructure network reinforcement	–	–	–	–	–	0.205	**0.205**
Total gross capital expenditure (excluding third party)	**1.125**	**11.621**	**0.472**	**(0.005)**	**61.856**	**48.577**	**123.646**
Third party services	0.167	0.866	–	–	1.507	0.327	**2.867**
Total gross capital expenditure	**1.292**	**12.487**	**0.472**	**(0.005)**	**63.363**	**48.904**	**126.513**
Grants and contributions	–	0.504	–	–	1.125	6.615	**8.244**
Totex	**5.673**	**19.689**	**0.837**	**0.299**	**103.445**	**101.257**	**231.200**
Cash expenditure							
Pension deficit recovery payments	–	0.183	–	0.022	2.306	2.495	**5.006**
Totex including cash items	**5.673**	**19.872**	**0.837**	**0.321**	**105.751**	**103.752**	**236.206**

Unit cost information (operating expenditure)

	Population (thousands)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume	Distribution input volume
Volume (Megalitres)		454,555	192,340	83,684	203,826	197,750	197,750
Unit cost (£/Megalitre)		**9.64**	**40.06**	**4.36**	**1.49**	**208.38**	**298.20**
Unit cost (£/population)	**2,572**	**1.70**	**3.00**	**0.14**	**0.12**	**16.02**	**22.93**

4E – Totex analysis for the 12 months ended 31 March 2020 – Wholesale Wastewater

	Network+ Sewage collection			Network+ Sewage treatment		Sludge			
	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal £m	Imported sludge liquor treatment £m	Sludge transport £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure									
Power	9.980	2.201	2.201	20.553	0.773	0.032	(2.426)	–	**33.314**
Income treated as negative expenditure	–	–	–	–	–	–	(4.606)	–	**(4.606)**
Discharge consents	0.794	0.173	0.173	2.864	0.058	–	–	–	**4.062**
Other operating expenditure									
– Renewals expensed in year (Infrastructure)	19.796	2.987	2.987	–	–	–	–	–	**25.770**
– Other operating expenditure excluding renewals	28.803	6.132	6.132	54.206	1.329	4.613	15.878	6.553	**123.646**
Local authority rates	0.017	0.004	0.004	12.882	0.459	–	1.764	–	**15.130**
Total operating expenditure excluding third party services	**59.390**	**11.497**	**11.497**	**90.505**	**2.619**	**4.645**	**10.610**	**6.553**	**197.316**
Third party services	–	–	–	–	–	–	–	–	**–**
Total operating expenditure	**59.390**	**11.497**	**11.497**	**90.505**	**2.619**	**4.645**	**10.610**	**6.553**	**197.316**
Capital expenditure									
Maintaining the long-term capability of the assets – infrastructure	22.211	4.842	4.842	3.768	–	–	–	–	**35.663**
Maintaining the long-term capability of the assets – non-infrastructure	12.150	2.647	2.647	127.911	–	–	14.573	–	**159.928**
Other capital expenditure – infrastructure	35.087	7.648	7.648	0.119	–	–	–	–	**50.502**
Other capital expenditure – non-infrastructure	2.099	0.458	0.458	68.223	–	–	5.604	–	**76.842**
Infrastructure network reinforcement	7.903	1.723	1.723	–	–	–	–	–	**11.349**
Total gross capital expenditure (excluding third party)	**79.450**	**17.318**	**17.318**	**200.021**	**–**	**–**	**20.177**	**–**	**334.284**
Third party services	0.704	0.153	0.153	5.949	–	–	–	–	**6.959**
Total gross capital expenditure	**80.154**	**17.471**	**17.471**	**205.970**	**–**	**–**	**20.177**	**–**	**341.243**
Grants and contributions	5.683	1.239	1.239	5.308	–	–	–	–	**13.469**
Totex	**133.861**	**27.729**	**27.729**	**291.167**	**2.619**	**4.645**	**30.787**	**6.553**	**525.090**
Cash expenditure									
Pension deficit recovery	3.289	0.548	0.548	5.147	0.572	–	0.819	–	**10.923**
Totex including cash items	**137.150**	**28.277**	**28.277**	**296.314**	**3.191**	**4.645**	**31.606**	**6.553**	**536.013**

Unit cost information (operating expenditure)

	Population (thousands)	Volume collected	Volume collected	Volume collected	Biochemical Oxygen Demand (BOD)	Biochemical Oxygen Demand (BOD)	Volume transported	Dried solid mass treated	Dried solid mass disposed
Volume (Megalitres)		185,711	40,481	40,481	109,615	16,077	958,174	137	137
Unit cost (£/Megalitre)		**319.80**	**284.01**	**284.01**	**825.66**	**162.91**	**4.85**	**77,455**	**47,838**
Unit cost (£/population)	**4,715.0**	**12.60**	**2.44**	**2.44**	**19.20**	**0.56**	**0.99**	**2.25**	**1.39**

4F – Cost analysis for the 12 months ended 31 March 2020 – Household Retail

	Household unmeasured				Household measured				
	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Total £m
Operating expenditure									
Customer services	0.201	2.622	2.225	**5.048**	1.257	4.764	14.524	**20.545**	**25.593**
Debt management	0.175	2.036	2.570	**4.781**	0.160	2.633	6.596	**9.389**	**14.170**
Doubtful debts	0.104	3.696	1.892	**5.692**	0.729	8.069	14.932	**23.730**	**29.422**
Meter reading					0.323	0.604	2.708	**3.635**	**3.635**
Other operating expenditure	0.050	0.842	0.487	**1.379**	0.229	1.994	3.363	**5.586**	**6.965**
Total operating expenditure excluding third party services	**0.530**	**9.196**	**7.174**	**16.900**	**2.698**	**18.064**	**42.123**	**62.885**	**79.785**
Third party services operating expenditure	–	–	–	**–**	–	–	–	**–**	**–**
Total operating expenditure	**0.530**	**9.196**	**7.174**	**16.900**	**2.698**	**18.064**	**42.123**	**62.885**	**79.785**
Depreciation – tangible fixed assets									
– on assets existing at 31 March 2015	0.011	0.181	0.105	**0.297**	0.049	0.429	0.723	**1.201**	**1.498**
– on assets acquired since 1 April 2015	–	0.002	0.001	**0.003**	0.001	0.005	0.008	**0.014**	**0.017**
Amortisation – intangible fixed assets									
– on assets existing at 31 March 2015	0.008	0.133	0.077	**0.218**	0.036	0.314	0.532	**0.882**	**1.100**
– on assets acquired since 1 April 2015	0.002	0.028	0.016	**0.046**	0.008	0.067	0.113	**0.188**	**0.234**
Total operating costs	**0.551**	**9.540**	**7.373**	**17.464**	**2.792**	**18.879**	**43.499**	**65.170**	**82.634**
Capital expenditure	**0.009**	**0.151**	**0.088**	**0.248**	**0.041**	**0.358**	**0.605**	**1.004**	**1.252**

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale

	£m
Household	
Demand-side water efficiency – gross expenditure	**0.073**
Demand-side water efficiency – expenditure funded by wholesale	**–**
Demand-side water efficiency – net retail expenditure	**0.073**
Customer-side leak repairs – gross expenditure	**–**
Customer-side leak repairs – expenditure funded by wholesale	**–**
Customer-side leak repairs – net retail expenditure	**–**

4G – Wholesale current cost financial performance for the 12 months ended 31 March 2020

	Water £m	Wastewater £m	Total £m
Revenue	186.618	595.171	**781.789**
Operating expenditure	(112.931)	(197.316)	**(310.247)**
Capital maintenance charges	(101.571)	(320.340)	**(421.911)**
Other operating income	0.300	0.558	**0.858**
Current cost operating (loss)/profit	**(27.584)**	**78.073**	**50.489**
Other income	5.272	18.584	**23.856**
Interest income	9.189	32.387	**41.576**
Interest expense	(41.846)	(147.498)	**(189.344)**
Other interest expense	(0.928)	(3.272)	**(4.200)**
Loss before tax and fair value movements	**(55.897)**	**(21.726)**	**(77.623)**
Fair value gains on financial instruments	75.132	264.819	**339.951**
Current cost profit before tax	**19.235**	**243.093**	**262.328**

4H – Financial Metrics

	Units	Metric	AMP to date
Financial Indicators			
Net debt	£m	**3,619.869**	
Regulated equity	£m	**1,522.142**	
Regulated gearing	%	**70.40**	
Post tax return on regulated equity	%	**4.17**	
RORE (return on regulated equity)	%	**0.59**	4.37
Dividend yield	%	**0.00**	
Retail profit margin – Household	%	**(3.93)**	
Retail profit margin – Non-household	%	**1.26**	
Credit rating	n/a	**Baa3, stable**	
Return on RCV	%	**4.23**	
Dividend cover	dec	**0.00**	
Funds from operations (FFO)	£m	**216.977**	
Interest cover (cash)	dec	**2.38**	
Adjusted interest cover (cash)	dec	**0.57**	
FFO/debt	dec	**0.06**	
Effective tax rate	%	**2.51**	
Free cash flow (RCF)	£m	**212.472**	
RCF/capex	dec	**0.45**	
Revenue and earnings			
Revenue (actual)	£m	**834.197**	
EBITDA (actual)	£m	**443.608**	
Movement in RORE			
Base Return	%	**5.63**	5.64
Totex out/(under) performance	%	**(3.76)**	0.01
Retail cost out/(under) performance	%	**(1.27)**	(0.93)
ODI out/(under) performance	%	**0.05**	(0.38)
Financing out/(under) performance	%	**(0.01)**	0.06
Other factors	%	**(0.05)**	(0.03)
Regulatory return for the year	**%**	**0.59**	**4.37**
Borrowings			
Proportion of borrowings which are fixed rate	%	**19.92**	
Proportion of borrowings which are floating rate	%	**8.80**	
Proportion of borrowings which are index linked	%	**71.28**	
Proportion of borrowings due within 1 year or less	%	**0.07**	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	**19.61**	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	**8.09**	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	**53.91**	
Proportion of borrowings due in more than 20 years	%	**18.32**	

The Return on Regulated Equity (RORE) provides a representation of the variance in financial performance between the return allowed in the PR14 Final Determination and actual results. The calculation of RORE follows guidance provided by Ofwat, and the movements in RORE are further explained below:

Totex out/(under) performance:

We share approximately 50% of wholesale totex savings we achieve with customers. In 2019–20 this was a retained post tax overspend of £72.3 million, equivalent to a decrease of 3.76% in RORE. This value differs from table 4B as a result of adjustments to remove the effect of any timing differences on delivery of the capital programme and the amount shared with customers.

In our previously reported RORE performance we had forecast an overall totex underspend for AMP6 but, with additional capital investment in 2019–20, our performance for the five-year period has been broadly in line with the funded amount.

Prior to the calculation of the amount to be shared with customers, but adjusting for timing differences on delivery of the capital programme as well as a higher proportion of infrastructure maintenance expenditure being treated as capital expenditure, post-tax fast money (i.e. costs recovered through customer bills as they are incurred) under-performance for the year equates to £64.1 million and post-tax slow money (i.e. costs recovered over the long-term through customer bills) under-performance to £60.3 million.

Retail out/(under) performance:

The company share of retail cost under-performance represents the amount by which we are overspending against the PR14 price determination. There is no sharing with customers of the retail expenditure variance, with the result that the £24.4 million post-tax over-spend for 2019–20 reduces RORE by 1.27%.

ODI out/(under) performance:

The impact of our performance on Outcome Delivery Incentives (ODIs) is £1.0 million for 2019–20, increasing RORE by 0.05%. Penalties or rewards are included in the adjusted RORE figures even if they are not payable or receivable until the next AMP. Table 3A provides further details. In 2019–20 we include an adjustment to the SIM penalty, previously shown in years 1-4 of the AMP to align with the period for which performance is assessed, to reflect the final SIM penalty included in our PR19 Final Determination which was £4.1 million (2012–13 prices) lower than we had previously assumed. We also include an adjustment to reduce the Bathing Waters ODI reward recognised last year, as one site did not maintain Excellent status.

Financing out/(under) performance:

The interest difference on notional debt represents a comparison of the implied real rate of interest allowed for the PR14 price determination against the actual implied real rate of interest, applied to a notional level of gearing of 62.5%.

Other factors:

We use the ‘other factors’ row to remove the returns relating to our non-household retail business, the sale of which was completed on 1 April 2017.

In 2017–18 we recognised a post-tax profit after costs of £9.1 million, on the sale of our non-household retail business to Business Stream. This additional return, equivalent to a 0.10% increase to cumulative average RORE in the AMP, does not form part of the reported RORE figure and is offset by the loss of the non-household operational return from 2017–18 onwards.

4I – Financial derivatives for the 12 months ended 31 March 2020

	Nominal value by maturity (net) at 31 March 2020			Total value at 31 March 2020		Total accretion at 31 March 2020	Interest rate (weighted average for 12 months to 31 March 2020)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	£m	Payable	Receivable
Interest rate swap (sterling)								
Floating to fixed rate	–	200.000	–	**200.000**	(0.046)	–	–	–
Fixed to index-linked	–	–	1,316.608	**1,316.608**	1,182.134	202.581	1.93%	4.72%
Total	**–**	**200.000**	**1,316.608**	**1,516.608**	**1,182.088**	**202.581**		

Floating to fixed rate derivatives comprise a £200 million LIBOR collar which limits the movement of LIBOR and has yet to fix with the result that there are no cash flows attributable to this derivative.

Fixed to index-linked derivatives are intended to expose interest cash flows, and the nominal value of debt outstanding, to short-term movement in RPI inflation. This ensures a proportion of our interest cost is a match against the nature of our inflation-linked cash flows and our inflation-linked RCV. Our inflation-linked financial instruments have a long maturity in order to finance the long life of our assets and the long-term nature of our investment decisions.

The value of the Mark to Market represents forecast future cash flows for the duration of the derivatives and discounted by prevailing interest rates. This value is extremely volatile given that market interest rates are constantly moving. The liability shown in the table above of £1,182.1 million associated with the Mark to Market valuations of our derivatives is very high at present given the current low interest rate environment. The risk of this Mark to Market value crystallsing is extremely remote given that it can only crystallise under certain conditions of a default of our financing covenants, in which case operations of the company are protected and will continue. Further details are available on page 234 of our Annual Report and Financial Statements.

Data assurance summary

We believe that our stakeholders deserve to have trust and confidence in the integrity of the information we provide in our annual reports. In order to achieve this, our performance reporting is subject to a system of checks to ensure that we meet the highest quality of reported information.

In addition, we have previously consulted our stakeholders to understand their views on our annual reports and reported information, their feedback has been valuable and we have used this information to improve our processes.

We have published a separate document that details the completed assurance work performed on our reported information for the 2019–20 financial year. The results, both positive and improvement areas are published in the document entitled 'Data Assurance Summary' which is available on our Southern Water website **southernwater.co.uk/our-reports.**

The main assurance areas for the annual reports are:

Significant Areas for Assurance	Assurance Results for 2019–20
The Annual Report including the Statutory and Regulatory Accounts, cost allocation and segmental reporting	The Annual Report and Financial Statements were audited by Deloitte LLP. Their opinion is included on page 251 of that report. The Annual Performance Report (APR), sections 1 and 2, excluding table 1F, were audited by Deloitte LLP. Their assurance statement is included on page 52. Deloitte LLP also performed assurance activities agreed with us on the financial information presented in table 1F and section 4 of the APR and the financial information published in the cost assessment tables alongside this report. No issues were identified.
Additional assurance undertaken	Deloitte LLP also undertook assurance procedures on the following statements made in the Annual Report and Annual Performance Report: • Viability statement • Certificate of adequacy (Licence Condition I17 Certificate)
Ofwat Performance Commitments and Outcome Delivery Incentives (ODIs)	Our technical assurers PricewaterhouseCoopers LLP have issued us with an unqualified limited assurance ISAE 3000 opinion over the reported performance against our high and medium risk Performance Commitments for the Business Plan period 2015–20 in the Annual Performance Report. In addition they performed assurance activities agreed with us in relation to the non-financial cost assessment data which is published separately alongside this report.
Specific assurances related to other regulators' required information (i.e. The Drinking Water Inspectorate and The Environment Agency)	Each specified requirement is detailed in our Data Assurance Summary
PR 19 Business Plan submissions	PricewaterhouseCoopers LLP and Deloitte LLP undertook assurance activities agreed with us in relation to our Business Plan submission and response to Ofwat's initial assessment of our plan.

Appendices

The information in the appendices has not been audited.

Appendix 1. Transactions with associates and the non-appointed business

Services supplied to the associated companies by the appointee

Greensands Holdings Limited (GSH) is the ultimate parent of Greensands Investments Limited (GSI), which is an intermediate parent of Southern Water Services Limited (SWS), the appointee. The purpose of GSH and GSI is to act as holding companies for SWS. As such they do not trade and have no turnover.

During the year, recharges for group-related management services, for example legal, treasury, governance and financial services, supplied by Southern Water Services Limited were as follows:

Services supplied to associated companies by the appointee

	Company	Turnover of associate	Terms of supply	Value £m
Management charges	Greensands Investments Limited	–	Cost/market price	1.000

Services received by the appointee from associated companies

There were no services supplied by associate companies to SWS.

Group relief received by the appointee

Service	Company	Turnover of associate	Terms of supply	Value £m
Corporation tax group relief	Southern Water Services Group	–	Cost	1.663
Corporation tax group relief	Greensands Investments Limited	–	No cost	11.413

Allocation of costs between regulated and non-regulated businesses

Each non-appointed activity is treated separately within the company's financial records. Examples of non-appointed activities include non-monopoly rechargeable works, property searches and services for waste tankering. Revenues, costs, assets and liabilities are generally directly allocated to particular business activities. Administrative overheads have been apportioned from the appointed business to the non-appointed business on an activity cost basis.

Service provided by non-appointed business	Basis of recharge made by the appointed business	Value £m
Treatment of imported sludge	Not applicable	–
Treatment of tankered waste	The Mogden Formula was used to calculate the income for tankered waste and the costs were derived from this calculation	6.339
Other	Headcount (FTE) was used to calculate administrative overhead for property searches, accommodation rental and Homeserve costs	0.107

Details of intercompany loans

Loans granted to Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2020 £m
Southern Water Services (Finance) Limited	Fixed rate	6.202	2029	348.703
	Index linked	3.716	2034	243.687
	Index linked	3.716	2034	56.809
	Fixed rate	6.650	2026	348.982
	Index linked	3.826	2023	243.687
	Fixed rate	5.010	2021	349.512
	Fixed rate	5.010	2041	147.103
	Fixed rate	4.510	2052	197.234
	Fixed rate	5.135	2056	292.683
	Fixed rate	2.790	2031	174.075
	Fixed rate	2.970	2036	74.572
	Index linked	4.086	2033	268.191
	Index linked	3.645	2032	248.199
	Fixed rate	0.000	On demand	30.250
Total				**3,023.687**

Loans granted by Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2020 £m
Southern Water Services (Finance) Limited	Fixed rate	0.000	On demand	56.272
Southern Water Services Group Limited	Fixed rate	7.000	2052	130.042
Total				**186.314**

Dividends paid by Southern Water Services Limited to group companies

Company	2020 £m	2019 £m
Southern Water Holdings (ordinary dividend)	–	–
Southern Water Holdings (for SWSG loan agreement)	7.092	34.858

No ordinary dividend was declared for payment to Southern Water Holdings Limited (SWH) in 2020 (2019: £nil).

A dividend of £7.092 million (2019: £34.858 million) is paid to SWS Holdings Limited to allow SWSG to service its interest obligations on the Southern Water Services Limited/SWSG loan agreement. The value of this dividend reduced significantly this year following the repayment of £682.3 million of the inter-company loan to SWSG during 2018–19.

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between investors and customers. To deliver on our vision for the successful delivery of our Business Plan for 2020–25, all stakeholders must share in success: customers benefitting through enhanced service and lower bills, and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend the Directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the Company's Licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account our financial and non-financial performance. This would reflect our overall financial performance as compared to the final Business Plan for 2020–25 as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision, and whether any financial outperformance should be re-invested to benefit our customers. This consideration will also include taking into account the interests of our employees, other stakeholders, and our pension schemes.

   Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three we carry out an assessment of:

   a) headroom under debt covenants

   b) the impact on the company's credit rating

   c) the liquidity position and ability to fulfil licence conditions

   d) key areas of business risk.
4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
5. We will publish our Dividend Policy annually (as part of the Annual Report), and highlight any changes.

Comparison of dividend to the PR14 Final Determination

These tests are not applied to the interim dividends of £7.1 million paid to Southern Water Services Group (SWSG), as this dividend payment is instantly offset by a corresponding interest receipt from SWSG and, therefore, does not get distributed to the shareholders of our ultimate parent company, Greensands Holdings Limited (GSH).

Having undertaken its assessment for 2019–20 the Board has decided not to declare an ordinary share dividend for 2019–20. The potential level of base dividend was calculated as £70.4 million.

This potential level of base dividend is calculated as per step 1 of our Dividend Policy. In discussing this potential base dividend and taking into account the remainder of our dividend policy it was decided that we would not make a dividend payment at this time.

In 2019–20 the Board approved repayments of preference share capital totalling £50.1 million and preference share dividend payments, which are disclosed as interest within the financial statements, of £9.0 million (2019: £5.9 million) of which £5.0 million related to an accrual made at 31 March 2019. A further £2.4 million has been accrued at 31 March 2020.

Asset transfers

There were no asset transfers during the year.

Appendix 2. KPI definitions and status assessment rules

Responsive customer service

Customer satisfaction – Service Incentive Mechanism (SIM) score

Definition:
Ofwat measure of overall customer satisfaction, based on the numbers of unwanted contacts and complaints, together with the response to customer satisfaction surveys.

Status:
- ✔ SIM score higher than industry average.
- – SIM score below industry average.
- ✖ SIM score below industry average by more than 10%.

Reward/penalty: Reward and penalty based on performance relative to other water companies.
Measurement: SIM score is measured and calculated according to Ofwat's guidance in 'Service incentive mechanism – guidance for collating customer service information for calculating the SIM score' (April 2015).
Unit of measure: Score out of a maximum of 100.

First-time resolution of customer contacts

Definition:
Proportion of customer contacts that are resolved on first contact.

Status:
- ✔ More than or equal to 80%.
- – Less than 80% but more than previous year.
- ✖ Less than 80% and less than previous year.

Reward/penalty: Reputational only, no financial reward or penalty.
Measurement: First-time resolution of customer contacts is measured using an approach which was developed for Southern Water's business plan and used to calculate the company's performance level in 2013–14.
Unit of measure: Percentage of contacts received..

Percentage of customers who feel our service meets their individual needs

Definition:
Proportion of customers agreeing that we meet their individual needs, measured by surveys.

Status:
- ✔ Greater than previous year.
- – Equal to or up to five percentage points lower than the previous year.
- ✖ More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.
Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.
Unit of measure: Percentage of customers surveyed.

Percentage of customers who feel our service meets the needs of their community

Definition:
Proportion of customers agreeing that we meet the needs of their community, measured by surveys.

Status:
- ✔ Greater than previous year.
- – Equal to or up to five percentage points lower than the previous year.
- ✖ More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.
Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.
Unit of measure: Percentage of customers surveyed.

Number of compensation payments made to customers (Guaranteed Standards of Service)

Definition:
Number of payments made against the Guaranteed Standards of Service scheme.

Status:
- ✔ Less than or equal to 2,436.
- – More than 2,436 but fewer than 3,711.
- ✖ More than 3,711 and more than previous year.

Reward/penalty: Not applicable.
Measurement: The number of compensation payments made is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 6 Key Outputs Customer Service Standards'.
Unit of measure: Number of payments.

Affordable bills

Customers in genuine hardship with improved support

Definition:
Cumulative number of one-off interventions and/or the number of customers accepted on to each of our schemes and tariffs.

Status:
- ✓ More than or equal to 217,100.
- – Less than 217,100 but annual increase is greater than 22,400.
- ✗ Less than 217,100 and annual increase is less than 22,400.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Performance is calculated as the number of customers who are enrolled on one of Southern Water's financial assistance schemes as defined in the company's business plan.

Unit of measure: Cumulative number of interventions and/or customers.

Percentage of customers who feel our services provide value for money

Definition:
Proportion of customers who feel they get value for money from our services, measured by surveys.

Status:
- ✓ Greater than previous year
- – Equal to or up to five percentage points lower than the previous year.
- ✗ More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Better information and advice

Water usage (per capita consumption)

Definition:
Average per capita consumption for households each day. Includes measured and unmeasured households.

Status:
- ✓ Average for 2015–16 to 2019–20 is below 133.7 litres per head, per day.
- – Average for 2015–16 to 2019–20 is above 133.7 litres per head, per day, but average for 2019–20 is below 133.7 litres per head per day.
- ✗ Average for 2015–16 to 2019–20 and average for 2019–20 is above 133.7 litres per head, per day.

Reward/penalty: Annual maximum reward £1.375 million, annual maximum penalty £2.192 million.

Measurement: Performance is calculated in accordance with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered'. The unit of measurement is post-Maximum Likelihood Estimation weighted average litres per person/per day on average over the year.

Unit of measure: Litres per head/per day (l/h/d).

Number of unwanted billing queries

Definition:
Number of customer queries related to the understanding of their bills.

Status:
- ✓ Less than 25,000.
- – Greater than 25,000 but fewer than the previous year.
- ✗ Greater than 25,000 but more than the previous year.

Reward/penalty: Reputational only, but high number will decrease SIM score.

Measurement: Numbers of customer queries related to billing are collated in accord with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 4 Key Outputs Customer Service 1'.

Unit of measure: Number of billing queries.

Better information and advice

Customers who are aware of the causes of blocked drains

Definition:
Proportion of customers who are aware of measures to avoid blocked drains, measured by surveys.

Status:
- Greater than previous year.
- Equal to or up to five percentage points lower than the previous year.
- More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third-party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Percentage of customers who are aware of how their money is used

Definition:
Proportion of customers with awareness of where their money goes, measured by surveys.

Status:
- Greater than previous year.
- Equal to or up to five percentage points lower than the previous year.
- More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third-party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Percentage of customers who are aware of how to deal with hard water

Definition:
Percentage of customers who are aware of how to deal with hard water, measured by surveys.

Status:
- Greater than previous year.
- Equal to or up to five percentage points lower than the previous year.
- More than five percentage points below the previous year.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third-party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

A constant supply of high-quality drinking water

Water quality (Mean Zonal Compliance)

Definition:
Compliance with the Drinking Water Inspectorate (DWI) measure for Mean Zonal Compliance (MZC).

Status:
- ✓ Equal to 100%.
- – Less than 100% but greater than 99.95%.
- ✗ Less than or equal to 99.95%.

Reward/penalty: Penalty only – annual maximum penalty £0.439 million.

Measurement: Performance is calculated according to the methodology used by DWI for reporting overall compliance with drinking water quality standards set out in the Water Supply (Water Quality) Regulations.

Unit of measure: Percentage.

Number of contacts regarding discolouration per 1,000 population

Definition:
Number of customer contacts regarding the discolouration of their drinking water per 1,000 population.

Status:
- ✓ Less than or equal to 0.82.
- – More than 0.82 but less than 0.86.
- ✗ More than 0.86.

Reward/penalty: Penalty only – annual maximum penalty £0.173 million.

Measurement: Performance is calculated as the total number of contacts received from customers related to black, brown or orange discolouration of their drinking water per 1,000 population, as reported by the company to the Drinking Water Inspectorate in accordance with the Water Industry (Suppliers' Information) Direction.

Unit of measure: Number per 1,000 population.

Leakage reported

Definition:
Total level of leakage, including customer supply-pipe losses.

Status:
- ✓ Average for 2015–16 to 2019–20 is below 87 megalitres per day.
- – Average of 2015–16 to 2019-–20 is above 87, but average for 2019–20 is below 87 megalitres per day.
- ✗ Average for 2015–16 to 2019–20 and average for 2019–20 is above 87 megalitres per day.

Reward/penalty: Annual maximum reward £0.153 million, annual maximum penalty £1.232 million.

Measurement: Performance is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered' and for the Ofwat KPI in 'Key performance indicators – guidance', IN 13/03.

Unit of measure: Megalitres per day (Ml/d).

Customer minutes lost supply greater than three hours

Definition:
Average minutes lost per property served per year, due to water supply interruptions of greater than three hours.

Status:
- ✓ Less than or equal to nine minutes/property/year.
- – More than nine but less than or equal to 12 minutes/property/year.
- ✗ More than 12 minutes/property/year.

Reward/penalty: Penalty only – annual maximum penalty £0.574 million.

Measurement: Performance is calculated according to the guidelines for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03. The impact of severe weather conditions is taken into account and any adjustments are independently assured.

Unit of measure: Minutes/property/year.

A constant supply of high-quality drinking water

Number of properties with low water pressure

Definition:
Number of properties on the DG2 low water pressure register.

Status:
- Less than or equal to 257 properties.
- More than 257 but less than 296 properties.
- More than or equal to 296 properties.

Reward/penalty: Penalty only – annual maximum penalty £0.174 million.

Measurement: Performance is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 2 Key Outputs - Water Service 2' and for the Ofwat KPI in IN 13/03.

Unit of measure: Number of properties.

Number of customers affected by temporary use bans

Definition:
The number of properties affected by temporary use bans before two consecutive dry winters. A dry winter is where rainfall is less than 85% of the long-term average.

Status:
- No temporary use bans applied during the year.
- Temporary use bans applied following two consecutive dry winters.
- Temporary use bans applied in the year, not preceded by two consecutive dry winters.

Reward/penalty: Penalty only – annual maximum penalty £16.255 million.

Measurement: Performance is calculated as the number of properties that are affected by temporary use bans before two consecutive dry winters have occurred. A dry winter is defined within the company business plan as less than 85% of the long-term average annual rainfall level.

Unit of measure: Number of properties affected.

Maintain water asset health

Definition:
Assessment of water asset health as measured against pre-determined performance levels for mains bursts, Distribution Maintenance Index (TIM), WSW coliform compliance, WSR coliform compliance, and WSW turbidity compliance.

Status:
- Stable. All components above the upper performance level.
- Improvement required. One or more components is below the upper performance level but not below the lower performance level.
- Significant improvement required. One or more components is below the lower performance level.

Reward/penalty: Penalty only – annual maximum penalties, burst mains £1.960 million, coliforms at WSW £0.38 million, TIM £0.904 million, coliforms at WSR £0.244 million, turbidity at WSW £0.761 million.

Measurement: Stable performance means that performance for all components of the ODI is better than the upper performance levels stated in the company business plan.

Unit of measure: Rating.

Measurement of components:
- The number of mains bursts in the reporting year is measured according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 11: Non-financial measures – water service activities'.
- Distribution Maintenance Index (TIM) is calculated according to the methodology used by DWI for report compliance with drinking water quality standards set out in the Water Supply (Water Quality) Regulations, specifically for iron, manganese and turbidity.
- Coliform compliance at WSWs is calculated as the number of water supply works with tests containing zero coliforms expressed as a percentage of the total number of tests taken at works to meet the requirements of the Water Supply (Water Quality) Regulations.
- Coliform compliance at WSRs is calculated as the number of water service reservoirs with no more than 5% of samples, tested to meet the requirements of the Water Supply (Water Quality) Regulations, containing coliforms. It is expressed as a percentage of the number of service reservoirs in supply during the year.
- Turbidity compliance at WSW is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 11a: Non-financial measures – water service serviceability measures'.

Removing wastewater effectively

Number of blockages per km per year

Definition:
Number of blockages in the year per kilometre of sewer.

Status:
- ✓ Less than or equal to 0.58 blockages per km.
- – More than 0.58 but less than 0.59 blockages per km.
- ✗ More than or equal to 0.59 blockages per km.

Reward/penalty: Penalty only – annual maximum penalty £0.976 million.

Measurement: Performance is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 16 Non-financial measures – Sewerage service activities' and for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03.

Unit of measure: Number per km.

Number of internal flooding incidents

Definition:
Number of incidents of internal flooding of properties in the year (all causes, including from formerly private sewers).

Status:
- ✓ Less than or equal to 382 for the year.
- – More than 382 but total for 2015–16 to 2019–20 is less than 2,070.
- ✗ Total for 2015–16 to 2019–20 is more than or equal to 2,070.

Reward/penalty: Annual maximum reward £4.337 million, annual maximum penalty £3.387 million.

Measurement: The number of flooding incidents is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 3 Key Outputs – Sewerage Service'. Incidents on private sewers are included. The only incidents that are excluded are those associated with 'severe' weather conditions.

Unit of measure: Number of incidents.

Number of external flooding incidents

Definition:
Number of incidents of external flooding in the year.

Status:
- ✓ Less than or equal to 9,694.
- – More than 9,694.
- ✗ More than 9,694 and the external flooding (other causes) measure contributing to wastewater asset health has not been met.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: The number of flooding incidents is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 3a Key Outputs – Sewerage Service'. Incidents on private sewers are included. All incidents from all causes are included.

Unit of measure: Number of incidents.

Number of customer complaints regarding odour

Definition:
Number of complaints received from customers related to odour from wastewater works. Note: only odour complaints from Portswood and Tonbridge are included in the associated ODI.

Status:
- ✓ Less than or equal to 390.
- – More than 390 but less than previous year.
- ✗ More than 390 and more than previous year.

Reward/penalty: Reputational only, no financial reward or penalty in 2017–18. Penalty only from 2018–19 onwards.

Measurement: This Business Promise is a more stringent measure which includes all odour complaints reported by members of the public for all wastewater treatment works and pumping stations during the calendar year. The ODI within the company business plan is a sub-set of odour complaints received for two specified works (Portswood and Tonbridge) where there are improvement schemes to specifically address odour.

Unit of measure: Number of odour complaints.

Removing wastewater effectively

Maintain wastewater asset health

Definition:
Assessment of wastewater asset health as measured against pre-determined performance levels for sewer collapses, Wastewater Treatment Works (WWTW) population equivalent (PE) compliance and external flooding – other causes.

Status:
- Stable. All components above the upper performance level.
- Improvement required. One or more components is below the upper performance level but not below the lower performance level.
- Significant improvement required. One or more components is below the lower performance level.

Reward/penalty: Penalty only – annual maximum penalties, external flooding (other causes) £0.601 million, sewer collapses £1.35 million, WWTW PE compliance £14.95 million.

Measurement: Performance is calculated according to guidance for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03. Stable performance means that performance for all components of the ODI is better than the upper performance levels stated in the company business plan.

Unit of measure: Rating.

Measurement of components:
- The number of sewer collapses is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 16
  Non-financial measures – Sewerage service activities'.
- Population equivalent served by WWTW compliant with consents is calculated as the total population equivalent for all wastewater treatment works that have complied with their Water Resources Act (WRA) and Urban Wastewater Treatment Directive (UWWTD) look-up table permit conditions as reported by the Environment Agency on MD109.
- The number of flooding incidents is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 3a Key Outputs – Sewerage Service'. Incidents on private sewers are included. Only incidents classified as 'other causes' are included.

Looking after the environment

Wastewater treatment works compliance

Definition:
Proportion of wastewater treatment works in compliance with their environmental permit as reported by the Environment Agency on MD109.

Status:
- 100.0%.
- Less than 100.0% but more than or equal to 97.7%.
- Less than 97.7%.

Reward/penalty: Penalty only – annual maximum penalty £14.949 million.

Measurement: Performance is calculated as the percentage of wastewater treatment works that have complied with their numeric consent. This is calculated in accordance with the methodology used by the Environment Agency for reporting on MD109.

Unit of measure: Percentage of works.

Increase the number of bathing waters with excellent water quality

Definition:
Increase the number of bathing waters with 'excellent' water quality, as defined by the revised Bathing Water Directive.

Status:
- More than or equal to 7 bathing waters.
- Less than 7 but greater than 5 bathing waters.
- Less than 5 bathing waters.

Reward/penalty: Annual maximum reward £1.727 million. Annual maximum penalty £25.480 million (applicable in 2019–20 only).

Measurement: Performance is calculated in accordance with the methodology, which is published by Defra, for measuring bathing water quality against the revised Bathing Water Directive. The measure of 'excellent' water quality is no more than 100 Intestinal Enterococci cfu/ml and 250 Escherichia coli cfu/ml based on the 95th percentile of a log normal distribution of samples taken over a single bathing water season.

Unit of measure: Number of bathing waters.

Looking after the environment

Maintain the number of bathing waters with excellent water quality

Definition:
Maintain the number of bathing waters with 'excellent' water quality, as defined by the revised Bathing Water Directive, at the 2014–15 level.

Status:
- ✓ More than or equal to 54 bathing waters.
- – Less than 54 but more than or equal to 48 bathing waters.
- ✗ Less than 48 bathing waters.

Reward/penalty: Annual maximum reward £1.481 million, annual maximum penalty £1.749 million.

Measurement: Performance is calculated in accordance with the methodology, which is published by Defra, for measuring bathing water quality against the revised Bathing Water Directive. The measure of 'excellent' water quality is no more than 100 Intestinal Enterococci cfu/ml and 250 Escherichia coli cfu/ml based on the 95th percentile of a log normal distribution of samples taken over a single bathing water season.

Unit of measure: Number of bathing waters.

Number of serious pollution incidents (category 1 and 2)

Definition:
Total number of category 1 and 2 pollution incidents related to wastewater assets as reported by the Environment Agency on MD109.

Status:
- ✓ Zero serious pollution incidents.
- – Less than two serious pollution incidents.
- ✗ More than two serious pollution incidents.

Reward/penalty: Pollutions may incur court fines for each serious pollution incident.

Measurement: Performance is stated in accordance with the number of pollution incidents, categorised as 1 and 2, reported by the Environment Agency on MD109.

Unit of measure: Number of incidents.

Number of pollution incidents (category 3)

Definition:
Number of category 3 pollution incidents related to wastewater assets (including transferred sewer assets but excluding private pumping stations) as reported by the Environment Agency on MD109.

Status:
- ✓ Less than or equal to 158 incidents.
- – More than 158 but less than 175 incidents.
- ✗ More than or equal to 175 incidents.

Reward/penalty: Penalty only – annual maximum penalty £2.16 million.

Measurement: Performance is stated in accordance with the number of pollution incidents, categorised as 3, reported by the Environment Agency on MD109.

Unit of measure: Number of incidents.

Distribution input

Definition:
Average daily amount (megalitres per day) of potable water entering the distribution system.

Status:
- ✓ Less than or equal to 526.79.
- – More than 526.79 but less than 533.97.
- ✗ More than 533.97 megalitres.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Performance is calculated in accordance with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered'. The unit of measurement is post-Maximum Likelihood Estimation Distribution Input.

Unit of measure: Megalitres per day (Ml/d).

Renewable energy usage

Definition:
Proportion of total energy consumption that is from renewable sources (e.g. biogas, solar and wind).

Status:
- ✓ More than or equal to annual target of 16.5%.
- – Less than 16.5% but more than 14.5%.
- ✗ Less than 14.5%.

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: The percentage of renewable energy generated out of total operational energy used in the financial year is calculated in accordance with methodology developed for Southern Water's business plan.

Unit of measure: Percentage.

Looking after the environment

Greenhouse Gas Emissions

Definition:
Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilogrammes carbon dioxide equivalent ($KgCO_2e$).

Reward/penalty: Not applicable.
Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
Unit of measure: Kilogrammes carbon dioxide equivalent ($KgCO_2e$).

Greenhouse Gas Emissions per person supplied with drinking water

Definition:
Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilogrammes carbon dioxide equivalent ($KgCO_2e$) per person supplied with water.

Reward/penalty: Not applicable.
Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
Unit of measure: Kilogrammes carbon dioxide equivalent per person supplied with water ($KgCO_2e$/person).

Greenhouse Gas Emissions per person supplied with wastewater services

Definition:
Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilogrammes carbon dioxide equivalent ($KgCO_2e$) per person supplied with wastewater services.

Reward/penalty: Not applicable.
Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
Unit of measure: Kilogrammes carbon dioxide equivalent per person supplied with wastewater services ($KgCO_2e$/person).

Appendix 3. Glossary of Regulatory Terms

Appointed business

The appointed business comprises the regulated activities of the company which are necessary for it to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading

Where the company treats associate companies on the same basis as external third parties.

Asset Management Plan (AMP)

A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP6 covers April 2015 to March 2020 and AMP7 covers April 2020 to March 2025.

Associate company

Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the company and its associated companies to be disclosed subject to specified materiality considerations.

Final Determination (FD)

The conclusion of discussions on the scale and content of the Asset Management Plan for the forthcoming five-year period. It is accompanied by a determination of the allowable 'K factor' for the period.

Financing adjustment

The impact of general inflation (RPI) on the real value of net finance for the business.

K factor

The annual increase, set by Ofwat, in wholesale charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula RPI + or – 'K'. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers.

Licence

The Instrument of Appointment dated August 1989 under Sections 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Southern Water Services Limited as a water and wastewater undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Non-appointed business

The non-appointed business activities of the company are activities for which the company as a water and wastewater undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the company (for example, the use of underground assets for cable television).

Ofwat

The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA is the economic regulator of the water industry.

Outcome Delivery Incentive (ODI)

Performance targets with rewards and/or penalties agreed with customers and Ofwat through the periodic review process.

Periodic review

The price determination process undertaken by Ofwat every five years. Each water and wastewater undertaker submits a business plan covering the five-year period for which Ofwat will determine prices (the 'K factor' – see above). (PR14 relates to 2015–20, PR19 relates to 2020–25).

Price control

The name given to the combination of the Retail Price Index (RPI) and 'K'. The charges limit is set by Ofwat at each price review. For wholesale services this is the Retail Price Index and an adjustment factor, K, applied to the previous year's revenue. For retail services it is a limit on the total revenue that can be collected from customers each year.

Regulatory Accounting Guidelines (RAG)

The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV)

The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail Price Index (RPI)

The RPI is compiled and published monthly by the Office for National Statistics. It is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM)

Ofwat's measure of customer satisfaction based on surveys of customers who have contacted the company and the number of unwanted contacts and complaints received.

Totex

The total of operating costs and capital expenditure in the year.

Working capital

The aggregate of stocks, trade debtors and trade creditors, if material.

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